



## **Annual Report for the Fiscal Year Ended**

**December 31, 2013**



**This Annual Report is being provided to provide updated information about Argyle Security, Inc. dba ISI Security. This report has not been prepared and is not intended to be presented in accordance with the Federal securities laws, such as Rules 10b-5 and 15c2-11 of the Securities Exchange Act of 1934 ("Exchange Act") as well as Rule 144 of the Securities Act of 1933 ("Securities Act"), and state Blue Sky laws or the OTC Markets Group Basic Disclosure Guidelines.**

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## Forward Looking Statements

This Annual Report may include forward-looking statements similar to those described within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), that are applicable to issuers that are subject to reporting requirements under Section 13(a) or Section 15(d) of the Exchange Act.. We have based these forward-looking statements on our current expectations and projections about future events. These forward-looking statements are subject to known and unknown risks, uncertainties and assumptions about us that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as “may,” “should,” “could,” “would,” “expect,” “plan,” “anticipate,” “believe,” “estimate,” “continue,” or the negative of such terms or other similar expressions. Factors that might cause or contribute to such a discrepancy include, but are not limited to, those described in the “Risk Factors” section of our Annual Report for the fiscal year ended December 31, 2009, filed with the OTC News and Disclosure Service on April 19, 2010 (the “2009 Annual Report”) and in our prior filings made with the Securities and Exchange Commission (“SEC”). The following information should be read in conjunction with our Financial Statements and related Notes thereto included elsewhere in this Annual Report.

## General Company Information

### **The exact name of the issuer and its predecessor (if any).**

Argyle Security, Inc. doing business as ISI Security (formerly Argyle Security Acquisition Corporation).

### **The address of the issuer’s principal executive offices.**

12903 Delivery Drive  
San Antonio, TX 78247  
Telephone: (210) 495-5245  
Fax: (210) 495-5613  
www.isisecurity.com

Investor requests should be directed to Ray Gilley, our President and CEO or Matthew Kepke, our Vice President, General Counsel and Corporate Secretary, at the address above.

### **The jurisdiction(s) and date of the issuer’s incorporation or organization.**

Argyle was incorporated in Delaware on June 22, 2005.

## Certain Business Information

### Background

Argyle Security, Inc. doing business as ISI Security (formerly Argyle Security Acquisition Corporation) was incorporated as a special purpose acquisition corporation in Delaware in June 2005 to acquire, through merger, capital stock exchange, asset acquisition, or other similar business combination, a business in the security industry. Argyle completed its initial public offering in January 2006. On July 31, 2007, Argyle acquired ISI Security Group, Inc. (f/k/a ISI Detention Contracting Group, Inc., referred to herein as “ISI Security”) and its subsidiaries. As a result of the merger, ISI Security became a wholly owned subsidiary of Argyle. When used herein, “Argyle”, the “Company”, “we”, “us”, “our”, refers to the pre-acquisition company until July 31, 2007 and the post-acquisition company after July 31, 2007. The Company’s fiscal year end is December 31.

On January 1, 2008, ISI Security acquired substantially all of the business assets and liabilities of Fire Quest Inc. ("Fire Quest").

On January 4, 2008, ISI Security acquired substantially all of the business assets and liabilities of Peterson Detention, Inc. ("PDI").

On January 31, 2008, ISI Security acquired Com-Tec Security LLC ("Com-Tec").

On October 1, 2009, MML Capital Partners LLC ("MML Capital") (in its capacity as advisor to, and on behalf of, Mezzanine Management Fund IV A, L.P and Mezzanine Management Fund IV Coinvest 'A', L.P. (the "MML Funds" and together with MML Capital, "MML")) elected to convert an aggregate of 11,327 shares of the Company's Series A Convertible Preferred Stock into an aggregate of 1,132,700 shares of the Company's Common Stock. MML and William Blair Mezzanine Capital Fund III, L.P. (collectively, the "Majority Stockholder Group"), owning beneficially and of record approximately 51% of the Company's issued and outstanding common stock, executed a written consent to amend and restate the Company's bylaws for purposes of, among other things, expanding the number of directors constituting the Board from six (6) to fourteen (14) directors. The Majority Stockholder Group also appointed and elected employees of entities affiliated with the MML to fill the eight (8) newly created directorships. The incumbent directors subsequently confirmed and ratified the actions of the Majority Stockholder Group, and effective October 13, 2009, after the resignation of three (3) of the incumbent directors and four (4) of the MML-affiliated directors, the number of directors constituting the Board was reduced from fourteen (14) to seven (7) directors, with MML-affiliated directors filling four (4) of the directorships.

On June 18, 2010, the Board was reduced from seven (7) directors to five (5), with MML-affiliated directors, continuing to fill two (2) of the directorships

## Summary of Operating Business

The Company is a detention and commercial security provider that specializes in designing and integrating physical and electronic security solutions in the United States. The Company provides turnkey installations of electronic security and low voltage systems, including fire alarm, access control, closed circuit television, intercom, sound/paging and other custom designed systems, as well as surveillance, access control equipment and software solutions. Argyle designs customized solutions for a wide range of security needs. This "total solutions strategy" enables us to be a leader in the corrections and commercial markets.

The Company has furnished and installed detention equipment for more than 2000 correctional facilities. The expertise of the individuals within the Company's team and the excellent vendor relations with all the major manufacturers allow clients to have access to the most durable products available in today's marketplace at the most economical prices.

The Company is an industry leader in the integrated systems custom design and manufacturing of electronic security and communication systems throughout the United States. Primary markets include correctional facilities, city and county jails and industrial facilities. The Company's integrated systems combine a wide range of functions into a single easily operated control console. Every function of the system is carefully engineered to operate smoothly and efficiently together. The Company's systems include remote diagnostics to aid in trouble shooting which dramatically reduces maintenance labor.

The Company manufactures steel and stainless steel detention products that include high security metal barriers, high security observation window systems, detention furniture and accessories. For thirty years, architects have chosen to specify our steel detention products for our expertise and outstanding service, as well as the value and quality that we consistently deliver. The Company has earned their confidence in a wide variety of projects across the country by providing:

- In-house drafting and design
- Complete product lines

- Responsive pre-sale and post-sale support teams
- Comprehensive coast-to-coast coverage

Manufacturing facilities in Orange, CA contain state-of-the-art equipment in a highly automated environment, providing ISI Security with the ability to cost effectively produce both standard products, and products to meet our clients' precise specifications of exceptional quality.

## Business Units

The Company operates through the following business units: ISI, MCS, PDI, Com-Tec and MCS Fire & Security.

### ISI

Over the past 30 years, ISI has furnished and installed detention equipment in more than 1,900 correctional facilities. ISI designs, engineers, supplies, installs, and maintains a full array of detention systems and equipment, targeting correctional facilities throughout the United States. Its expertise and track record position ISI favorably among the nation's leading providers of products and solutions for correctional facilities. Its custom-designed systems meet local standards and are in full compliance with the applicable standards of the American Correctional Association, a voluntary organization whose standards for correctional facility design, operation and construction are the recognized industry benchmark for quality and safety.

ISI offers a complete array of electronic security system solutions revolving around electronic locking systems and hardware, security doors and frames, jail furniture, security glazing and other security-based systems. ISI acts as prime contractor or as a subcontractor for projects spanning all levels of security.

ISI's primary products include detention hardware (prison bars, locks and locking systems), security glass, security furniture (metal furniture), detention grade hollow metal doors, frames, windows and related accessories. ISI's customers are both general contractors and owners (governmental or private entities) that are building, expanding or renovating city lockups, county jails, state and federal prisons.

### MCS

For over 20 years, MCS has specialized in designing, engineering, supplying, installing and maintaining complex electronic security systems for correctional facilities. MCS provides access and door controls, intercoms, closed circuit television and software for command center controls and intrusion perimeter systems. MCS' customers include ISI, general contractors or in some cases competitors of ISI. Experience in planning, installation and service, combined with state-of-the-art equipment, provides MCS with a platform from which it can effectively market and develop solutions for clients.

### PDI

For approximately 30 years, PDI has manufactured high security metal barriers, high security observation window systems, wire mesh, bar grating, detention furniture and accessories. In the design and fabrication of its detention furniture and accessories, PDI also utilizes its patented "Steel Block". PDI also fabricates components for the automotive industry.

### Com-Tec

Since 2004, Com-Tec has designed electronic security and communications systems. Com-Tec is involved from the initial stages of design to post-installation maintenance. Com-Tec's integrated solutions combine a wide range of functions into a single-operated control console with remote diagnostics. Com-Tec provides touch screen control, UL 508A control panels, door and gate controls, closed circuit television, intercom and paging, security management, access control and perimeter intrusion detection systems.

## MCS Fire & Security

MCS Fire & Security designs, engineers, supplies, installs and maintains professional security, access control, video and fire alarm, closed circuit television, sound paging systems and structured cabling primarily for petro-chemical, healthcare, utilities and education customers that are building or renovating their facilities.

## Other Information

Other than PDI, none of the business units manufactures the hardware that it sells. Hardware is purchased from third parties and resold. We have made a concerted effort to become a total solutions provider of security and detention solutions for the corrections design/build market. In the security industry, a “total solutions provider” generally means that a vendor has the ability to design customized solutions for a wide range of security needs, as well as provide all of the hardware and software for such solutions. If a customer selects a series of security vendors, each providing a separate and independent system that addresses only a limited security need, then the numerous systems required to provide overall security can cause many unanticipated problems in operations, maintenance, and upgrades. As a “total solutions provider,” we can provide our customers with one source for a wide range of security solutions that are tested and proven to work together.

Our operating units provide a range of products, as well as value-added services, such as design assistance to architects, engineers and owners through writing specifications, providing CAD documents, equipment selection and vendor recommendation. The breadth of our offerings has enabled us to establish a leadership position in the design/build corrections market. Our expertise in providing customized, high-level solutions to the most demanding of customers has allowed us to acquire projects in other security-sensitive sectors, such as the healthcare industry, water treatment plants, utilities, federal courthouses and upscale private commercial buildings.

Argyle’s primary SIC Code and NAICS Code are as follows:

- SIC Code: 7382
- NAICS Code: 238990

## Deregistration of Argyle Securities

On March 30, 2010, Argyle voluntarily deregistered its common stock, warrants and units consisting of common stock and warrants and suspended its reporting obligations under the federal securities laws by filing a Form 15 with the SEC. Argyle was eligible to deregister these securities because it had fewer than 300 holders of record of each class of these securities. As of the filing of the Form 15, Argyle’s obligation to file certain reports with the SEC, including Forms 10-K, 10-Q and 8-K, was immediately suspended, and deregistration of the securities occurred 90 days after the filing of the Form 15.

## Employees

As of December 31, 2013, we had 292 employees of which none were considered part-time employees. Future success of the Company depends on our ability to attract, retain and motivate qualified personnel. We have not experienced any strikes or work stoppages and consider our relationship with our employees to be satisfactory.

## Principal Properties

Our principal properties at December 31, 2013 are as follows. All of our properties are leased.

### Location

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- 12903 Delivery Drive, San Antonio, Texas 78247
- 12915 Delivery Drive, San Antonio, Texas 78247
- 12918 Delivery Drive, San Antonio, Texas 78247
- 12902 Flagship Drive, San Antonio, Texas 78247
- 12906 Flagship Drive, San Antonio, Texas 78247
- 9155 Sterling Street, Suite 160, Irving, Texas 75063
- 10624 Rockley Road, Houston, Texas 77099
- 2601 McHale Court, Suite 145, Austin, Texas 78758
- 231 Agnes Street Ste-A13, Corpus Christi, Texas 78401
- 577 and 583 N. Batavia Street, Orange, California 92868
- W6484 Design Drive, Suite A, Greenville, Wisconsin 54942

## Share Structure

### General

Argyle's publicly-traded securities currently consist of the following:

- Common Stock, par value \$0.0001 per share ("Common Stock")
- Units (each a "Unit") consisting of one share of Common Stock and one expired warrant to purchase Common Stock (each a "Common Stock Purchase Warrant")

The Units initially commenced public trading on January 30, 2006, and the Common Stock initially commenced public trading on March 2, 2006. Until March 30, 2010, the Common Stock and Units had been quoted on the OTC Bulletin Board under the symbols ARGL and ARGLU, respectively. Following their deregistration on March 30, 2010, the Common Stock, Common Stock Purchase Warrant and Units are quoted on the Pink Sheets under the symbols, ARGL.PK and ARGLU.PK, respectively. The CUSIP numbers are: 040311102 and 040311201 respectively.

Argyle also has designated the following series of preferred stock:

- Series A Convertible Preferred Stock, par value \$0.0001 per share
- Series B Convertible Preferred Stock, par value \$0.0001 per share

## Par or stated value and description of the security

The following is the par or stated value for each class of securities.

Common Stock, par value \$.0001 per share

Series A Convertible Preferred Stock, par value \$0.0001 per share

Series B Convertible Preferred Stock, par value \$0.0001 per share

## Common Stock

Holders of Common Stock are entitled to one vote for each share held of record on all matters to be voted on by stockholders.

Holders of Common Stock have no dividend, redemption, preemptive or other subscription rights, and there are no sinking fund or redemption provisions applicable to the common stock.

We have never declared or paid dividends, cash or otherwise, on our Common Stock and do not anticipate declaring or paying dividends in the foreseeable future. Payments of future dividends, if any, will be at the discretion of our Board of Directors after taking into account various factors, including our financial condition, operating results, current and anticipated cash needs, plans for expansion and other factors that our Board of Directors may deem relevant. In addition, we are currently restricted from paying dividends on the Common Stock by our senior and subordinated credit facilities and, in certain circumstances, by our Series A and Series B Convertible Preferred Stock.

## Preferred Stock

Shares of preferred stock may be issued from time to time in one or more series. The Board of Directors has the power, without the approval of the stockholders (subject to the rights of the holders of the Series A and Series B Convertible Preferred Stock), is authorized to designate a series of preferred stock and to designate the rights, privileges, restrictions and conditions to be attached to such series.

## Series A Convertible Preferred Stock ("Series A Preferred Stock")

The shares of Series A Preferred Stock have no voting rights, except as required by law.

Each share of Series A Preferred Stock is convertible into 100 shares of Common Stock, at any time, at the option of the holder, initially at a conversion price of \$8.00 per share of Common Stock, subject to adjustment for stock dividends, stock splits or similar capital reorganizations, and weighted average price anti-dilution protection for certain issuances below the fair market value price.

The holders of the Series A Preferred Stock are entitled to receive, on a cumulative basis, cash dividends, when, as and if declared by the Company's Board of Directors, at the greater of (i) 3% per annum or (ii) the dividend payable on the equivalent amount of Common Stock into which the Series A Preferred Stock could be converted; provided, however, that such cash dividend must be paid at the earliest any of the following occur: (A) the Company pays a dividend on the Common Stock, (B) the Company liquidates or there is a change in control, or (C) upon conversion of the Series A Preferred Stock, but only with respect to those Series A Preferred Stock so converted.

The Series A Preferred Stock have a liquidation preference to the Common Stock equal to the greater of (i) the sum of the original issue price (subject to adjustment for stock dividends, stock splits or similar capital reorganizations) plus all accrued but unpaid dividends, or (ii) the amount the holder would receive if all Series A Preferred Stock had been converted into Common Stock.

For as long as any shares of Series A Preferred Stock remain outstanding, the Company will be prohibited from (i) amending, waiving, altering or repealing in a way that adversely affects the rights, powers, preferences, or other special rights or privileges of the holders of the Series A Preferred Stock, whether by amendment to the Certificate of Incorporation, Bylaws, Certificate of Designation or other organization documents, or by merger, consolidation, reorganization or otherwise, (ii) increasing or decreasing (other than by redemption or conversion) the authorized number of shares of preferred stock or Series A Preferred Stock, or (iii) repurchasing, redeeming or reissuing any equity securities of the Company to which the Series A Preferred Stock rank senior and prior (whether with respect to dividends, redemption, or upon liquidation or otherwise), including the Common Stock, and any rights or options exercisable or convertible therefor, other than repurchases of shares of Common Stock from employees, officers, directors or consultants under agreements providing for such repurchase under certain conditions.

As of December 31, 2013, there were no shares of Series A Preferred Stock outstanding.

### **Series B Convertible Preferred Stock (“Series B Preferred Stock”)**

Each share of Series B Preferred Stock is convertible into 100 shares of Common Stock, at any time, at the option of the holder, initially at a conversion price of \$1.10 per share of Common Stock, subject to adjustment for stock dividends, stock splits or similar capital reorganizations, and weighted average price anti-dilution protection for certain issuances below the conversion price. As a result of the issuance of certain promissory notes, the anti-dilution protections have been triggered.

The shares of Series B Preferred Stock have voting rights equal to the number of shares of Common Stock the holder would receive if all shares of Series B Preferred Stock had been converted into Common Stock. The holders of the Series B Preferred Stock may also designate one individual to serve on the Company’s Board of Directors.

The holders of the Series B Preferred Stock are entitled to receive, on a cumulative basis, cash dividends, when, as and if declared by the Company’s Board of Directors, at the greater of (i) 4% per annum or (ii) the dividend payable on the equivalent amount of Common Stock into which the Series B Preferred Stock could be converted; provided, however, that such cash dividend must be paid at the earliest any of the following occur: (A) the Company pays a dividend on the Common Stock, (B) the Company liquidates or there is a change in control, or (C) upon conversion of the Series B Preferred Stock, but only with respect to those shares of Series B Preferred Stock so converted.

The shares of Series B Preferred Stock have a liquidation preference as to both the Company’s Series A Preferred Stock and the Common Stock equal to the greater of (i) the sum of the original issue price (subject to adjustment for stock dividends, stock splits or similar capital reorganizations) plus all accrued but unpaid dividends, or (ii) the amount the holder would receive if all shares of Series B Preferred Stock had been converted into Common Stock.

For as long as any shares of Series B Preferred Stock remain outstanding, the Company is prohibited from (i) amending, waiving, altering or repealing in a way that adversely affects the rights, powers, preferences, or other special rights or privileges of the holders of the Series B Preferred Stock, whether by amendment to the Certificate of Incorporation, Bylaws, Certificate of Designation or other organization documents, or by merger, consolidation, reorganization or otherwise, (ii) increasing or decreasing (other than by redemption or conversion) the authorized number of shares of preferred stock or shares of Series B Preferred Stock, (iii) creating, issuing or authorizing the issuance of any equity securities senior to the Series B Preferred Stock, or (iv) repurchasing, redeeming or reissuing any equity securities of the Company to which the Series B Preferred Stock rank senior and prior (whether with respect to dividends, redemption, or upon liquidation or otherwise), including the Series A Preferred Stock and the Common Stock, and any rights or options exercisable or convertible therefor, other than repurchases of shares of Common Stock from employees, officers, directors or consultants under agreements providing for such repurchase under certain conditions.

The Company also granted certain demand registration rights to the purchasers of Series A Preferred Stock and certain piggyback registration rights to the purchasers of the Series A Preferred Stock and the Series B Preferred Stock.

The Company has granted a preemptive right to the purchasers of the Series B Preferred Stock with respect to future financings by the Company and a right of first offer to provide financing for certain transactions.

## Units

We currently have units outstanding, consisting of one share of Common Stock and one expired warrant to purchase common stock (each a “Common Stock Purchase Warrant”).

The number of shares or total amount of the securities outstanding for each class of securities authorized.

The following is a summary of the total number of securities authorized and outstanding as of the end of Argyle’s last fiscal year.

<b>Name of Security</b>	<b>Period end date</b>	<b>Number of shares authorized</b>	<b>Number of shares outstanding</b>	<b>Freely tradable shares (public float)</b>	<b>Total number of beneficial shareholders</b>	<b>Total number of shareholders of record</b>
Common Stock	December 31, 2013	89,000,000	28,436,271(1)	1,712,151	91 (2)	46 (3)
Series A Convertible Preferred Stock	December 31, 2013	18,750	0	0	0	0
Series B Convertible Preferred Stock	December 31, 2013	27,273	16,337	0	2	2

- (1) Includes holders of 82,221 shares of Common Stock included as part of Units consisting of one share of Common Stock and one expired Common Stock Purchase Warrant. Does not include 945,548 shares of Common Stock held as treasury shares.
- (2) Includes seven (7) beneficial shareholders holding Units.
- (3) Includes one holder of record holding Units.

At December 31, 2013, 8,494,221 shares of Common Stock are reserved for issuance upon conversion of \$2,450,000 aggregate principal amount plus interest of 10% convertible subordinated promissory notes of the Company convertible at a conversion price of \$0.4302 (the “Convertible Notes”).

Additionally, as of December 31, 2013, we had (a) 85,000 shares of Common Stock reserved for issuance upon the exercise of options pursuant to the 2007 Omnibus Securities and Incentive Plan, (b) 3,624,194 shares of common stock were reserved for issuance upon the exercise of options pursuant to the 2013 Stock Option Plan and (c) 2,773,081 shares of Common Stock have been reserved for issuance upon conversion of our outstanding shares of Series B Convertible Preferred Stock.

The name and address of the transfer agent for the Common Stock and Units:

**American Stock Transfer & Trust Company, LLC**  
6201 15<sup>th</sup> Avenue  
Brooklyn, New York 11219  
Tel: (718) 921-8200 or (800) 937-5449

## Subsidiaries

The following is the name, state of incorporation or formation and capital structure of Argyle's direct and indirect subsidiaries:

<b>Issuer</b>	<b>Owner</b>	<b>State of Incorporation or Formation</b>	<b>Issued and Outstanding interests</b>	<b>Percentage of issued and outstanding interests</b>	<b>Percentage of voting interests</b>
ISI Security Group, Inc.	Argyle Security, Inc.	Delaware	119,0064 shares	100%	100%
ISI Detention Contracting Group, Inc. (Texas)	ISI Security Group, Inc.	Texas	10 shares	100%	100%
Metroplex Control Systems, Inc.	ISI Security Group, Inc.	Texas	1000 shares	100%	100%
Metroplex Commercial Fire and Security Alarms, Inc.	ISI Security Group, Inc.	Texas	1000 shares	100%	100%
ISI Detention Systems, Inc.	ISI Security Group, Inc.	Texas	1000 shares	100%	100%
ISI Controls, Ltd.	ISI Security Group, Inc.	Texas	990 LP units	99%	0%
	Metroplex Control Systems, Inc.		10 GP units	1%	100%
MCFSa, Ltd.	ISI Security Group, Inc.	Texas	990 LP units	99%	0%
	Metroplex Commercial Fire and Security Alarms, Inc.		10 GP units	1%	100%
ISI Systems, Ltd.	ISI Security Group, Inc.	Texas	990 LP units	99%	0%
	ISI Detention Systems, Inc.		10 GP units	1%	100%
Detention Contracting Group, Ltd.	ISI Security Group, Inc.	Texas	990 LP units	99%	0%
	ISI Detention Contracting Group, Inc. (Texas)		10 GP units	1%	100%
ISI Detention Contracting Group, Inc. (California)	ISI Detention Contracting Group, Inc. (Texas)	California	100 shares	100%	100%

<b>Issuer</b>	<b>Owner</b>	<b>State of Incorporation or Formation</b>	<b>Issued and Outstanding interests</b>	<b>Percentage of issued and outstanding interests</b>	<b>Percentage of voting interests</b>
ISI Detention Contracting Group, Inc. (New Mexico)	ISI Detention Contracting Group, Inc. (Texas)	New Mexico	1000 shares	100%	100%
Com-Tec Security, LLC	ISI Controls, Ltd.	Wisconsin	100 Units	100%	100%
Com-Tec California Limited Partnership	Com-Tec Security, LLC	Wisconsin	1 LP Unit	50%	0%
	Metroplex Control Systems, Inc.		1 GP Unit	50%	100%

## Directors and Executive Officers

Name	Position with the Company and Principal Occupation	Held Office Since	Current Board Term Expires
Ray Gilley	President, Chief Executive Officer, Chief Operating Officer and Director	2012(1)	2016
Richard Watts	Chief Financial Officer	2010	N/A
Robert Davies	Chairman of the Board of Directors	2009	2015
Sam Youngblood	Director	1991(2)	2016
James Read	Director	2009	2015
Simon Whitmey	Director	2011	2014

- (1) Prior to being appointed as President, Chief Executive Officer and Chief Operating Officer of Argyle, Mr. Gilley served as President and Chief Operating Officer of MCS Fire & Security.
- (2) Prior to being elected as a Director, Mr. Youngblood had served in several executive roles with Argyle and ISI. From 2009 through 2013, he served as Argyle's President and Chief Executive Officer. Previously, he served as Chief Operating Officer of Argyle and President of Argyle's operating business since January 2008. He had previously served as the Chief Executive Officer of ISI prior to its acquisition in 2007.

### Business Experience About Directors Not Previously Disclosed

**Ray Gilley** has been a Director and our President, Chief Executive Officer and Chief Operating Officer since March 2013. Previously, he served as President and Chief Operating officer of MCS Fire & Security from May 2012. Prior to joining the Company, from 2004-2010, Mr. Gilley owned and served as CEO of Encompass Security, a commercial security company located in Southlake, TX. Prior to that, from 1992-2004, he served as EVP and COO of Sonitrol. Mr. Gilley has a BGS from Texas Christian University and he maintains a Certified Fraud Examiner credential along with a number of security and contractor qualifier credentials.

**Simon Whitmey** has served as a Director since 2011. Mr. Whitmey is a real estate developer with expertise in land acquisition, mixed-use development, master-planned communities, military base reuse, homebuilding, international banking, project financing, and distressed asset workouts. He is currently President – North America of TST Ltd., a British company in the construction engineering industry, where he has served since 2011. From 2003 to 2009, Mr. Whitmey held several roles with J. F. SHEA, CO., INC and related entities, most recently holding the role of Senior Vice President of SHEA PROPERTIES. Mr. Whitmey holds a MA Degree in Chemical Engineering from Churchill College, Cambridge University, UK.

## Beneficial Owners

The following table sets forth, as of December 31, 2013, certain information regarding beneficial ownership of our Common Stock by each person who is known by us to beneficially own more than 5% of our Common Stock. The table also identifies the stock ownership of each of our directors, each of our executive officers, and all directors and officers as a group. Except as otherwise indicated, the stockholders listed in the table have sole voting and investment powers with respect to the shares indicated.

Shares of Common Stock which a person has a right to acquire within 60 days pursuant to the exercise or conversion of options, warrants, preferred stock or other similar convertible or derivative securities are deemed to be outstanding for the purpose of computing the percentage ownership of such person, but are not deemed to be outstanding for the purpose of computing the percentage ownership of any other person shown in the table.

The applicable percentage of ownership is based on (i) 28,436,271 shares of Common Stock and (ii) 16,337 shares of Series B Preferred Stock (convertible into 2,773,081 shares of Common Stock) outstanding as of December 31, 2013. In addition, Argyle had 3,779,194 options outstanding as of December 31, 2013, of which 353,393 have vested and are fully exercisable. Such options are included in the percentage of ownership for only the holders of options, as specifically indicated below.

Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership	Approximate Percentage of Common Stock
Mezzanine Management Limited Century House 16 Par la Ville Road Hamilton, Bermuda Attention : Arthur Morris	25,230,945 <sup>(1)</sup>	81.2 %
William Blair Mezzanine Capital Fund III, L.P. <sup>(2)</sup> c/o Merit Capital Partners Attention: David Jones 303 West Madison Street, Suite 2100 Chicago, IL 60606	2,886,997	9.3 %
Sam Youngblood 12903 Delivery Drive San Antonio, TX 78247	519,392 <sup>(3)</sup>	1.7 %
Other directors and executive officers as a group (6 individuals)	0 <sup>(3)</sup>	* %

\* Less than 1%.

- (1) Mezzanine Management Fund IV A, L.P. ("MML A") has the shared power to vote or direct the vote and the shared power to dispose or direct the disposition of 20,445,865 shares of Common Stock. Mezzanine Management Fund IV Coinvest A, L.P. ("MML Coinvest A") has the shared power to vote or direct the vote and the shared power to dispose or direct the disposition of 314,269 shares of Common Stock. Mezzanine Management Limited has the shared power to vote or direct the vote and the shared power to dispose or direct the disposition of 25,230,945 shares of Common Stock which includes (i) 767,500 shares directly held, (ii) 20,760,134 shares held by MML A and MML Coinvest A. They do not include 2,773,081 shares of Common Stock underlying 16,337 shares of Series B Preferred Stock nor does it include shares of Common Stock issuable upon conversion of Convertible Notes.

- (2) William Blair Mezzanine Capital Partners III, L.L.C. has voting and dispositive power over the shares held by William Blair Mezzanine Capital Fund III, L.P. This information is derived from a Schedule 13D filed by the reporting persons with the SEC on January 6, 2010.
- (3) Includes 50,000 options to purchase Common Stock which have vested and are fully exercisable at \$1.10 per share.

## **Accountant or Auditor**

Padgett Stratemann & Co. LLP  
100 N.E. Loop 410  
Suite 1100  
San Antonio, TX 78216  
(210) 828-6281

Padgett Stratemann & Co. LLP (“Padgett”) provides audit and tax preparation services. Padgett performed an audit of the Company’s 2013 consolidated financial statements which were prepared by the Company.

## Summary of Financial Information

Argyle's audited financial statements for the fiscal year ended December 31, 2013 are attached to this Annual Report.

The audited consolidated financial statements of Argyle, as of December 31, 2013, include the accounts of the Company and all subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation. In the opinion of management, all normal recurring adjustments considered necessary for a fair presentation have been included.

Our consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles. As such, we are required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. By their nature, these estimates and judgments are subject to an inherent degree of uncertainty. Our management reviews its estimates on an on-going basis, including those related to revenue recognition based on the percentage-of-completion methodology, sales allowances, recognition of service sales revenues and the allowance for doubtful accounts. We base our estimates and assumptions on historical experience, knowledge of current conditions and our understanding of what we believe to be reasonable that might occur in the future considering available information. Actual results may differ from these estimates, and material effects on our operating results and financial position may result.

## Risk Factors

There have been no material changes in our business, operations or prospects that would require a change to the Risk Factor disclosure included in our 2009 Annual Report that have not already been disclosed.

The risks and uncertainties described in the 2009 Annual Report are not the only ones the Company faces. Additional risks and uncertainties not presently known to the Company or that the Company currently deemed immaterial also may impair the Company's business operations. If any of the following risks occur, the Company's business prospects, financial condition, operating results and cash flows could be adversely affected in amounts that could be material.

**Argyle Security, Inc.,  
dba ISI Security**

**Consolidated Financial Statements  
and Supplementary Data**

December 31, 2013 and 2012

# Argyle Security, Inc., dba ISI Security

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## Independent Auditor's Report

To the Board of Directors  
Argyle Security, Inc., dba ISI Security  
San Antonio, Texas

### ***Report on the Consolidated Financial Statements***

We have audited the accompanying consolidated financial statements of Argyle Security, Inc., dba ISI Security, which comprise the consolidated balance sheets as of December 31, 2013 and 2012, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for the years then ended and the related notes to the consolidated financial statements.

### ***Management's Responsibility for the Consolidated Financial Statements***

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditor's Responsibility***

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### ***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly in all material respects, the financial position of Argyle Security, Inc., dba ISI Security as of December 31, 2013 and 2012, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

*Padgett, Stratemann & Co., L.L.P.*

Certified Public Accountants  
San Antonio, Texas  
February 11, 2014

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# Argyle Security, Inc., dba ISI Security

## Consolidated Balance Sheets

December 31, 2013 and 2012

(Dollars in Thousands, Except Share Data)

### Assets

	<u>2013</u>	<u>2012</u>
<b>Current Assets</b>		
Cash and cash equivalents	\$ 585	\$ 1,371
Restricted cash	-	3,000
Receivables:		
Contract – net of allowance for doubtful accounts of \$392 (\$501 in 2012)	15,042	16,950
Costs and estimated earnings in excess of billings on incomplete contracts	3,026	2,268
Inventory	777	780
Prepays and other current assets	539	592
Deferred taxes	980	-
Refundable income taxes	<u>6</u>	<u>8</u>
Total current assets	<u>20,955</u>	<u>24,969</u>
 <b>Other Assets</b>		
Investment in affiliate	-	1,774
Property and equipment – net	3,551	4,019
Intangible assets – net	4,598	5,554
Deferred taxes	4,889	-
Deposits and other assets	<u>237</u>	<u>256</u>
Total other assets	<u>13,275</u>	<u>11,603</u>
Total assets	<u>\$ 34,230</u>	<u>\$ 36,572</u>

*Notes to the consolidated financial statements form an integral part of these statements.*

## Liabilities and Stockholders' Equity

	<u>2013</u>	<u>2012</u>
<b>Current Liabilities</b>		
Accounts payable and accrued liabilities	\$ 7,958	\$ 9,339
Billings in excess of costs and estimated earnings on incomplete contracts	5,663	4,778
Dividends payable	8	1,825
Current portion of capitalized lease obligations	564	547
Income tax payable	<u>146</u>	<u>69</u>
Total current liabilities	<u>14,339</u>	<u>16,558</u>
<b>Long-Term Liabilities</b>		
Long-term debt	4,450	6,962
Interest payable	1,204	1,092
Long-term capitalized lease obligations – less current portion	<u>2,225</u>	<u>2,558</u>
Total long-term liabilities	<u>7,879</u>	<u>10,612</u>
Total liabilities	<u>22,218</u>	<u>27,170</u>
<b>Stockholders' Equity</b>		
Preferred stock – Argyle Security, Inc. – \$0.0001 par value; 1,000,000 shares authorized; 0 Series A shares (7,423 at December 31, 2012) and 16,337 Series B shares (27,273 at December 31, 2012) issued and outstanding	1,610	7,157
Common stock – Argyle Security, Inc. – \$0.0001 par value; 89,000,000 shares authorized; 29,381,819 shares issued and 28,436,271 shares outstanding at December 31, 2013 (28,446,271 at December 31, 2012);	3	3
Treasury stock, par value; 945,548 common shares at December 31, 2013 (935,548 at December 31, 2012)	-	-
Additional paid-in capital	58,260	58,257
Accumulated deficit	<u>(47,861)</u>	<u>(56,015)</u>
Total stockholders' equity	<u>12,012</u>	<u>9,402</u>
Total liabilities and stockholders' equity	<u>\$ 34,230</u>	<u>\$ 36,572</u>

# Argyle Security, Inc., dba ISI Security

## Consolidated Statements of Operations

Years Ended December 31, 2013 and 2012

(Dollars in Thousands)

	<u>2013</u>	<u>2012</u>
Revenues from continuing operations:		
Contract revenues	\$ 51,652	\$ 47,501
Service, manufacturing, and other revenues	<u>18,791</u>	<u>21,893</u>
Total revenues	<u>70,443</u>	<u>69,394</u>
Cost of revenues from continuing operations:		
Contract costs	42,627	41,669
Service, manufacturing, and other costs, including \$43 of depreciation (\$139 in 2012)	<u>12,871</u>	<u>17,133</u>
Total cost of revenues	<u>55,498</u>	<u>58,802</u>
Gross profit	<u>14,945</u>	<u>10,592</u>
Operating expenses from continuing operations:		
Salaries and related expense	7,865	7,221
Professional fees and outside services	906	1,189
General and administrative expenses	4,431	4,583
Depreciation	965	1,362
Intangible assets impairment charge	-	176
Amortization of intangible assets	<u>956</u>	<u>1,224</u>
Total operating expenses	<u>15,123</u>	<u>15,755</u>
Operating loss from continuing operations	<u>(178)</u>	<u>(5,163)</u>
Other income (expense) from continuing operations:		
Other	71	145
Interest expense	(955)	(1,524)
Earnings in affiliate	<u>6,082</u>	<u>5,273</u>
Total other income from continuing operations	<u>5,198</u>	<u>3,894</u>
Income (loss) from continuing operations before provision for income taxes	5,020	(1,269)
Income tax benefit (expense)	<u>5,019</u>	<u>(172)</u>
Income (loss) from continuing operations	10,039	(1,441)
Discontinued operations (note 15)		
Gain from operations of discontinued Denver component	<u>-</u>	<u>300</u>
Net income (loss)	10,039	(1,141)
Dividends on redeemable preferred stock	<u>(291)</u>	<u>(346)</u>
Income (loss) allocable to holders of nonredeemable common stock	<u>\$ 9,748</u>	<u>\$ (1,487)</u>

*Notes to the consolidated financial statements form an integral part of these statements.*

# Argyle Security, Inc., dba ISI Security

## Consolidated Statements of Changes in Stockholders' Equity

Years Ended December 31, 2013 and 2012

(Dollars in Thousands, Except Share Data)

	Preferred Stock		Common Stock		Treasury Stock		Additional Paid-in Capital	Accumulated Deficit	Total
	Shares	Amount	Shares	Amount	Shares	Amount			
Balance at December 31, 2011	34,696	\$ 7,157	29,381,819	\$ 3	-	\$ -	\$ 58,304	\$ (54,528)	\$ 10,936
Net loss – year ended December 31, 2012	-	-	-	-	-	-	-	(1,141)	(1,141)
Purchase of treasury stock	-	-	(935,548)	-	935,548	-	(47)	-	(47)
Dividends on preferred stock	-	-	-	-	-	-	-	(346)	(346)
Balance at December 31, 2012	34,696	7,157	28,446,271	3	935,548	-	58,257	(56,015)	9,402
Net income – year ended December 31, 2013	-	-	-	-	-	-	-	10,039	10,039
Purchase of treasury stock	-	-	(10,000)	-	10,000	-	(4)	-	(4)
Redemption of Series A preferred stock	(7,423)	(4,470)	-	-	-	-	-	(1,468)	(5,938)
Redemption of Series B preferred stock	(10,936)	(1,077)	-	-	-	-	-	(126)	(1,203)
Stock options granted	-	-	-	-	-	-	7	-	7
Dividends on preferred stock	-	-	-	-	-	-	-	(291)	(291)
Balance at December 31, 2013	<u>16,337</u>	<u>\$ 1,610</u>	<u>28,436,271</u>	<u>\$ 3</u>	<u>945,548</u>	<u>\$ -</u>	<u>\$ 58,260</u>	<u>\$ (47,861)</u>	<u>\$ 12,012</u>

Notes to the consolidated financial statements form an integral part of these statements.

# Argyle Security, Inc., dba ISI Security

## Consolidated Statements of Cash Flows

Years Ended December 31, 2013 and 2012

(Dollars in Thousands)

	<u>2013</u>	<u>2012</u>
<b>Cash Flows From Operating Activities</b>		
Net income (loss)	\$ 10,039	\$ (1,141)
Net gain from discontinued operations	-	(300)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Earnings in affiliate	(6,082)	(5,273)
Amortization of intangible assets	956	1,224
Bad debt expense	245	678
Depreciation	1,008	1,501
Intangible asset impairment	-	176
Stock-based compensation	7	-
Gain on sale of property and equipment – net	(46)	(118)
Deferred tax benefit	(5,869)	-
Changes in operating assets and liabilities:		
Contract receivables	1,663	(2,745)
Costs and estimated earnings in excess of billings on incomplete contracts	(758)	(401)
Inventory and prepaids and other assets	75	690
Accounts payable and accrued liabilities	(1,269)	4,572
Billings in excess of costs and estimated earnings on incomplete contracts	885	2,467
Other long-term liabilities	-	(69)
Income taxes refundable/payable	79	69
Net cash provided by operating activities – continuing operations	933	1,330
Net cash used in operating activities – discontinued operations	-	(82)
Net cash provided by operating activities	<u>933</u>	<u>1,248</u>
<b>Cash Flows From Investing Activities</b>		
Proceeds from disposal of property and equipment	-	538
Investment in affiliate	7,856	4,000
Purchase of intangible assets	-	(160)
Purchase of property and equipment	(222)	(236)
Net cash provided by investing activities	<u>7,634</u>	<u>4,142</u>

Notes to the consolidated financial statements form an integral part of these statements.

# Argyle Security, Inc., dba ISI Security

## Consolidated Statement of Cash Flows

Year Ended December 31, 2013 and 2012

(Dollars in Thousands)

	<u>2013</u>	<u>2012</u>
<b>Cash Flows From Financing Activities</b>		
Restricted cash	\$ 3,000	\$ 1,500
Principal payments on long-term debt	(20,012)	(18,240)
Proceeds from long-term debt	17,500	12,750
Redemption of preferred stock and accrued dividends	(9,249)	-
Purchase of treasury stock	(4)	(47)
Payments on capital lease obligations	<u>(588)</u>	<u>(721)</u>
Net cash used in financing activities	<u>(9,353)</u>	<u>(4,758)</u>
Net increase (decrease) in cash and cash equivalents	(786)	632
Cash and cash equivalents at beginning of year	<u>1,371</u>	<u>739</u>
Cash and cash equivalents at end of year	\$ <u><u>585</u></u>	\$ <u><u>1,371</u></u>
<b>Supplemental Disclosures of Cash Flow Information</b>		
Cash paid for interest	\$ <u><u>562</u></u>	\$ <u><u>995</u></u>
Cash paid for income taxes	\$ <u><u>721</u></u>	\$ <u><u>117</u></u>
<b>Supplemental Disclosures of Noncash Flow Information</b>		
Dividends accrued	\$ <u><u>8</u></u>	\$ <u><u>346</u></u>
Vehicles financed with capital lease	\$ <u><u>273</u></u>	\$ <u><u>972</u></u>

# **Argyle Security, Inc., dba ISI Security**

## **Notes to the Consolidated Financial Statements**

### **1. Summary of Significant Accounting Policies**

#### ***Reporting Entity and Nature of Operations***

Argyle Security, Inc., dba ISI Security (the “Company” or “Argyle”) is a comprehensive security solutions provider to its diverse customer base because it addresses the majority of its customers’ physical electronic security requirements. The Company is also a detention and commercial equipment contractor that specializes in designing and integrating security solutions, including turnkey installations, design, engineering, supply, and installation of various detention, surveillance, and access control equipment, and software solutions for correctional facilities and commercial institutions. The work is performed under fixed-price contracts. The projects are located in various cities throughout the United States. The lengths of the contracts vary, but are typically less than two years. The Company also provides turnkey installations covering the full spectrum of electronic security and low voltage systems, including fire alarm, access control, closed circuit television, intercom, sound/paging, and other custom designed systems. The Company operates through 13 subsidiaries making up the following business units: ISI, MCS, PDI, Com-Tec, and MCS Fire & Security.

#### ***Principles of Consolidation***

The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

#### ***Use of Estimates***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities 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. Significant estimates inherent in the accompanying consolidated financial statements include estimated costs on incomplete contracts and realization of deferred tax assets.

#### ***Warranty Costs***

The Company warrants its products against defects in design, materials, and workmanship generally for periods ranging from one to two years. A provision for estimated warranty costs is included in the total estimated costs of its contracts.

# Argyle Security, Inc., dba ISI Security

## Notes to the Consolidated Financial Statements

### 1. Summary of Significant Accounting Policies (continued)

#### *Sales Taxes*

The Company's policy is to present taxes collected from customers and remitted to governmental authorities on a net basis. The Company records the amounts collected as a current liability and relieves such liability upon remittance to the taxing authority without impacting revenues or expenses.

#### *Equity Method*

Investee companies that are not consolidated, but over which the Company exercises significant influence, are accounted for under the equity method of accounting. Whether or not the Company exercises significant influence with respect to an investee depends on an evaluation of several factors including, among others, representation on the investee company's board of directors and ownership level, which is generally a 20% to 50% interest in the voting securities of the investee company. Under the equity method of accounting, an investee company's accounts are not reflected within the Company's consolidated balance sheets and statements of operations; however, the Company's share of the earnings or losses of the investee company is reflected in the caption "earnings in affiliate" in the consolidated statements of operations. The Company's carrying value in an equity method investee company is reflected in the caption "investment in affiliate" in the Company's consolidated balance sheets.

During 2011, the Company entered into a joint venture agreement relating to the execution of a contract for a project in California, which is accounted for under the equity method. The contract was completed, and the joint venture was liquidated during the year ended December 31, 2013. Selected financial information from the joint venture, net of the affiliated subcontract profit elimination, as of and for the years ended December 31, 2013 and 2012, respectively, consists of the following:

	<u>2013</u>	<u>2012</u>
<b>Balance Sheet</b>		
Current and total assets	\$ <u>-</u>	\$ <u>13,992</u>
Current and total liabilities	\$ <u>-</u>	\$ <u>12,219</u>
<b>Income Statement</b>		
Construction revenue	\$ <u>11,654</u>	\$ <u>44,737</u>
Construction costs	\$ <u>5,572</u>	\$ <u>39,465</u>

# **Argyle Security, Inc., dba ISI Security**

## **Notes to the Consolidated Financial Statements**

### **1. Summary of Significant Accounting Policies (continued)**

#### ***Cash and Cash Equivalents***

Cash equivalents for purposes of the consolidated statements of cash flows are all highly liquid investments purchased with a maturity of three months or less and the carrying amounts approximate fair value.

#### ***Restricted Cash***

Restricted cash represents bank accounts and certificates of deposit securing the Company's letter of credit agreements. These letters of credit expired during the year ended December 31, 2013.

#### ***Contracts Receivable***

The allowance for doubtful accounts is established as losses are estimated to have occurred through a provision for bad debts charged to earnings. Losses are charged against the allowance when management believes the uncollectibility of a receivable is confirmed. Subsequent recoveries, if any, are credited to bad debt recovery. The allowance for doubtful accounts is evaluated on a regular basis by management and is based on historical experience and specifically identified questionable receivables. The evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available.

#### ***Inventory***

Inventory is stated at the lower of cost (first-in, first-out method) or market (net realizable value).

#### ***Depreciation and Amortization***

Property and equipment are stated at cost. Assets held under capital leases are recorded at the lower of the net present value of the minimum lease payments or the fair value of the leased asset at the inception of the lease. Depreciation and amortization are calculated on the straight-line method based on the following estimated useful lives: buildings – 10 to 40 years; furniture, fixtures, and equipment – 3 to 10 years; vehicles – 3 to 7 years and website development costs – 3 years. Amortization of intangible assets and leasehold improvements is computed using the straight-line method over the shorter of the estimated useful lives of the assets or the remaining term of the related lease. Amortization of assets held under capital lease is computed using the straight-line method over the shorter of the estimated useful lives of the assets or the term of the related lease.

# **Argyle Security, Inc., dba ISI Security**

## **Notes to the Consolidated Financial Statements**

### **1. Summary of Significant Accounting Policies (continued)**

#### ***Impairment of Long-Lived Assets***

The Company reviews the carrying value of property and equipment and intangible assets for impairment whenever events and circumstances indicate the carrying value of an asset may not be recoverable from the estimated future cash flows expected to result from its use and eventual disposition. In cases where undiscounted expected future cash flows are less than the carrying value, an impairment loss is recognized equal to an amount by which the carrying value exceeds the fair value of assets.

The factors considered by management in performing this assessment include current operating results, trends and prospects, and the effects of obsolescence, demand, competition, and other economic factors. Accordingly, the Company did not recognize an impairment loss for the year ended December 31, 2013 (\$176,000 recognized for the year ended December 31, 2012).

#### ***Revenue and Cost Recognition***

##### ***Construction and Related Services***

Revenues from fixed-fee and modified fixed-price contracts are recognized on the percentage-of-completion method, measured by the cost-to-cost method. This method is used because management considers costs incurred to date to be the best available means of progress on these contracts.

Contract costs include all direct material and labor costs and those indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs, and depreciation. General and administrative costs are charged to expense as incurred. Provisions for estimated losses on incomplete contracts are made in the period in which such losses are determined. Changes in job performance, job conditions, and estimated profitability, including those arising from contract penalty provisions, and final contract settlements may result in revisions to costs and income and are recognized in the period in which the revisions are determined.

Management believes that its estimates of the percentage-of-completion and earnings or losses on contracts are reasonable; however, due to the nature of the contracting business and the type of contracts, the current estimates of the percentage-of-completion and earnings or losses on contracts may differ materially from the ultimate results upon completion of the contracts.

The asset "costs and estimated earnings in excess of billings" represents revenues recognized in excess of amounts billed on incomplete contracts. The liability "billings in excess of costs and estimated earnings" represents billings in excess of revenues recognized on incomplete contracts.

# **Argyle Security, Inc., dba ISI Security**

## **Notes to the Consolidated Financial Statements**

### **1. Summary of Significant Accounting Policies (continued)**

#### ***Revenue and Cost Recognition (continued)***

##### *Construction and Related Services (continued)*

Some contracts have certain milestone due dates that must be met, or the Company could be subject to penalties for liquidated damages if claims are asserted by the customer, and the Company is responsible for the delays. These contractual requirements generally relate to specified activities that must occur for a project by a specified date. Each contract defines the conditions under which a customer may make a claim against the Company for such damages. Management has determined that no claims for liquidated damages meet the criteria for accrual at December 31, 2013 and 2012.

Profit incentives are included in revenues when their realization is reasonably assured. An amount equal to contract costs attributable to claims is included in revenues when realization is probable and the amount can be reliably estimated.

##### *Service Sales*

Service sales revenues are recognized when the services have been delivered to and accepted by the customer. These are generally short-term projects, which are evidenced by signed service agreements or customer work orders or purchase orders. These sales agreements/customer orders generally provide for billing to customers based on time at quoted hourly or project rates plus costs of materials and supplies furnished by the Company.

##### *Manufactured Products*

Revenues are recognized by PDI when the product is shipped to the customer in accordance with the contractual shipping terms. In almost all cases, the shipping of products to PDI's customers is FOB origin, whereby title passes to the purchaser when the product leaves the PDI premises under the bail of a common carrier.

##### *Other Revenue*

Revenue from other services is recognized as such services are provided.

#### ***Income Taxes***

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets, including tax loss and credit carryforwards, and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those

# **Argyle Security, Inc., dba ISI Security**

## **Notes to the Consolidated Financial Statements**

### **1. Summary of Significant Accounting Policies (continued)**

#### ***Income Taxes (continued)***

temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred income tax expense represents the change during the period in the deferred tax assets and deferred tax liabilities.

The components of the deferred tax assets and liabilities are individually classified as current and noncurrent based on their characteristics. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

#### ***Stock-Based Compensation***

The Company recognizes compensation expense for all stock-based payment awards made to employees, including grants of stock options based on estimated fair values. Stock-based compensation expense is recognized based on the estimated value of the portion of stock-based payment awards that the Company ultimately expected to vest during the year.

#### ***Contingencies***

Certain conditions may exist as of the date the consolidated financial statements are issued, which may result in a loss to the Company, but which will only be resolved when one or more future events occur or fail to occur. The Company's management and its legal counsel assess such contingent liabilities, and such assessment inherently involves an exercise of judgment. In assessing loss contingencies related to legal proceedings that are pending against the Company or unasserted claims that may result in such proceedings, the Company's legal counsel evaluates the perceived merits of any legal proceedings or unasserted claims, as well as the perceived merits of the amount of relief sought or expected to be sought therein.

If the assessment of a contingency indicates it is probable that a material loss has been incurred and the amount of the liability can be estimated, then the estimated liability would be accrued in the Company's financial statements. If the assessment indicates a potentially material loss contingency is not probable, but is reasonably possible, or is probable, but cannot be estimated, then the nature of the contingent liability, together with an estimate of the range of possible loss, if determinable and material, would be disclosed.

Loss contingencies considered remote are generally not disclosed unless they involve guarantees, in which case the guarantees would be disclosed.

# Argyle Security, Inc., dba ISI Security

## Notes to the Consolidated Financial Statements

### 1. Summary of Significant Accounting Policies (continued)

#### *Reclassification*

Certain reclassifications have been made in the prior year's consolidated financial statements to conform to the current year's presentation.

#### *Subsequent Events*

The Company has evaluated subsequent events through February 11, 2014, the date the consolidated financial statements were available to be issued.

### 2. Contract Receivables

Contract receivables consist of the following (in thousands):

	December 31,	
	<u>2013</u>	<u>2012</u>
Completed contracts and contracts in progress	\$ 13,114	\$ 15,328
Retainage	<u>2,320</u>	<u>2,123</u>
	15,434	17,451
Less allowance for doubtful accounts	<u>392</u>	<u>501</u>
Total contract receivable	<u>\$ 15,042</u>	<u>\$ 16,950</u>

## Argyle Security, Inc., dba ISI Security

### Notes to the Consolidated Financial Statements

#### 3. Costs and Estimated Earnings on Contracts

Costs and estimated earnings on contracts are as follows (in thousands):

	December 31,	
	2013	2012
Costs incurred to date	\$ 119,114	\$ 129,166
Estimated earnings	<u>20,716</u>	<u>18,845</u>
Revenue recognized to date	139,830	148,011
Less billings to date	<u>142,467</u>	<u>150,521</u>
	\$ <u>(2,637)</u>	\$ <u>(2,510)</u>
Costs and estimated earnings in excess of billings on incomplete contracts	\$ 3,026	\$ 2,268
Billings in excess of costs and estimated earnings on incomplete contracts	<u>(5,663)</u>	<u>(4,778)</u>
	\$ <u>(2,637)</u>	\$ <u>(2,510)</u>

#### 4. Inventory

Inventory consists of the following (in thousands):

	December 31,	
	2013	2012
Raw materials	\$ 122	\$ 82
Work in process	48	111
Finished goods	<u>607</u>	<u>587</u>
	\$ <u>777</u>	\$ <u>780</u>

# Argyle Security, Inc., dba ISI Security

## Notes to the Consolidated Financial Statements

### 5. Property and Equipment

Property and equipment consists of the following (in thousands):

	December 31,	
	2013	2012
Buildings	\$ 3,622	\$ 3,622
Leasehold improvements	1,441	1,441
Furniture, fixtures, and equipment	4,785	4,731
Vehicles	1,429	1,162
Website	46	46
	<u>11,323</u>	<u>11,002</u>
Less accumulated depreciation	<u>7,772</u>	<u>6,983</u>
Net property and equipment	<u>\$ 3,551</u>	<u>\$ 4,019</u>

Depreciation expense related to property and equipment totaled approximately \$1.0 million and \$1.5 million for the years ended December 31, 2013 and 2012, respectively, and includes amortization of assets held under capital leases.

### 6. Intangible Assets

At December 31, 2013, intangible assets consisted of the following (in thousands):

	Gross Carrying Amount	2013 Impairment Charges	Accumulated Amortization	Net Carrying Amount
Amortizable:				
Customer relationships	\$ 10,687	\$ -	\$ 7,328	\$ 3,359
Unamortizable:				
Trade name	\$ 1,239	\$ -	\$ -	\$ 1,239
Total	<u>\$ 11,926</u>	<u>\$ -</u>	<u>\$ 7,328</u>	<u>\$ 4,598</u>

# Argyle Security, Inc., dba ISI Security

## Notes to the Consolidated Financial Statements

### 6. Intangible Assets and Other Assets (continued)

At December 31, 2012, intangible assets consisted of the following (in thousands):

	<u>Gross Carrying Amount</u>	<u>2012 Impairment Charges</u>	<u>Accumulated Amortization</u>	<u>Net Carrying Amount</u>
Amortizable:				
Customer relationships	\$ 10,687	\$ 176	\$ 6,196	\$ 4,315
Unamortizable:				
Trade name	\$ <u>1,521</u>	\$ <u>282</u>	\$ <u>-</u>	\$ <u>1,239</u>
Total	\$ <u><u>12,208</u></u>	\$ <u><u>458</u></u>	\$ <u><u>6,196</u></u>	\$ <u><u>5,554</u></u>

Estimated amortization expense for the next five years is as follows (in thousands):

Year ending December 31,	
2014	\$ 956
2015	939
2016	907
2017	552
2018	<u>5</u>
	<b>\$ <u><u>3,359</u></u></b>

# Argyle Security, Inc., dba ISI Security

## Notes to the Consolidated Financial Statements

### 7. Long-Term Debt

Long-term debt consists of the following (in thousands):

	December 31,	
	2013	2012
Notes payable:		
Unsecured term debt – stockholder (A)	\$ -	\$ 3,012
Unsecured convertible debt – stockholders (B)	2,450	3,950
Line of credit and senior secured credit facility (C)	2,000	-
	<u>4,450</u>	<u>6,962</u>
Less current maturities	<u>-</u>	<u>-</u>
	<u>\$ 4,450</u>	<u>\$ 6,962</u>

(A) ISI had an unsecured note bearing interest at 14% to a stockholder for approximately \$3.0 million as of December 31, 2012. The note had a maturity of April 30, 2013, and was paid in full in March 2013.

(B) In December 2009, the Company issued, in exchange for cash, convertible subordinated promissory notes in the aggregate principle amount of \$2.45 million (the “Convertible Notes”), bearing interest at 10% per annum. On each interest payment date, accrued but unpaid interest is capitalized and also bears interest at 10% per annum. The principal and any unpaid interest on the note mature on April 30, 2015. Each dollar of outstanding principal and accrued interest is convertible into shares of common stock, at the option of the holders of the Convertible Notes, at a price of \$0.4302 per share. The outstanding principal and accrued and unpaid interest of the Convertible Notes was convertible into 8,494,221 shares of common stock, at the option of the note holder, at December 31, 2013. There are financial covenants related to the Convertible Notes.

In December 2011, the Company entered into a series of subordinated promissory notes in the original aggregate principal amount of \$1,500,000 which bear interest of 14%. In March 2013, the Company paid the principal and interest of the subordinated promissory notes in full.

(C) ISI had a line of credit facility for a secured revolving line of credit in the amount of \$8.0 million with a \$5.0 million sublimit for the issuance of letters of credit (the “Revolver”).

The Revolver is collateralized by liens on and security interests in substantially all assets and guaranteed by ISI. Such guaranty will remain in effect until the payment in full of the obligation and termination of the senior debt holder’s commitment to extend credit under the senior line of credit facility. The interest rate of the Revolver is equal to the lesser of (i) the prime rate plus

## **Argyle Security, Inc., dba ISI Security**

### **Notes to the Consolidated Financial Statements**

#### **7. Long-Term Debt (continued)**

2.5%, or (ii) the London Interbank Offer Rate ("LIBOR") plus 4.5%. The weighted average interest rate for the Revolver was 6.9% at December 31, 2013 (6.2% at December 31, 2012). There are both financial and restrictive covenants related to the agreement, including a restriction on the payment of dividends by ISI.

As of December 31, 2013, the line of credit facility had an outstanding balance of \$2.0 million, and it matures on April 29, 2015.

In addition, Argyle and the senior debt holder entered into a pledge agreement whereby Argyle pledged 100% of the capital stock of ISI to collateralize payment and performance of all obligations arising under the credit facility.

As of December 31, 2013, the Company has two outstanding letters of credit in the aggregate amount \$1.8 million expiring in 2014 (four outstanding letters in the aggregate of \$4.5 million at December 31, 2012). This balance reduced the borrowing capacity on the ISI line of credit facility.

#### **8. Leases**

ISI sold its owner-occupied real estate to Green Wing Management, Ltd. ("Green Wing"), an entity owned and controlled by a member of the Board of Directors (the "Board") of the Company during 2004 and entered into a leaseback of the properties with Green Wing. ISI entered into a second lease on another property owned by Green Wing in 2006. ISI entered into a third lease on another property owned by the Green Wing in June 2008. The Company is responsible for real estate taxes, building insurance, and maintenance for all three leases, which are accounted for as capital leases. In November 2013, Green Wing sold a portion of its leased property to an unrelated third party. The Company made lease payments of \$469,000 to Green Wing for the year ended December 31, 2013 (\$493,000 for the year ended December 31, 2012).

In January 2012, the Company entered into an agreement with a third party to sell and leaseback all vehicles for approximately \$538,000. The gain of \$185,000 realized in this transaction has been deferred and is being amortized to income in proportion to rent charged over the term of the lease. The deferred gain balance was recognized in full at December 31, 2013 (the deferred gain balance was \$54,000 at December 31, 2012). During 2013, the Company increased the lease obligation approximately \$290,000 for vehicle leases.

# Argyle Security, Inc., dba ISI Security

## Notes to the Consolidated Financial Statements

### 8. Leases (continued)

The following is a summary of property leased under capital leases, included in property and equipment, in the accompanying consolidated financial statements (in thousands):

	December 31,	
	2013	2012
Buildings	\$ 3,622	\$ 3,622
Vehicles	<u>1,230</u>	<u>975</u>
	4,852	4,597
Less accumulated amortization	<u>2,505</u>	<u>1,987</u>
	<u>\$ 2,347</u>	<u>\$ 2,610</u>

The Company leases equipment and a portion of its facilities pursuant to noncancellable operating lease agreements expiring through 2018. Rental expense totaled approximately \$0.9 million and \$1.0 million for the years ended December 31, 2013 and 2012, respectively.

Future minimum lease payments under noncancellable operating leases and future minimum lease payments under capital leases together as of December 31, 2013 were as follows:

	Capital Leases	Operating Leases
Year Ending December 31,		
2014	\$ 751	\$ 603
2015	691	370
2016	577	325
2017	493	221
2018	493	77
Thereafter	<u>380</u>	<u>-</u>
Future minimum lease payments	3,385	<u>\$ 1,596</u>
Less – amount of minimum lease payments attributable to interest	<u>596</u>	
Present value of net minimum lease payments	2,789	
Current portion of capitalized lease obligations	<u>564</u>	
Long-term portion of capitalized lease obligations	<u>\$ 2,225</u>	

# **Argyle Security, Inc., dba ISI Security**

## **Notes to the Consolidated Financial Statements**

### **9. Self Insurance**

During 2013 and 2012, the Company was self-insured to certain limits under certain group health and dental plans. Stop-loss coverage was provided for claims above \$100,000 per employee up to a lifetime maximum of \$3 million for 2013 and 2012. Operations are charged with the cost of claims reported and an estimate of claims incurred but not reported based on prior experience. The determination of such claims and expenses and the appropriateness of the related liability are continually reviewed and updated. Claims payable and claims incurred but not reported totaled \$130,000 and \$156,000 at December 31, 2013 and 2012, respectively. The amounts are recorded in accounts payable and accrued liabilities in the accompanying consolidated balance sheets.

### **10. Common Stock Reserved for Issuance**

As of December 31, 2013, 155,000 shares of common stock were reserved for issuance upon exercise of ten-year incentive stock options with exercise prices from \$1.10 to \$7.80, which expire through 2019.

In March 2013, the Company implemented a share option plan, adopted in fiscal year 2012, in which 3,624,194 shares of common stock were reserved for issuance upon exercise of ten-year incentive stock options with exercise prices of \$0.02. Under this plan, the Company recognized approximately \$7,000 in compensation expense for the current year.

At December 31, 2013, 8,494,221 shares of common stock are issuable upon conversion of \$2,450,000 aggregate principal amount plus interest of 10% convertible subordinated promissory notes of the Company.

At December 31, 2013, 2,773,081 shares of common stock were reserved for issuance pursuant to the preferred stock conversion option described in note 11.

### **11. Preferred Stock**

The Company is authorized to issue 1,000,000 shares of preferred stock with such designations, voting, and other rights and preferences, as may be determined from time-to-time by the Board.

#### ***Series A Preferred Stock***

During 2013, the Company redeemed all 7,423 outstanding shares of Series A Convertible Preferred Stock for \$7.4 million, including \$1.5 million in accrued dividends.

## Argyle Security, Inc., dba ISI Security

### Notes to the Consolidated Financial Statements

#### 11. Preferred Stock (continued)

##### *Series B Preferred Stock*

Each share of Series B Convertible Preferred Stock ("Series B Preferred Stock") is convertible into 100 shares of common stock, at any time, at the option of the holder, initially at a conversion price of \$1.10 per share of common stock, subject to adjustment for stock dividends, stock splits or similar capital reorganizations, and weighted average price anti-dilution protection for certain issuances below the conversion price. The shares of Series B Preferred Stock accrue dividends at 4% per annum and have voting rights equal to the number of shares of common stock the holder would receive if all shares of Series B Preferred Stock had been converted into common stock. The holders of the Series B Preferred Stock may also designate one individual to serve on the Company's Board.

During 2013, the Company redeemed 10,936 outstanding shares of Series B Preferred Stock for \$1.8 million, including \$0.6 million in accrued dividends.

#### 12. Income Taxes

Income tax benefit (expense) on income consists of and represents the tax effect of the following:

	Years Ended December 31,	
	2013	2012
Current – state	\$ (850)	\$ (172)
Deferred – federal	<u>5,869</u>	<u>-</u>
	<u>\$ 5,019</u>	<u>\$ (172)</u>

# Argyle Security, Inc., dba ISI Security

## Notes to the Consolidated Financial Statements

### 12. Income Taxes (continued)

Income tax benefit (expense) differs from the amount which would be provided by applying the statutory federal income tax rates because of the following:

	Years Ended December 31,	
	2013	2012
Computed at the expected statutory rate of 34%	\$ (1,707)	\$ 330
Increase resulting from:		
Permanent differences	(7)	(24)
State income tax – net of federal tax benefit	(561)	(108)
Changes in valuation allowance	7,694	(646)
Other	(400)	276
	<u>\$ 5,019</u>	<u>\$ (172)</u>

The tax effects of temporary differences that give rise to the significant portions of the deferred tax assets and deferred tax liabilities are presented below:

	December 31,	
	2013	2012
Deferred tax assets:		
Net operating loss	\$ 4,507	\$ 6,214
Allowance for doubtful accounts	150	192
Intangibles	519	395
Capital leases	212	206
Accrued interest	409	381
Other	248	473
Total deferred tax assets	<u>6,045</u>	<u>7,861</u>
Deferred tax liabilities:		
Property and equipment	136	127
Contract receivables	22	20
Deferred rent	7	9
Other	11	11
Total deferred tax liabilities	<u>176</u>	<u>167</u>
Net deferred tax assets	5,869	7,694
Less valuation allowance	<u>-</u>	<u>(7,694)</u>
Net deferred tax asset	<u>\$ 5,869</u>	<u>\$ -</u>

## Argyle Security, Inc., dba ISI Security

### Notes to the Consolidated Financial Statements

#### 12. Income Taxes (continued)

Deferred taxes are presented in the accompanying consolidated balance sheets as follows:

	December 31,	
	2012	2011
Current deferred tax asset	\$ 980	\$ -
Noncurrent deferred tax asset	<u>4,889</u>	<u>-</u>
Net deferred tax asset	<u>\$ 5,869</u>	<u>\$ -</u>

At December 31 2012, the Company had a valuation allowance of approximately \$7.7 million against its deferred tax assets in excess of reversing taxable temporary differences (deferred tax liabilities). At December 31, 2013, management determined that no valuation allowance was required based on estimated future taxable income. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income (including reversals of deferred tax liabilities) during the periods in which those temporary differences will become deductible. At December 31, 2013, the Company had net operating loss carryovers of approximately \$13.3 million that begin to expire July 31, 2027.

Argyle and ISI file a consolidated United States federal income tax return. The Internal Revenue Service is currently examining the 2011 tax return for one of the Company's subsidiaries. While the examination is not complete, management does not anticipate significant additional taxes will be assessed. With few exceptions, the Company is no longer subject to federal, state, and local income tax examinations by authorities for years before 2009.

#### 13. Commitments and Contingent Liabilities

The Company is involved in claims and litigation in the normal course of business. Management believes the applicable insurance coverage is adequate to cover costs of settlement and defense of such claims and litigation.

The Company, as a condition for entering into some of its construction contracts, had outstanding surety bonds as of December 31, 2013 and 2012.

## **Argyle Security, Inc., dba ISI Security**

### **Notes to the Consolidated Financial Statements**

#### **14. Customers and Credit Risk**

For the year ended December 31, 2013, approximately 11% of the Company's construction revenue was related to one customer. The contracts and retainage receivable balance from this customer was 13% of the total contracts and retainage receivable balance at December 31, 2013. For the year ended December 31, 2012, construction revenue and retainage receivable from one customer was approximately 22% and 16%, respectively, of the total construction revenue and retainage receivable balances at December 31, 2012.

The Company maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. Accounts are guaranteed by the Federal Deposit Insurance Corporation up to a maximum of \$250,000. The Company has not experienced any losses in such accounts.

#### **15. Discontinued Operations**

On March 31, 2011, the Company discontinued operations of MCFSa, Ltd. – Denver due to a lack of market share in the area and to consolidate Company resources to better take advantage of market opportunities in other regions. MCFSa, Ltd. – Denver was substantially liquidated as of December 31, 2012.

Supplementary Data

## Independent Auditor's Report on Supplementary Data

To the Board of Directors  
Argyle Security, Inc., dba ISI Security  
San Antonio, Texas

We have audited the consolidated financial statements of Argyle Security, Inc. dba ISI Security as of and for the years ended December 31, 2013 and 2012, and have issued our report thereon dated February 11, 2014, which contained an unmodified opinion on those consolidated financial statements.

Our audits were performed for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating data, as listed in the table of contents, is presented for purposes of additional analysis rather than to present the financial position, results of operations, and cash flows of the individual companies and is not a required part of the consolidated financial statements. Such data is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating data has been subjected to the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such data directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the data is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

*Padgett, Stratemann + Co., L.L.P.*

Certified Public Accountants  
San Antonio, Texas  
February 11, 2014

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# Argyle Security, Inc., dba ISI Security

## Consolidating Balance Sheet

December 31, 2013

(Dollars in Thousands, Except Share Data)

### Assets

<b>Current Assets</b>	<u>ASI</u>	<u>ISI</u>	<u>Eliminations</u>	<u>Total</u>
Cash and cash equivalents	\$ 2	\$ 583	\$ -	\$ 585
Receivables:				
Contract – net of allowance for doubtful accounts of \$392	-	15,042	-	15,042
Costs and estimated earnings in excess of billings on incomplete contracts	-	3,026	-	3,026
Inventory	-	777	-	777
Prepays and other current assets	2	537	-	539
Deferred taxes	398	582	-	980
Refundable income taxes	6	-	-	6
	<u>408</u>	<u>20,547</u>	<u>-</u>	<u>20,955</u>
Total current assets				
	<u>408</u>	<u>20,547</u>	<u>-</u>	<u>20,955</u>
 <b>Other Assets</b>				
Investment in subsidiary	5,224	-	(5,224)	-
Property and equipment – net	12	3,539	-	3,551
Intangible assets – net	-	4,598	-	4,598
Deferred taxes	4,506	383	-	4,889
Deposits and other assets	-	237	-	237
	<u>9,742</u>	<u>8,757</u>	<u>(5,224)</u>	<u>13,275</u>
Total other assets				
	<u>9,742</u>	<u>8,757</u>	<u>(5,224)</u>	<u>13,275</u>
Total assets	\$ <u>10,150</u>	\$ <u>29,304</u>	\$ <u>(5,224)</u>	\$ <u>34,230</u>

See independent auditor's report on supplementary data.

## Liabilities and Stockholders' Equity

<b>Current Liabilities</b>	<u>ASI</u>	<u>ISI</u>	<u>Eliminations</u>	<u>Total</u>
Accounts payable and accrued liabilities	\$ 6	\$ 7,952	\$ -	\$ <b>7,958</b>
Billings in excess of costs and estimated earnings on incomplete contracts	-	5,663	-	<b>5,663</b>
Dividends payable	8	-	-	<b>8</b>
Current portion of capitalized lease obligations	-	564	-	<b>564</b>
Income tax payable	-	146	-	<b>146</b>
	<u>14</u>	<u>14,325</u>	<u>-</u>	<u><b>14,339</b></u>
<b>Long-Term Liabilities</b>				
Long-term debt	2,450	2,000	-	<b>4,450</b>
Interest payable	1,204	-	-	<b>1,204</b>
Long-term capitalized lease obligations – less current portion	-	2,225	-	<b>2,225</b>
	<u>3,654</u>	<u>4,225</u>	<u>-</u>	<u><b>7,879</b></u>
Total long-term liabilities				
	<u>3,668</u>	<u>18,550</u>	<u>-</u>	<u><b>22,218</b></u>
<b>Stockholders' Equity</b>				
Preferred stock – Argyle Security, Inc. – \$0.0001 par value; 1,000,000 shares authorized; 16,337 Series B shares issued and outstanding	1,610	-	-	<b>1,610</b>
Common stock – Argyle Security, Inc. – \$0.0001 par value; 89,000,000 shares authorized; 29,381,819 shares issued and 28,436,271 shares outstanding	3	-	-	<b>3</b>
Treasury stock, par value; 945,548 common shares	-	-	-	-
Additional paid-in capital	58,260	32,534	(32,534)	<b>58,260</b>
Accumulated earnings (deficit)	(53,391)	(21,780)	27,310	<b>(47,861)</b>
	<u>6,482</u>	<u>10,754</u>	<u>(5,224)</u>	<u><b>12,012</b></u>
Total stockholders' equity				
	<u>\$ 10,150</u>	<u>\$ 29,304</u>	<u>\$ (5,224)</u>	<u><b>\$ 34,230</b></u>

# Argyle Security, Inc., dba ISI Security

## Consolidating Statement of Income

Year Ended December 31, 2013

(Dollars in Thousands, Except Share Data)

	ASI	ISI	Eliminations	Total
Revenues:				
Contract revenues	\$ -	\$ 51,652	\$ -	\$ 51,652
Service, manufacturing, and other revenues	-	18,791	-	18,791
Total revenues	-	70,443	-	70,443
Cost of revenues:				
Contract costs	-	42,627	-	42,627
Service, manufacturing, and other costs, including \$43 of depreciation	-	12,871	-	12,871
Total cost of revenues	-	55,498	-	55,498
Gross profit	-	14,945	-	14,945
Operating expenses:				
Salaries and related expense	-	7,865	-	7,865
Professional fees and outside services	-	906	-	906
General and administrative expenses	-	4,431	-	4,431
Depreciation	8	957	-	965
Amortization of intangible assets	-	956	-	956
Total operating expenses	8	15,115	-	15,123
Operating loss	(8)	(170)	-	(178)
Other income (expense):				
Other	-	71	-	71
Interest expense	(393)	(562)	-	(955)
Earnings in affiliate	-	6,082	-	6,082
Total other income (expense)	(393)	5,591	-	5,198
Income (loss) before provision for income taxes	(401)	5,421	-	5,020
Income tax benefit	4,910	109	-	5,019
Net income	4,509	5,530	-	10,039
Dividends on redeemable preferred stock	(291)	-	-	(291)
Net income allocable to holders of nonredeemable common stock	\$ 4,218	\$ 5,530	\$ -	\$ 9,748

See independent auditor's report on supplementary data.

# Argyle Security, Inc., dba ISI Security

## Consolidating Statement of Changes in Stockholders' Equity

Year Ended December 31, 2013

(Dollars in Thousands)

	<u>ASI</u>	<u>ISI</u>	<u>Eliminations</u>	<u>Total</u>
Balance at beginning of year	\$ 9,402	\$ 13,263	\$ (13,263)	\$ 9,402
Net income	4,509	5,530	-	10,039
Dividends	-	(8,039)	8,039	-
Purchase of treasury stock	(4)	-	-	(4)
Redemption of preferred stock	(7,141)	-	-	(7,141)
Stock options granted	7	-	-	7
Dividends on preferred stock	<u>(291)</u>	<u>-</u>	<u>-</u>	<u>(291)</u>
Balance at December 31, 2013	<u><u>\$ 6,482</u></u>	<u><u>\$ 10,754</u></u>	<u><u>\$ (5,224)</u></u>	<u><u>\$ 12,012</u></u>

*See independent auditor's report on supplementary data.*

# Argyle Security, Inc., dba ISI Security

## Consolidating Statement of Cash Flows

Year Ended December 31, 2013

(Dollars in Thousands)

	<u>ASI</u>	<u>ISI</u>	<u>Eliminations</u>	<u>Total</u>
<b>Cash Flows From Operating Activities</b>				
Net income	\$ 4,509	\$ 5,530	\$ -	\$ 10,039
Adjustments to reconcile net income to net cash provided by (used in) operating activities:				
Earnings in affiliate	-	(6,082)	-	(6,082)
Amortization of intangible assets	-	956	-	956
Bad debt expense	-	245	-	245
Depreciation	8	1,000	-	1,008
Stock-based compensation	7	-	-	7
Gain on sale of property and equipment – net	-	(46)	-	(46)
Deferred tax benefit	(4,904)	(965)	-	(5,869)
Changes in operating assets and liabilities:				
Contract receivables	-	1,663	-	1,663
Costs and estimated earnings in excess of billings on incomplete contracts	-	(758)	-	(758)
Inventory and prepaids and other assets	19	56	-	75
Accounts payable and accrued liabilities	77	(1,346)	-	(1,269)
Billings in excess of costs and estimated earnings on incomplete contracts	-	885	-	885
Income taxes refundable/payable	(6)	85	-	79
Net cash provided by (used in) operating activities	<u>(290)</u>	<u>1,223</u>	<u>-</u>	<u>933</u>
<b>Cash Flows From Investing Activities</b>				
Investment in affiliate	8,039	7,856	(8,039)	7,856
Purchase of property and equipment	<u>-</u>	<u>(222)</u>	<u>-</u>	<u>(222)</u>
Net cash provided by investing activities	<u>8,039</u>	<u>7,634</u>	<u>(8,039)</u>	<u>7,634</u>

See independent auditor's report on supplementary data.

# Argyle Security, Inc., dba ISI Security

## Consolidating Statement of Cash Flows

Year Ended December 31, 2013

(Dollars in Thousands)

(Continued)

	<u>ASI</u>	<u>ISI</u>	<u>Eliminations</u>	<u>Total</u>
<b>Cash Flows From Financing Activities:</b>				
Restricted cash	\$ 3,000	\$ -	\$ -	\$ 3,000
Dividends	-	(8,039)	8,039	-
Principal payments on long-term debt	(1,500)	(18,512)	-	(20,012)
Proceeds from long-term debt	-	17,500	-	17,500
Redemption of preferred stock and accrued dividends	(9,249)	-	-	(9,249)
Purchase of treasury stock	(4)	-	-	(4)
Payments on capital lease obligations	-	(588)	-	(588)
Net cash used in financing activities	<u>(7,753)</u>	<u>(9,639)</u>	<u>8,039</u>	<u>(9,353)</u>
Net decrease in cash and cash equivalents	(4)	(782)	-	(786)
Cash and cash equivalents at beginning of year	<u>6</u>	<u>1,365</u>	<u>-</u>	<u>1,371</u>
Cash and cash equivalents at end of year	<u>\$ 2</u>	<u>\$ 583</u>	<u>\$ -</u>	<u>\$ 585</u>
<b>Supplemental Disclosures of Cash Flow Information</b>				
Cash paid for interest	<u>\$ -</u>	<u>\$ 562</u>	<u>\$ -</u>	<u>\$ 562</u>
Cash paid for income taxes	<u>\$ -</u>	<u>\$ 721</u>	<u>\$ -</u>	<u>\$ 721</u>
<b>Supplemental Disclosures of Noncash Flow Information</b>				
Dividends accrued	<u>\$ 8</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 8</u>
Vehicles financed with capital lease	<u>\$ -</u>	<u>\$ 273</u>	<u>\$ -</u>	<u>\$ 273</u>