



Annual Report for the Fiscal Year Ended December 31, 2014

This Annual Report is being provided to provide updated information about Argyle Security, Inc.. 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 has been prepared with information as of December 31, 2014 and, unless otherwise indicated, it may not reflect events occurring subsequent to such date. 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. (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.argylesecurity.com

Investor requests should be directed to Buddy Johns, 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. (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.

On July 14, 2014, the Board was increased from five (5) to six (6) directors, with MML-affiliated directors, continuing to fill three (3) 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 and fire detection solutions in the United States. The Company is a full-service provider of integrated solutions and it 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, commercial buildings and complexes, schools and universities, hospitals, petrochemical 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.

Security Hardware, Security Electronics and Fire Detection Solutions

Over the past 30 years, the Company has furnished and installed detention equipment in more than 2,000 correctional facilities. It 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 the Company 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.

The Company 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. It acts as prime contractor or as a subcontractor for projects spanning all levels of security.

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.

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

The Company also 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.

Argyle Precision Steel Fabrication

Through its Argyle Precision division, it manufactures 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, Argyle Precision also utilizes its patented "Steel Block". It also fabricates components for the automotive industry.

Com-Tec, an Argyle Security Company

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.

Other Information

Other than Argyle Precision, 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, 2014, we had 268 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, 2014 are as follows. All of our properties are leased.

Location

- 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
- 405 Main Street, Suite 9, Port Washington, New York 11050
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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
- Series C 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

Series C 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.

Series C Convertible Preferred Stock (“Series C Preferred Stock”)

Each share of Series C 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 \$0.4302 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 C Preferred Stock have voting rights equal to the number of shares of Common Stock the holder would receive if all shares of Series C Preferred Stock had been converted into Common Stock. The holders of the Series C Preferred Stock may also designate one individual to serve on the Company’s Board of Directors.

The holders of the Series C 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) 16% per annum or (ii) the dividend payable on the equivalent amount of Common Stock into which the Series C 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 C Preferred Stock, but only with respect to those shares of Series C Preferred Stock so converted.

Unless prohibited by Delaware law governing distributions to stockholders, shares of Series C Preferred Shares shall be redeemed by the Company at a price per share equal to the greater of \$0.4302 per share, plus all declared but unpaid dividends thereon as of the Redemption Date and (B) the product of (1) the Market Price of a Share of Common Stock as of the date of the Company’s receipt of the Redemption Request multiplied by (2) the Series C Conversion Ratio as of the Redemption Date (the “Redemption Price”), which redemption shall occur not more than sixty (60) days after receipt by the Corporation, at any time on or after April 30, 2018 from not less than the majority of the holders of Series C Preferred Shares, of written notice requesting redemption of all outstanding shares of Series C Preferred Stock (the “Redemption Request”).

The shares of Series C Preferred Stock have a liquidation preference as to the Company’s Series A Preferred Stock, Series B 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 C Preferred Stock had been converted into Common Stock.

For as long as any shares of Series C 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 C Preferred Stock, (iii) creating, issuing or authorizing the issuance of any equity securities senior to the Series C Preferred Stock, or (iv) repurchasing, redeeming or reissuing any equity securities of the Company to which the Series C 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.

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.

Name of Security	Period end date	Number of shares authorized	Number of shares outstanding	Freely tradable shares (public float)	Total number of beneficial shareholders	Total number of shareholders of record
Common Stock	December 31, 2014	89,000,000	28,436,271(1)	1,712,151	91 (2)	46 (3)
Series A Convertible Preferred Stock	December 31, 2014	18,750	0	0	0	0
Series B Convertible Preferred Stock	December 31, 2014	27,273	16,337	0	2	2
Series C Convertible Preferred Stock	December 31, 2014	-	-	-	-	-

- (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, 2014, 9,374,955 shares of Common Stock are reserved for issuance upon conversion of \$8,400,000 aggregate principal amount plus interest of 14% convertible subordinated promissory notes of the Company convertible at a conversion price of \$0.4302 (the “Convertible Notes”).

Additionally, as of December 31, 2014, 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) 4,218,185 shares of common stock were reserved for issuance upon the exercise of options pursuant to the 2013 Stock Option Plan (as amended) and (c) 2,831,612 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 15th 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:

Issuer	Owner	State of Incorporation or Formation	Issued and Outstanding interests	Percentage of issued and outstanding interests	Percentage of voting interests
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%

Issuer	Owner	State of Incorporation or Formation	Issued and Outstanding interests	Percentage of issued and outstanding interests	Percentage of voting interests
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
Buddy Johns	President, Chief Executive Officer, Chief Operating Officer and Director	2014	2017
Richard Watts	Chief Financial Officer	2010	N/A
Robert Davies	Chairman of the Board of Directors	2009	2015
Jason Morgan	Director	2014	2016
James Read	Director	2009	2015
Simon Whitmey	Director	2011	2017

Business Experience About Directors Not Previously Disclosed

Buddy Johns has served as President and Chief Executive Officer of the Company since July 2014. Prior to joining the Company, he served as Chief Executive Officer of CGL Capital Management Group where he worked for four years. Prior to CGL, Mr. Johns was a Managing Director of Real Estate for Corrections Corporation of America. He has more than 20 years of experience in the construction and development industries. He has developed, built and managed more than 5 million square feet of industrial properties including Class A flex, heavy industrial and correctional properties. He has six years of public accounting experience with Deloitte & Touche and is a Certified Public Accountant.

Jason Morgan has served as a Director at MML Capital Partners since 2012. He served as a Director at CIT from 2008 to 2012 and previously as Vice President at FirstLight Financial Corporation from 2007 to 2008 and GE Capital from 1997 to 2007. He has originated and executed a wide range of transactions, including middle market leveraged buyouts and corporate financings in the U.S. and Europe. As an institutional investor Mr. Morgan has led junior and senior financings for private equity transactions across numerous sectors. He graduated magna cum laude with a BBA in Finance, Commonwealth Scholar, from the University of Massachusetts at Amherst.

Beneficial Owners

The following table sets forth, as of December 31, 2014, 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, 2014. In addition, Argyle had 4,303,185 options outstanding as of December 31, 2014, of which 738,102 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	(1) 81.2 %
William Blair Mezzanine Capital Fund III, L.P. (2) c/o Merit Capital Partners Attention: David Jones 303 West Madison Street, Suite 2100 Chicago, IL 60606	2,886,997	9.3 %
Other directors and executive officers as a group (8 individuals)	0	(3) * %

* 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 2,831,612 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. In addition, they do not include any shares of Common Stock underlying shares of Series C Preferred Stock issued upon the exchange of the Convertible Notes subsequent to December 31, 2014.
- (2) Mr. David Jones 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.

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 2014 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, 2014 are attached to this Annual Report.

The audited consolidated financial statements of Argyle, as of December 31, 2014, 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.

Consolidated Financial Statements and Supplementary Information

December 31, 2014 and 2013

Argyle Security, Inc.

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Padgett Stratemann

Independent Auditor's Report

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

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Argyle Security, Inc., which comprise the consolidated balance sheets as of December 31, 2014 and 2013, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended and the related notes to the financial statements.

Management's Responsibility for the 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 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 audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design 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. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit 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. as of December 31, 2014 and 2013, and the results of its operations and its cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

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

San Antonio, Texas
July 17, 2015

Argyle Security, Inc.

Consolidated Balance Sheets

December 31, 2014 and 2013

(Dollars in Thousands, Except Share Data)

	<u>2014</u>	<u>2013</u>
Current Assets		
Cash and cash equivalents	\$ 155	\$ 585
Contract receivables – net of allowance for doubtful accounts of \$372 (\$392 in 2013)	13,484	15,042
Costs and estimated earnings in excess of billings on incomplete contracts	2,467	3,026
Inventory	894	777
Prepays and other current assets	579	539
Deferred taxes	-	980
Refundable income taxes	63	6
Total current assets	<u>17,642</u>	<u>20,955</u>
Other Assets		
Property and equipment – net	3,128	3,551
Intangible assets – net	-	4,598
Deferred taxes	-	4,889
Deposits and other assets	236	237
Total other assets	<u>3,364</u>	<u>13,275</u>
Total assets	<u>\$ 21,006</u>	<u>\$ 34,230</u>
Current Liabilities		
Accounts payable and accrued liabilities	\$ 7,241	\$ 7,958
Billings in excess of costs and estimated earnings on incomplete contracts	3,091	5,663
Dividends payable	80	8
Current portion of capitalized lease obligations	612	564
Income tax payable	-	146
Current maturities of long-term debt	12,138	-
Total current liabilities	<u>23,162</u>	<u>14,339</u>
Long-Term Liabilities		
Long-term debt	-	4,450
Interest payable	286	1,204
Long-term capitalized lease obligations – less current portion	1,801	2,225
Total long-term liabilities	<u>2,087</u>	<u>7,879</u>
Total liabilities	<u>25,249</u>	<u>22,218</u>
Stockholders' Equity (Deficit)		
Preferred stock – Argyle Security, Inc. – \$0.0001 par value; 1,000,000 shares authorized; 16,337 Series B shares issued and outstanding at December 31, 2014 and 2013	1,610	1,610
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, 2014 and 2013	3	3
Treasury stock, par value; 945,548 common shares at December 31, 2014 and 2013	-	-
Additional paid-in capital	58,267	58,260
Accumulated deficit	(64,123)	(47,861)
Total stockholders' equity (deficit)	<u>(4,243)</u>	<u>12,012</u>
Total liabilities and stockholders' equity (deficit)	<u>\$ 21,006</u>	<u>\$ 34,230</u>

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

Argyle Security, Inc.

Consolidated Statements of Operations

Years Ended December 31, 2014 and 2013

(Dollars in Thousands)

	<u>2014</u>	<u>2013</u>
Revenues:		
Contract revenues	\$ 39,470	\$ 51,652
Service, manufacturing, and other revenues	<u>16,337</u>	<u>18,791</u>
Total revenues	<u>55,807</u>	<u>70,443</u>
Cost of revenues:		
Contract costs	35,056	42,627
Service, manufacturing, and other costs, including \$27 of depreciation (\$43 in 2013)	<u>12,055</u>	<u>12,871</u>
Total cost of revenues	<u>47,111</u>	<u>55,498</u>
Gross profit	<u>8,696</u>	<u>14,945</u>
Operating expenses:		
Salaries and related expense	6,540	7,865
Professional fees and outside services	881	906
General and administrative expenses	4,931	4,431
Depreciation	881	965
Amortization of intangible assets	956	956
Impairment of intangible assets	<u>3,642</u>	<u>-</u>
Total operating expenses	<u>17,831</u>	<u>15,123</u>
Operating loss	<u>(9,135)</u>	<u>(178)</u>
Other income (expense):		
Other – net	41	71
Interest expense	(1,155)	(955)
Earnings in affiliate	<u>-</u>	<u>6,082</u>
Total other income (expense)	<u>(1,114)</u>	<u>5,198</u>
Income (loss) before provision for income taxes	<u>(10,249)</u>	<u>5,020</u>
Income tax (benefit) expense	<u>5,941</u>	<u>(5,019)</u>
Net income (loss)	<u>(16,190)</u>	<u>10,039</u>
Dividends on redeemable preferred stock	<u>(72)</u>	<u>(291)</u>
Income (loss) allocable to holders of nonredeemable common stock	<u>\$ (16,262)</u>	<u>\$ 9,748</u>

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

Argyle Security, Inc.

Consolidated Statements of Changes in Stockholders' Equity (Deficit)

Years Ended December 31, 2014 and 2013

(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, 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	16,337	1,610	28,436,271	3	945,548	-	58,260	(47,861)	12,012
Net loss – year ended December 31, 2014	-	-	-	-	-	-	-	(16,190)	(16,190)
Stock options granted	-	-	-	-	-	-	7	-	7
Dividends on preferred stock	-	-	-	-	-	-	-	(72)	(72)
Balance at December 31, 2014	<u>16,337</u>	<u>\$ 1,610</u>	<u>28,436,271</u>	<u>\$ 3</u>	<u>945,548</u>	<u>\$ -</u>	<u>\$ 58,267</u>	<u>\$ (64,123)</u>	<u>\$ (4,243)</u>

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

Argyle Security, Inc.

Consolidated Statements of Cash Flows

Years Ended December 31, 2014 and 2013
(Dollars in Thousands)

	<u>2014</u>	<u>2013</u>
Cash Flows From Operating Activities		
Net income (loss)	\$ (16,190)	\$ 10,039
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Earnings in affiliate	-	(6,082)
Amortization of intangible assets	956	956
Bad debt expense	94	245
Depreciation	908	1,008
Impairment of intangible assets	3,642	-
Stock-based compensation	7	7
Gain on sale of property and equipment – net	(40)	(46)
Deferred tax (benefit) expense	5,869	(5,869)
Changes in operating assets and liabilities:		
Contract receivables	1,464	1,663
Costs and estimated earnings in excess of billings on incomplete contracts	559	(758)
Inventory, prepaids and other assets	(146)	75
Accounts payable and accrued liabilities	(157)	(1,269)
Billings in excess of costs and estimated earnings on incomplete contracts	(2,572)	885
Income taxes refundable/payable	(203)	79
Net cash provided by (used in) operating activities	<u>(5,809)</u>	<u>933</u>
Cash Flows From Investing Activities		
Investment in affiliate	-	7,856
Purchase of property and equipment	<u>(220)</u>	<u>(222)</u>
Net cash provided by (used in) investing activities	<u>(220)</u>	<u>7,634</u>
Cash Flows From Financing Activities		
Restricted cash	-	3,000
Principal payments on long-term debt	(8,250)	(20,012)
Proceeds from long-term debt	14,450	17,500
Redemption of preferred stock and accrued dividends	-	(9,249)
Purchase of treasury stock	-	(4)
Payments on capital lease obligations	<u>(601)</u>	<u>(588)</u>
Net cash provided by (used in) financing activities	<u>5,599</u>	<u>(9,353)</u>
Net decrease in cash and cash equivalents	<u>(430)</u>	<u>(786)</u>
Cash and cash equivalents at beginning of year	<u>585</u>	<u>1,371</u>
Cash and cash equivalents at end of year	<u>\$ 155</u>	<u>\$ 585</u>
Supplemental Disclosures of Cash Flow Information		
Cash paid for interest	<u>\$ 585</u>	<u>\$ 562</u>
Cash paid for income taxes	<u>\$ 335</u>	<u>\$ 721</u>
Supplemental Disclosures of Noncash Flow Information		
Dividends accrued	<u>\$ 72</u>	<u>\$ 8</u>
Vehicles financed with capital lease	<u>\$ 225</u>	<u>\$ 273</u>
Accrued interest added to debt	<u>\$ 1,488</u>	<u>\$ -</u>

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

Argyle Security, Inc.

Notes to the Consolidated Financial Statements

1. Summary of Significant Accounting Policies

Reporting Entity and Nature of Operations

Argyle Security, Inc. (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

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. The effect of significant changes in the estimated fair value of intangible assets at December 31, 2013 was to decrease income in 2014 by approximately \$3.6 million. The effect of significant changes in the estimated realization of the deferred tax assets at December 31, 2013 was to decrease income in 2014 by approximately \$5.9 million.

Recent Accounting Pronouncements

Revenue – In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update No. 2014-09, *Revenue From Contracts With Customers*, requiring an entity to recognize the amount of revenue which it expects to be entitled for the transfer of promised goods or services to customers. The updated standard will replace most existing revenue recognition guidance in accounting principles generally accepted in the United States of America when it becomes effective and permits the use of either a full retrospective or retrospective with cumulative effect transition method. The updated standard will be effective for annual reporting periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018. The Company has not yet selected a transition method and is currently evaluating the effect the updated standard will have on the consolidated financial statements. Effective April 1, 2015, FASB voted for a one-year deferral of the effective date of the new revenue recognition standard.

Argyle Security, Inc.

Notes to the Consolidated Financial Statements

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.

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. During 2013, the joint venture recognized revenue and construction costs of \$11.7 million and \$5.6 million respectively.

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.

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.

Argyle Security, Inc.

Notes to the Consolidated Financial Statements

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 11 years; vehicles – 3 to 7 years and website development costs – 3 years. Amortization of 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.

Impairment of Long-Lived Assets

The Company reviews the carrying value of long-lived assets, including intangibles, 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. Accordingly, impairment losses resulting from the write-down of intangible assets totaled approximately \$3.6 million for the year ended December 31, 2014 (\$0 in 2013).

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.

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.

Argyle Security, Inc.

Notes to the Consolidated Financial Statements

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, 2014 and 2013.

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.

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.

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 when the product is shipped to the customer in accordance with the contractual shipping terms. In almost all cases, the shipping of products to the Company's customers is FOB origin, whereby title passes to the purchaser when the product leaves the Company's 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 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.

The Company is subject to various state income taxes.

Argyle Security, Inc.

Notes to the Consolidated Financial Statements

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.

Subsequent Events

The Company has evaluated subsequent events through July 17, 2015, the date the consolidated financial statements were available to be issued.

2. Contract Receivables

Contract receivables consist of the following (in thousands):

	December 31,	
	2014	2013
Completed contracts and contracts in progress	\$ 12,293	\$ 13,114
Retainage	<u>1,563</u>	<u>2,320</u>
	13,856	15,434
Less allowance for doubtful accounts	<u>372</u>	<u>392</u>
Total contract receivable	<u>\$ 13,484</u>	<u>\$ 15,042</u>

Argyle Security, Inc.

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,	
	2014	2013
Costs incurred to date	\$ 118,370	\$ 119,114
Estimated earnings	<u>20,577</u>	<u>20,716</u>
Revenue recognized to date	138,947	139,830
Less billings to date	<u>139,571</u>	<u>142,467</u>
	\$ <u>(624)</u>	\$ <u>(2,637)</u>
Costs and estimated earnings in excess of billings on incomplete contracts	\$ 2,467	\$ 3,026
Billings in excess of costs and estimated earnings on incomplete contracts	<u>(3,091)</u>	<u>(5,663)</u>
	\$ <u>(624)</u>	\$ <u>(2,637)</u>

4. Inventory

Inventory consists of the following (in thousands):

	December 31,	
	2014	2013
Raw materials	\$ 103	\$ 122
Work in process	78	48
Finished goods	<u>713</u>	<u>607</u>
	\$ <u>894</u>	\$ <u>777</u>

Argyle Security, Inc.

Notes to the Consolidated Financial Statements

5. Property and Equipment

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

	December 31,	
	2014	2013
Buildings	\$ 3,622	\$ 3,622
Leasehold improvements	1,524	1,441
Furniture, fixtures, and equipment	4,798	4,785
Vehicles	1,661	1,429
Website	46	46
	<u>11,651</u>	<u>11,323</u>
Less accumulated depreciation and amortization	<u>8,523</u>	<u>7,772</u>
	<u>\$ 3,128</u>	<u>\$ 3,551</u>

Depreciation expense related to property and equipment totaled approximately \$0.9 million and \$1.0 million for the years ended December 31, 2014 and 2013, respectively, and includes amortization of assets held under capital leases.

6. Intangible Assets

At December 31, 2014, intangible assets consisted of the following (in thousands):

	Gross Carrying Amount	Impairment	Accumulated Amortization	Net Carrying Amount
Amortizable:				
Customer relationships	\$ 10,687	\$ 2,403	\$ 8,284	\$ -
Unamortizable:				
Trade name	\$ <u>1,239</u>	\$ <u>1,239</u>	\$ -	\$ -
Total	\$ <u>11,926</u>	\$ <u>3,642</u>	\$ <u>8,284</u>	\$ -

Argyle Security, Inc.

Notes to the Consolidated Financial Statements

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

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

7. Long-Term Debt

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

	December 31,	
	<u>2014</u>	<u>2013</u>
Notes payable:		
Unsecured convertible debt – stockholders (A)	\$ 8,438	\$ 2,450
Line of credit and senior secured credit facility (B)	<u>3,700</u>	<u>2,000</u>
	12,138	4,450
Less current maturities	<u>12,138</u>	<u>-</u>
	<u><u>\$ -</u></u>	<u><u>\$ 4,450</u></u>

- (A) 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.

In October 2014, the Company issued, in exchange for cash and the replacement of the Convertible Notes and accrued interest, convertible subordinated promissory notes in the aggregate principal amount of \$8.4 million (the “Amended Convertible Notes”). The Amended Convertible Notes bear at 14% per annum. On each interest payment date, accrued and unpaid interest is added to the outstanding principal balance of the Amended Convertible Notes and also bears interest at 14% per annum. The principal and any unpaid interest on the Amended Convertible Notes mature on April 30, 2018. Each dollar of outstanding principal and accrued interest is convertible into shares of common stock, at the option of the holders of the Amended

Argyle Security, Inc.

Notes to the Consolidated Financial Statements

Convertible Notes, at a price of \$0.4302 per share. The outstanding principal and accrued and unpaid interest of the Amended Convertible Notes was convertible in to 20,278,869 shares of common stock, at the option of the note holder, at December 31, 2014 (8,494,221 shares at December 31, 2013). There are financial covenants related to the Amended Convertible Notes.

- (B) The Company has 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 the Company. 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 2.5%, or (ii) the London Interbank Offer Rate plus 4.5%. The weighted average interest rate for the Revolver was 5.5% at December 31, 2014 (6.9% at December 31, 2013). There are both financial and restrictive covenants related to the agreement, including a restriction on the payment of dividends by the Company.

As of December 31, 2014, the line of credit facility had an outstanding balance of \$3.7 million, and it matures on April 29, 2017.

As of December 31, 2014, the Company has a \$1.3 million outstanding letter of credit that expires in 2015 (two outstanding letters totaling \$1.8 million at December 31, 2013). This balance reduced the borrowing capacity on the Company’s line of credit facility.

Subsequent to December 31, 2014, the Company was not in compliance with certain covenants. Accordingly, the entire debt balance was classified as current on the consolidated balance sheet at December 31, 2014.

8. Leases

The Company 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. The Company entered into a second lease on another property owned by Green Wing in 2006. The Company 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 \$274,000 to Green Wing for the year ended December 31, 2014 (\$469,000 for the year ended December 31, 2013).

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. During 2014, the Company entered into new capital leases for vehicles totaling approximately \$225,000.

Argyle Security, Inc.

Notes to the Consolidated Financial Statements

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,	
	2014	2013
Buildings	\$ 3,622	\$ 3,622
Vehicles	<u>1,407</u>	<u>1,230</u>
	5,029	4,852
Less accumulated amortization	<u>2,928</u>	<u>2,505</u>
	<u>\$ 2,101</u>	<u>\$ 2,347</u>

The Company leases equipment and a portion of its facilities pursuant to noncancellable operating lease agreements expiring through 2018. Rental expense totaled approximately \$0.8 million and \$0.9 million for the years ended December 31, 2014 and 2013, respectively.

Future minimum lease payments under noncancellable operating leases and future minimum lease payments under capital leases together as of December 31, 2014 were as follows:

	Capital Leases	Operating Leases
Year Ending December 31,		
2015	\$ 770	\$ 629
2016	656	508
2017	535	289
2018	493	107
2019	<u>380</u>	<u>-</u>
Future minimum lease payments	2,834	<u>\$ 1,533</u>
Less – amount attributable to interest	<u>421</u>	
Present value of net minimum lease payments	2,413	
Current portion of capitalized lease obligations	<u>612</u>	
Long-term portion of capitalized lease obligations	<u>\$ 1,801</u>	

9. Self Insurance

During 2014 and 2013, 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 2014 and 2013. 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 approximately \$180,000 and \$130,000 at December 31, 2014 and 2013, respectively. The amounts are recorded in accounts payable and accrued liabilities in the accompanying consolidated balance sheets.

Argyle Security, Inc.

Notes to the Consolidated Financial Statements

10. Common Stock Reserved for Issuance

In March 2013, the Company implemented a share option plan. The fair value of the options is computed using the Black-Scholes option pricing model. The following table sets for the assumptions used in arriving at the fair value of the options granted during the years ended December 31, 2014 and 2013.

<u>Grant Date</u>	<u>Grant Date Fair Value (Dollars In Thousands)</u>	<u>Risk-free Interest Rate</u>	<u>Dividend Yield</u>	<u>Expected Volatility</u>	<u>Expected Life (Years)</u>
July 2013	\$ 7	0.87%	0	25%	4
July 2014	\$ 7	0.87%	0	25%	4

The following is a summary of option activity as of December 31, 2014 and 2013, and changes during the years then ended:

<u>Options</u>	<u>Shares</u>	<u>Weighted-Average Exercise Price</u>	<u>Weighted-Average Remaining Contractual Term</u>
Outstanding at December 31, 2012	155,000	\$ 4.13	
Granted	3,624,194	\$ 0.02	
Outstanding at December 31, 2013	3,779,194	\$ 0.19	
Granted	3,513,883	\$ 0.02	
Outstanding at December 31, 2014	<u>7,293,077</u>	\$ 0.11	9.4
Exercisable at December 31, 2014	<u>3,284,682</u>	<u>\$ 0.02</u>	

The following is a summary of the status of the Company's nonvested shares as of December 31, 2014 and 2013, and changes during the years then ended:

<u>Nonvested Shares</u>	<u>Shares</u>	<u>Weighted-Average Grant-Date Price</u>
Nonvested at December 31, 2012	-	\$ -
Granted	3,624,194	\$ -
Nonvested at December 31, 2013	3,624,194	
Granted	3,513,883	\$ -
Vested	<u>(779,721)</u>	\$ -
Nonvested at December 31, 2013	<u>6,358,356</u>	<u>\$ -</u>

At December 31, 2014, 20,278,869 shares of common stock are issuable upon conversion of \$8,438,000 aggregate principal amount plus interest of 14% convertible subordinated promissory notes of the Company.

Argyle Security, Inc.

Notes to the Consolidated Financial Statements

At December 31, 2014, 4,254,005 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.

Series B Preferred Stock

Each share of Series B Convertible Preferred Stock ("Series B Preferred Stock") is convertible into 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

The provision (benefit) for taxes on income consists of and represents the tax effect of the following:

	Years Ended December 31,	
	2014	2013
Current:		
Federal	\$ -	\$ -
State	72	850
Deferred:		
Federal	5,869	(5,869)
State	-	-
	<u>\$ 5,941</u>	<u>\$ (5,019)</u>

Argyle Security, Inc.

Notes to the Consolidated Financial Statements

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,	
	2014	2013
Computed at the expected statutory rate of 34%	\$ 3,485	\$ (1,707)
Increase resulting from:		
Permanent differences	(13)	(7)
State income tax – net of federal tax benefit	(45)	(561)
Changes in valuation allowance	(9,764)	7,694
Other	396	(400)
	<u>\$ (5,941)</u>	<u>\$ 5,019</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,	
	2014	2013
Deferred tax assets:		
Net operating loss	\$ 6,673	\$ 4,507
Allowance for doubtful accounts	142	150
Intangibles (nonamortizable)	2,024	519
Capital leases	209	212
Accrued interest	603	409
Other	249	248
Total deferred tax assets	<u>9,900</u>	<u>6,045</u>
Deferred tax liabilities:		
Property and equipment	88	136
Contract receivables	37	22
Deferred rent	-	7
Other	11	11
Total deferred tax liabilities	<u>136</u>	<u>176</u>
Net deferred tax assets	<u>9,764</u>	<u>5,869</u>
Less valuation allowance	<u>(9,764)</u>	<u>-</u>
Net deferred tax asset	<u>\$ -</u>	<u>\$ 5,869</u>

Argyle Security, Inc.

Notes to the Consolidated Financial Statements

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

	December 31,	
	2014	2013
Current deferred tax asset	\$ -	\$ 980
Noncurrent deferred tax asset	-	4,889
Net deferred tax asset	\$ -	\$ 5,869

At December 31 2014, the Company had a valuation allowance of approximately \$9.8 million against its deferred tax assets in excess of reversing taxable temporary differences (deferred tax liabilities). The valuation allowance increased by approximately \$9.8 million and decreased by \$7.7 million during 2014 and 2013, respectively. The ultimate realization of the 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, 2014, the Company had net operating loss carryovers of approximately \$19.6 million that begin to expire December 31, 2029.

The Company files a consolidated United States federal income tax return. With few exceptions, the Company is no longer subject to federal, state, and local income tax examinations by authorities for years before 2011. There are no federal or state tax returns under examination by a taxing authority as of December 31, 2014.

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, 2014 and 2013.

14. Customers and Credit Risk

For the year ended December 31, 2014, no single customer accounted for greater than 10% of the Company's construction revenue. 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.

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.

Argyle Security, Inc.

Notes to the Consolidated Financial Statements

15. Liquidity

The Company's cash requirements relate primarily to working capital needed to operate and grow the business, including funding operating expenses and meeting debt service requirements. The Company's ability to achieve profitability and meet future liquidity needs and capital requirements will depend upon numerous factors, including the timing and amount of contract and service revenue; the timing and amount of operating expenses; the timing and costs of working capital needs; and changes in strategy or planned activities.

The Company has experienced and continues to experience negative cash flows from operations and expects to continue to incur net losses in the foreseeable future.

If the Company raises additional capital, there can be no assurances that the revenue or capital infusion will be sufficient to enable the Company to develop the business to a level where it will be profitable or generate positive cash flow. If additional funds are raised through the issuance of equity or convertible debt securities, the percentage ownership of current stockholders could be significantly diluted, and these newly issued securities may have rights, preferences or privileges senior to those of existing stockholders. If the Company incurs additional debt, a substantial portion of operating cash flow may be dedicated to the payment of principal and interest on such indebtedness, thus limiting funds available for business activities. The terms of any debt securities issued could also impose significant restrictions on operations.

The consolidated financial statements for the year ended December 31, 2014 were prepared on the basis of a going concern which contemplates that the Company will be able to realize assets and discharge liabilities in the normal course of business. Accordingly, they do not give effect to adjustments that would be necessary should the Company be required to liquidate its assets. The ability of the Company to meet its total liabilities at December 31, 2014, and to continue as a going concern is dependent upon the availability of future funding, continued growth in revenue, and the Company's ability to manage costs. The financial statements do not include any adjustments that might result from the outcome of these uncertainties. Management has subsequently taken multiple steps to improve the Company's profitability, cash flows, and liquidity. These actions are discussed in note 16.

16. Subsequent Events

Amendment and Waiver to the PrivateBank Second Amended and Restated Loan and Security Agreement – On February 26, 2015, the Company entered into Amendment No. 4 and Waiver to the Second Amended and Restated Loan and Security Agreement (the "Loan Amendment") to the Second Amended and Restated Loan and Security Agreement, dated March 14, 2013 (the "Loan Agreement"), with The PrivateBank and Trust Company, an Illinois banking corporation (the "Bank").

Under the Loan Amendment, the Bank amended the senior debt financial covenants and modified the borrowing base criteria for the Company's revolving line of credit with the Bank. The Loan Amendment also allowed for additional senior subordinated debt in the form of convertible subordinated promissory

Argyle Security, Inc.

Notes to the Consolidated Financial Statements

notes in the aggregate principal amount of \$2 million bearing interest at 16% per annum, as well as allowed for an increase in the per annum interest rate on the existing Amended Convertible Notes from 14% to 16% per annum.

Both the Loan Agreement and an additional Waiver to Second Amended and Restated Loan and Security Agreement dated April 24, 2015 (the “Waiver”), extended the required audit filing date from 90 calendar days after the Company’s fiscal year end to 120 days and 150 days, respectively.

On July 14, 2015, the Company entered into Amendment No. 5 to the Second Amended and Restated Loan and Security Agreement (the “Additional Loan Amendment”) to the Loan Agreement.

Under the Additional Loan Amendment, the Bank increased the maximum principal borrowing amount, amended senior debt financial covenants, and modified the borrowing base criteria for the Company’s revolving line of credit with the Bank. The Additional Loan Amendment also allowed for additional senior subordinated debt in the form of convertible subordinated promissory notes in the aggregate principal amount of \$1.25 million bearing interest at 20% per annum.

The Additional Loan Amendment extended the required audit filing date from 150 calendar days after the Company’s fiscal year end to no later than 10 days subsequent to the closing of the Additional Loan Amendment.

Amendment to Convertible Notes – On February 26, 2015, the Company issued, in exchange for cash, convertible subordinated promissory notes in the aggregate principal amount of \$2 million (the “Additional Convertible Notes”), bearing interest at 16% per annum. On each interest payment date, accrued but unpaid interest is added to the principal balance and also bears interest at 16% per annum. Concurrent with the issuance of the Additional Convertible Notes, the Company increased the per annum interest rate on the existing Amended Convertible Notes from 14% to 16% per annum.

Further, on February 26, 2015, the Company’s majority shareholder contributed \$1.25 million of cash to support a letter of credit. Such letter of credit is for the purpose of establishing collateral for the benefit of the Company’s existing bonding facilities. The shareholder has no recourse against the Company to the extent that the letter of credit is utilized to satisfy obligations of the bonding companies. The letter of credit is an off-balance sheet item solely for the benefit of the Company. The Company is responsible to pay 20% interest so long as the letter of credit remains effective.

An additional waiver to the Amended Convertible Notes and Additional Convertible Notes dated April 24, 2015 extended the required audit filing date from 90 calendar days after the Company’s fiscal year end to 150 days.

On July 14, 2015, the Company issued, in exchange for cash, convertible subordinated promissory notes in the aggregate principal amount of \$1.25 million (the “Second Additional Convertible Notes”), bearing interest at 20% per annum. On each interest payment date, accrued but unpaid interest is added to the principal balance and also bears interest at 20% per annum.

Argyle Security, Inc.

Notes to the Consolidated Financial Statements

Simultaneously on July 14, 2015, 26,945,981 shares of a new Series C Convertible Preferred Stock (the "Series C Preferred Stock") were issued upon conversion of \$10.44 million aggregate principal amount of convertible subordinated promissory notes of the Company, along with \$1.15 million in paid-in-kind interest, at a conversion price of \$0.4302.

Each share of Series C Preferred Stock is convertible into shares of common stock, at any time, at the option of the holder, initially at a conversion price of \$0.4302 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 C Preferred Stock have voting rights equal to the number of shares of common stock the holder would receive if all shares of Series C Preferred Stock had been converted into common stock. The holders of the Series C Preferred Stock may also designate one individual to serve on the Company's Board of Directors.

The holders of the Series C 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) 20% per annum or (ii) the dividend payable on the equivalent amount of common stock into which the Series C 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 C Preferred Stock, but only with respect to those shares of Series C Preferred Stock so converted.

Unless prohibited by Delaware law governing distributions to stockholders, shares of Series C Preferred Shares shall be redeemed by the Company at a price per share equal to the greater of \$0.4302 per share, plus all declared but unpaid dividends thereon as of the Redemption Date and (B) the product of (1) the Market Price of a Share of common stock as of the date of the Company's receipt of the Redemption Request multiplied by (2) the Series C Conversion Ratio as of the Redemption Date (the "Redemption Price"), which redemption shall occur not more than sixty (60) days after receipt by the Corporation, at any time on or after April 30, 2018 from not less than the majority of the holders of Series C Preferred Shares, of written notice requesting redemption of all outstanding shares of Series C Preferred Stock (the "Redemption Request").

The shares of Series C Preferred Stock have a liquidation preference as to the Company's Series A Preferred Stock, Series B 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 C Preferred Stock had been converted into common stock.

For as long as any shares of Series C 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

Argyle Security, Inc.

Notes to the Consolidated Financial Statements

decreasing (other than by redemption or conversion) the authorized number of shares of preferred stock or shares of Series C Preferred Stock, (iii) creating, issuing or authorizing the issuance of any equity securities senior to the Series C Preferred Stock, or (iv) repurchasing, redeeming or reissuing any equity securities of the Company to which the Series C 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. In addition, the Company eliminated its designation of Series A Preferred Stock as no shares were issued and outstanding.

Further, on July 14, 2015, the Company's majority shareholder contributed \$2.75 million of cash to support an aggregate of \$4.0 million letter of credit. Such letter of credit is for the purpose of establishing additional collateral for the benefit of the Company's existing bonding facilities. The shareholder has no recourse against the Company to the extent that the letter of credit is utilized to satisfy obligations of the bonding companies. The letter of credit is an off-balance sheet item solely for the benefit of the Company. The Company is responsible to pay 20% interest to the shareholder so long as the letter of credit remains effective.

Supplementary Information



Padgett Stratemann

Independent Auditor's Report on Supplementary Information

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

We have audited the consolidated financial statements of Argyle Security, Inc. as of and for the years ended December 31, 2014 and 2013, and have issued our report thereon dated July 17, 2015, which contained an unmodified opinion on those consolidated financial statements. Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole.

The accompanying supplementary information is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information 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 information 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 information 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 information is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

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

San Antonio, Texas
July 17, 2015

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Argyle Security, Inc.

Consolidating Balance Sheet

December 31, 2014

(Dollars in Thousands, Except Share Data)

	ASI	ISI	Eliminations	Total
Current Assets				
Cash and cash equivalents	\$ 2	\$ 153	\$ -	\$ 155
Contract receivables – net of allowance for doubtful accounts of \$372 (\$392 in 2013)	-	13,484	-	13,484
Costs and estimated earnings in excess of billings on incomplete contracts	-	2,467	-	2,467
Inventory	-	894	-	894
Prepays and other current assets	2	577	-	579
Refundable income taxes	6	57	-	63
Total current assets	10	17,632	-	17,642
Other Assets				
Investment in subsidiary	9,728		(9,728)	-
Property and equipment – net	4	3,124	-	3,128
Deposits and other assets	-	236	-	236
Total other assets	9,732	3,360	(9,728)	3,364
Total assets	<u>\$ 9,742</u>	<u>\$ 20,992</u>	<u>\$ (9,728)</u>	<u>\$ 21,006</u>
Current Liabilities				
Accounts payable and accrued liabilities	\$ 6	\$ 7,235	\$ -	\$ 7,241
Billings in excess of costs and estimated earnings on incomplete contracts	-	3,091	-	3,091
Dividends payable	80	-	-	80
Current portion of capitalized lease obligations	-	612	-	612
Current maturities of long-term debt	8,438	3,700	-	12,138
Total current liabilities	8,524	14,638	-	23,162
Long-Term Liabilities				
Interest payable	286	-	-	286
Long-term capitalized lease obligations – less current portion	-	1,801	-	1,801
Total long-term liabilities	286	1,801	-	2,087
Total liabilities	8,810	16,439	-	25,249
Stockholders' Equity (Deficit)				
Preferred stock – Argyle Security, Inc. – \$0.0001 par value; 1,000,000 shares authorized; 16,337 Series B shares issued and outstanding	1,610	-	-	1,610
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	-	-	3
Treasury stock, par value; 945,548 common shares	-	-	-	-
Additional paid-in capital	58,267	32,534	(32,534)	58,267
Accumulated earnings (deficit)	(58,948)	(27,981)	22,806	(64,123)
Total stockholders' equity (deficit)	932	4,553	(9,728)	(4,243)
Total liabilities and stockholders' equity (deficit)	<u>\$ 9,742</u>	<u>\$ 20,992</u>	<u>\$ (9,728)</u>	<u>\$ 21,006</u>

See independent auditor's report on supplementary information.

Argyle Security, Inc.

Consolidating Statement of Operations

Year Ended December 31, 2014

(Dollars in Thousands, Except Share Data)

	ASI	ISI	Eliminations	Total
Revenues:				
Contract revenues	\$ -	\$ 39,470	\$ -	\$ 39,470
Service, manufacturing, and other revenues	-	16,337	-	16,337
Total revenues	-	55,807	-	55,807
Cost of revenues:				
Contract costs	-	35,056	-	35,056
Service, manufacturing, and other costs, including \$27 of depreciation	-	12,055	-	12,055
Total cost of revenues	-	47,111	-	47,111
Gross profit	-	8,696	-	8,696
Operating expenses:				
Salaries and related expense	-	6,540	-	6,540
Professional fees and outside services	-	881	-	881
General and administrative expenses	-	4,931	-	4,931
Depreciation	8	873	-	881
Amortization of intangible assets	-	956	-	956
Impairment of intangible assets	-	3,642	-	3,642
Total operating expenses	8	17,823	-	17,831
Operating loss	(8)	(9,127)	-	(9,135)
Other income (expense):				
Other – net	-	41	-	41
Interest expense	(570)	(585)	-	(1,155)
Total other income (expense)	(570)	(544)	-	(1,114)
Loss before provision for income taxes	(578)	(9,671)	-	(10,249)
Income tax expense	4,907	1,034	-	5,941
Net loss	(5,485)	(10,705)	-	(16,190)
Dividends on redeemable preferred stock	(72)	-	-	(72)
Net loss allocable to holders of nonredeemable common stock	\$ (5,557)	\$ (10,705)	\$ -	\$ (16,262)

See independent auditor's report on supplementary information.

Argyle Security, Inc.

Consolidating Statement of Changes in Stockholders' Equity (Deficit)

Year Ended December 31, 2014

(Dollars in Thousands)

	<u>ASI</u>	<u>ISI</u>	<u>Eliminations</u>	<u>Total</u>
Balance at December 31, 2013	\$ 6,482	\$ 10,754	\$ (5,224)	\$ 12,012
Net loss	(5,485)	(10,705)	-	(16,190)
Contributions	-	4,504	(4,504)	-
Stock options granted	7	-	-	7
Dividends on preferred stock	<u>(72)</u>	<u>-</u>	<u>-</u>	<u>(72)</u>
Balance at December 31, 2014	<u>\$ 932</u>	<u>\$ 4,553</u>	<u>\$ (9,728)</u>	<u>\$ (4,243)</u>

See independent auditor's report on supplementary information.

Argyle Security, Inc.

Consolidating Statement of Cash Flows

Year Ended December 31, 2014
(Dollars in Thousands)

	ASI	ISI	Eliminations	Total
Cash Flows From Operating Activities				
Net loss	\$ (5,485)	\$ (10,705)	\$ -	\$ (16,190)
Adjustments to reconcile net income to net cash provided by (used in) operating activities:				
Amortization of intangible assets	-	956	-	956
Bad debt expense	-	94	-	94
Depreciation	8	900	-	908
Impairment of intangible assets	-	3,642	-	3,642
Stock-based compensation	7	-	-	7
Gain on sale of property and equipment – net	-	(40)	-	(40)
Deferred tax expense	4,904	965	-	5,869
Changes in operating assets and liabilities:				
Contract receivables	-	1,464	-	1,464
Costs and estimated earnings in excess of billings on incomplete contracts	-	559	-	559
Inventory, prepaids and other assets	-	(146)	-	(146)
Accounts payable and accrued liabilities	570	(727)	-	(157)
Billings in excess of costs and estimated earnings on incomplete contracts	-	(2,572)	-	(2,572)
Income taxes refundable/payable	-	(203)	-	(203)
Net cash provided by (used in) operating activities	4	(5,813)	-	(5,809)
Cash Flows From Investing Activities				
Investment in affiliate	(4,504)	-	4,504	-
Purchase of property and equipment	-	(220)	-	(220)
Net cash used in investing activities	(4,504)	(220)	4,504	(220)
Cash Flows From Financing Activities				
Contributions	-	4,504	(4,504)	-
Principal payments on long-term debt	-	(8,250)	-	(8,250)
Proceeds from long-term debt	4,500	9,950	-	14,450
Payments on capital lease obligations	-	(601)	-	(601)
Net cash provided by financing activities	4,500	5,603	(4,504)	5,599
Net decrease in cash and cash equivalents	-	(430)	-	(430)
Cash and cash equivalents at beginning of year	2	583	-	585
Cash and cash equivalents at end of year	\$ 2	\$ 153	\$ -	\$ 155
Supplemental Disclosures of Cash Flow Information				
Cash paid for interest	\$ -	\$ 585	\$ -	\$ 585
Cash paid for income taxes	\$ -	\$ 335	\$ -	\$ 335
Supplemental Disclosures of Noncash Flow Information				
Dividends accrued	\$ 72	\$ -	\$ -	\$ 72
Vehicles financed with capital lease	\$ -	\$ 225	\$ -	\$ 225
Accrued interest added to debt	\$ 1,488	\$ -	\$ -	\$ 1,488

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