



Annual Report for the Fiscal Year Ended December 31, 2015

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, 2015 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 Executive 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, operating as the Argyle Security Group, 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 2,500 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 35 years, the Company has furnished and installed detention equipment in more than 2,500 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 petrochemical, 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, 2015, we had 325 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, 2015 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
- 1477 Market Street, Tallahassee, Florida 32312

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 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 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 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 one share 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, 2015	89,000,000	28,436,271(1)	937,621 (2)	82 (3)	46 (4)
Series B Convertible Preferred Stock	December 31, 2015	27,273	16,337	0	2	2
Series C Convertible Preferred Stock	December 31, 2015	27,000,000	26,945,980	0	2	2

- (1) Includes holders of 82,221 shares of Common Stock included as part of Units consisting of one share of Common Stock and one expired Common Stock Purchase Warrant. Does not include 945,548 shares of Common Stock held as treasury shares.
- (2) Does not include 2,309,489 shares of restricted Common Stock held by current or former employees or directors of the Company and 2,886,997 shares of Common Stock held by ISI’s former subordinated debtholder.
- (3) Includes seven (7) beneficial shareholders holding Units.
- (4) Includes one holder of record holding Units.

At December 31, 2015, 3,181,418 shares of Common Stock are reserved for issuance upon conversion of \$1,250,000 aggregate principal amount plus interest of 20% convertible subordinated promissory notes of the Company convertible at a conversion price of \$0.4302 (the “Convertible Notes”).

Additionally, as of December 31, 2015 we had (a) 85,000 shares of Common Stock reserved for issuance upon the exercise of options pursuant to the 2007 Omnibus Securities and Incentive Plan, (b) 3,051,305 shares of common stock were reserved for issuance upon the exercise of options pursuant to the 2013 Stock Option Plan (as amended) and (c) 4,538,465 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
Andy Rogler	Executive Vice President, Chief Financial Officer and Treasurer	2016	N/A
Robert Davies	Chairman of the Board of Directors	2009	2018
James Read	Director	2009	2018
Simon Whitney	Director	2011	2017

Beneficial Owners

The following table sets forth, as of December 31, 2015, 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 59,394,679 shares of Common Stock on a fully-diluted, fully converted basis including (i) 28,436,271 shares of Common Stock, (ii) 16,337 shares of Series B Preferred Stock (convertible into 4,012,428 shares of Common Stock including the effect of anti-dilution triggers but not including accrued dividends) outstanding as of December 31, 2015 and (iii) 26,945,980 shares of Series C Preferred Stock (convertible into 26,945,980 shares of Common Stock not including accrued dividends) outstanding as of December 31, 2015. In addition, Argyle had 3,051,305 options outstanding as of December 31, 2015, of which 209,617 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. Such amount does not include shares of Common Stock issuable upon the conversion of outstanding Convertible Promissory Notes in the aggregate principal amount of \$1,250,000 (plus accrued and unpaid interest through December 31, 2015) and convertible into approximately 3,457,210 shares of Common Stock (the “Convertible Notes”).

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	52,486,042 ⁽¹⁾	88.4 %
Other directors and executive officers as a group (5 individuals)	0	* %

* 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 50,930,915 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 787,627 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 52,486,042 shares of Common Stock which includes (i) 767,500 shares directly held and (ii) 54,243,344 shares held by MML A and MML Coinvest A. They do not include any shares of Common Stock underlying shares issuable upon the conversion of accrued and unpaid dividends earned by holders of the Series B Preferred Stock and Series C Preferred Stock exchange of the Convertible Notes subsequent to December 31, 2015 or the effect of accrued and unpaid interest on the Convertible Notes.

Note: The foregoing assumes a conversion of the Series B Preferred Stock and Series C Preferred Stock rather than a redemption for cash. In the event 100% of the Series B Preferred Stock and Series C Preferred Stock is fully redeemed, shares of Common Stock issuable upon such conversion would be excluded from the calculation of percentage of Common Stock, resulting in a potential beneficial ownership of greater than 5% by William Blair Mezzanine Capital Fund III, L.P., as previously disclosed in the Company’s Annual Report for the Fiscal Year Ended December 31, 2014.

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 2015 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, 2015 are attached to this Annual Report.

The audited consolidated financial statements of Argyle, as of December 31, 2015, 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.

Information Subsequent to December 31, 2015 Not Previously Disclosed

On June 24, 2016, Argyle issued, in exchange for cash, to each of the MML Funds convertible bridge notes (the “MML Bridge Notes”) in an aggregate principal amount of \$2.0 million, with each of these notes bearing interest at 20% per annum. On each interest payment date accrued but unpaid interest on the MML Bridge Notes is capitalized and added to the principal balance thereof. The conversion price of the MML Bridge Notes was at a

price equal to \$0.4302, which reflects the volume weighted average sales price for the Common Stock from trades quoted on the OTC Bulletin Board for the ten trading days ending on the day prior to the funding by MML Funds in December 2009 and subsequent periods (“Conversion Price”). The total outstanding principal and accrued and unpaid interest of the MML Bridge Notes is convertible into approximately 4,649,000 shares of Common Stock (plus the conversion of then additional accrued and unpaid interest), at the option of the MML Entities, at a price equal to the Conversion Price.

On July 13, 2016, ISI entered into Amendment No. 6 and Waiver dated as of July 13, 2016 (the “Loan Amendment”) to the Second Amended and Restated Loan and Security Agreement dated March 13, 2014 (as amended) with The PrivateBank and Trust Company, an Illinois banking corporation (the “Bank”). Under the Loan Amendment, ISI received an irrevocable waiver from the Bank of all ISI’s breaches of its financial covenants for the quarters ended March 31, 2016 and June 30, 2016. Under the Loan Amendment, the Bank agreed to, among other things, establish a new revolving line of credit for up to \$2,000,000 (the “RLOC”), amend the calculation of the borrowing base used to establish availability on the existing senior loan facility and amend its minimum EBITDA covenant through December 31, 2016. Further, in connection with the Loan Amendment, ISI drew \$2,000,000 from the RLOC and used the proceeds to return \$2,000,000 of invested capital to Argyle. Argyle then prepaid the MML Bridge Notes. In connection therewith, MML then deposited \$2,000,000 in a deposit account controlled by the Bank for the benefit of ISI in the form of collateral for the RLOC for which ISI has agreed to repay subsequent to the satisfaction of all obligations owed to the Bank.

On August 1, 2016, ISI entered into amendments to extend the term of its leases for property at 12902 and 12906 Flagship, San Antonio, Texas through August 2026 (the “Lease Extensions”). The facilities are leased from Green Wing Management, Ltd., an entity owned and controlled by Sam Youngblood, former officer and director of the Company. In connection with the Lease Extensions, Mr. Youngblood agreed to return to the Company for cancellation 469,392 shares of Common Stock (the “Stock”) and forfeit all stock option granted to him, resulting in a relinquishment of all equity interest in the Company. The Stock has been retired and held in treasury. Mr. Youngblood also agreed to extend his existing non-solicitation, non-competition and confidentiality agreement with the Company through the term of the Lease Extension.

Argyle Security, Inc.

Consolidated Financial Statements and Consolidating Information

December 31, 2015 and 2014

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, 2015 and 2014, and the related consolidated statements of operations, changes in stockholders' equity (deficit), and cash flows for the years then ended and the related notes to the consolidated 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, 2015 and 2014, 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
February 16, 2016

Argyle Security, Inc.

Consolidated Balance Sheets

December 31, 2015 and 2014

(Dollars in Thousands, Except Share Data)

	<u>2015</u>	<u>2014</u>
Current Assets		
Cash and cash equivalents	\$ 703	\$ 155
Contract receivables – net of allowance for doubtful accounts of \$191 (\$372 in 2014)	15,636	13,484
Costs and estimated earnings in excess of billings on incomplete contracts	5,153	2,467
Inventory	1,009	894
Prepaid expenses and other current assets	640	579
Refundable income taxes	<u>6</u>	<u>63</u>
Total current assets	23,147	17,642
Property and Equipment – net	2,770	3,128
Other Assets – deposits and other assets	<u>780</u>	<u>236</u>
Total assets	<u>\$ 26,697</u>	<u>\$ 21,006</u>
Current Liabilities		
Accounts payable and accrued liabilities	\$ 9,015	\$ 7,241
Billings in excess of costs and estimated earnings on incomplete contracts	3,756	3,091
Dividends payable	1,242	80
Current portion of capitalized lease obligations	596	612
Income tax payable	32	-
Current maturities of long-term debt	<u>-</u>	<u>12,138</u>
Total current liabilities	14,641	23,162
Long-Term Liabilities		
Long-term debt – less current maturities	9,750	-
Interest payable	583	286
Long-term capitalized lease obligations – less current portion	<u>1,376</u>	<u>1,801</u>
Total long-term liabilities	11,709	2,087
Total liabilities	26,350	25,249
Stockholders' Equity (Deficit)		
Preferred stock – Argyle Security, Inc. – \$0.0001 par value; 30,000,000 shares authorized (1,000,000 shares in 2014); 16,337 Series B shares issued and outstanding in 2015 and 2014; and 26,945,980 of Series C shares issued and outstanding in 2015 (0 shares in 2014)	3	-
Common stock – Argyle Security, Inc. – \$0.0001 par value; 120,000,000 shares authorized (89,000,000 shares in 2014); 29,381,819 shares issued; and 28,436,271 shares outstanding in 2015 and 2014	3	3
Treasury stock – par value; 945,548 common shares in 2015 and 2014	-	-
Additional paid-in capital	71,476	59,877
Accumulated deficit	<u>(71,135)</u>	<u>(64,123)</u>
Total stockholders' equity (deficit)	347	(4,243)
Total liabilities and stockholders' equity (deficit)	<u>\$ 26,697</u>	<u>\$ 21,006</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, 2015 and 2014
(Dollars in Thousands)

	<u>2015</u>	<u>2014</u>
Revenues:		
Contract revenues	\$ 58,602	\$ 39,470
Service, manufacturing, and other revenues	<u>15,920</u>	<u>16,337</u>
Total revenues	<u>74,522</u>	<u>55,807</u>
Cost of revenues:		
Contract costs	50,868	35,056
Service, manufacturing, and other costs, including \$22 of depreciation (\$27 in 2014)	<u>11,306</u>	<u>12,055</u>
Total cost of revenues	<u>62,174</u>	<u>47,111</u>
Gross profit	<u>12,348</u>	<u>8,696</u>
Operating expenses:		
Salaries and related expense	8,458	6,540
Professional fees and outside services	1,186	881
General and administrative expenses	5,615	4,931
Depreciation	853	881
Amortization of intangible assets	-	956
Impairment of intangible assets	<u>-</u>	<u>3,642</u>
Total operating expenses	<u>16,112</u>	<u>17,831</u>
Operating loss	<u>(3,764)</u>	<u>(9,135)</u>
Other income (expense):		
Other – net	38	41
Interest expense	<u>(2,034)</u>	<u>(1,155)</u>
Total other expense – net	<u>(1,996)</u>	<u>(1,114)</u>
Loss before provision for income taxes	(5,760)	(10,249)
Income tax expense	<u>91</u>	<u>5,941</u>
Net loss	(5,851)	(16,190)
Dividends on redeemable preferred stock	<u>(1,161)</u>	<u>(72)</u>
Net loss allocable to holders of common stock	<u>\$ (7,012)</u>	<u>\$ (16,262)</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, 2015 and 2014

(Dollars in Thousands, Except Share Data)

	Series C Preferred Stock		Series B Preferred Stock		Common Stock		Treasury Stock		Additional Paid-in Capital	Accumulated Deficit	Total
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount			
Balance at December 31, 2013	-	\$ -	16,337	\$ -	28,436,271	\$ 3	945,548	\$ -	\$ 59,870	(47,861)	\$ 12,012
Net loss	-	-	-	-	-	-	-	-	-	(16,190)	(16,190)
Stock options granted	-	-	-	-	-	-	-	-	7	-	7
Dividends on preferred stock	-	-	-	-	-	-	-	-	-	(72)	(72)
Balance at December 31, 2014	-	-	16,337	-	28,436,271	3	945,548	-	59,877	\$ (64,123.0)	(4,243)
Net loss	-	-	-	-	-	-	-	-	-	(5,851)	(5,851)
Conversion of debt	26,945,980	3	-	-	-	-	-	-	11,589	-	11,592
Stock options granted	-	-	-	-	-	-	-	-	10	-	10
Dividends on preferred stock	-	-	-	-	-	-	-	-	-	(1,161)	(1,161)
Balance at December 31, 2015	<u>26,945,980</u>	<u>\$ 3</u>	<u>16,337</u>	<u>\$ -</u>	<u>28,436,271</u>	<u>\$ 3</u>	<u>945,548</u>	<u>\$ -</u>	<u>\$ 71,476</u>	<u>\$ (71,135)</u>	<u>\$ 347</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, 2015 and 2014
(Dollars in Thousands)

	<u>2015</u>	<u>2014</u>
Cash Flows From Operating Activities		
Net loss	\$ (5,851)	\$ (16,190)
Adjustments to reconcile net loss to net cash used in operating activities:		
Amortization of intangible assets	-	956
Bad debt expense	63	94
Depreciation	875	908
Impairment of intangible assets	-	3,642
Stock options granted	10	7
Gain on sale of property and equipment – net	(36)	(40)
Deferred tax expense	-	5,869
Changes in operating assets and liabilities:		
Contract receivables	(2,215)	1,464
Costs and estimated earnings in excess of billings on incomplete contracts	(2,685)	559
Inventory, prepaid expenses, deposits, and other assets	(731)	(146)
Accounts payable and accrued liabilities	3,235	(157)
Billings in excess of costs and estimated earnings on incomplete contracts	665	(2,572)
Income taxes refundable/payable	88	(203)
Net cash used in operating activities	<u>(6,582)</u>	<u>(5,809)</u>
Cash Flows From Investing Activities		
Proceeds from disposal of property and equipment	3	-
Purchase of property and equipment	<u>(303)</u>	<u>(220)</u>
Net cash used in investing activities	<u>(300)</u>	<u>(220)</u>
Cash Flows From Financing Activities		
Principal payments on long-term debt	(2,850)	(8,250)
Proceeds from long-term debt	10,900	14,450
Payments on capitalized lease obligations	<u>(620)</u>	<u>(601)</u>
Net cash provided by financing activities	<u>7,430</u>	<u>5,599</u>
Net increase (decrease) in cash and cash equivalents	548	(430)
Cash and cash equivalents at beginning of year	<u>155</u>	<u>585</u>
Cash and cash equivalents at end of year	\$ <u><u>703</u></u>	\$ <u><u>155</u></u>
Supplemental Disclosures of Cash Flow Information		
Cash paid for interest	\$ <u><u>583</u></u>	\$ <u><u>585</u></u>
Cash paid for income taxes	\$ <u><u>3</u></u>	\$ <u><u>335</u></u>
Supplemental Disclosures of Noncash Flow Information		
Dividends accrued	\$ <u><u>1,161</u></u>	\$ <u><u>72</u></u>
Vehicles financed with capital lease	\$ <u><u>181</u></u>	\$ <u><u>225</u></u>
Accrued interest added to debt	\$ <u><u>-</u></u>	\$ <u><u>1,488</u></u>
Conversion of debt to Series C Preferred Stock	\$ <u><u>11,592</u></u>	\$ <u><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”) provides comprehensive security solutions to a diverse customer base, addressing the majority of its customers’ physical electronic security needs. 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 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 (“U.S. GAAP”) 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, 2014 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, 2014 was to decrease income in 2014 by approximately \$5.9 million.

Recent Accounting Pronouncements

Deferred Taxes – In November 2015, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2015-17, *Income Taxes: Balance Sheet Classification of Deferred Taxes*, which concludes that deferred tax liabilities and assets should be classified as noncurrent in a classified statement of financial position. Current U.S. GAAP requires an entity to separate deferred income tax liabilities and assets into current and noncurrent amounts in a classified statement of financial position. This ASU will be effective for the Company for fiscal years beginning after December 15, 2016. Early adoption is permitted.

Inventory – In July 2015, FASB issued ASU No. 2015-11, *Inventory: Simplifying the Measurement of Inventory*. The amendments in this ASU require entities that measure inventory using the first-in, first-out or average cost methods to measure inventory at the lower of cost and net realizable value. Net realizable value is defined as the estimated selling price in the ordinary course of business less reasonably

Argyle Security, Inc.

Notes to the Consolidated Financial Statements

predictable costs of completion, disposal, and transportation. ASU No. 2015-11 is effective for financial statements issued for fiscal years and interim periods within those fiscal years beginning after December 15, 2016 on a prospective basis. The Company does not expect the adoption of ASU No. 2015-11 to have a material effect on its consolidated financial statements. The Company is currently evaluating the effects the adoption of this guidance will have on its consolidated financial statements.

Debt Issuance Costs – In April 2015, FASB issued ASU No. 2015-03, *Interest – Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs*. The amendments in this ASU require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this ASU. The amendments are effective for financial statements issued for fiscal years beginning after December 15, 2015 and for interim periods within fiscal years beginning after December 15, 2016. Early adoption of the amendments is permitted for financial statements that have not been previously issued.

Consolidation – In February 2015, FASB issued ASU No. 2015-02, *Consolidation: Amendments to the Consolidation Analysis*, which amends the guidance that reporting entities apply when evaluating whether certain legal entities should be consolidated. ASU No. 2015-02 is effective for interim and annual periods beginning after December 15, 2015. The Company is currently evaluating the effects, if any, the adoption of this guidance will have on its consolidated financial statements. The Company does not expect the adoption of ASU No. 2015-02 to have a material impact on the Company's consolidated financial statements.

Revenue – In May 2014, FASB issued ASU No. 2014-09, *Revenue From Contracts With Customers*, requiring an entity to recognize the amount of revenue to 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 U.S. GAAP when it becomes effective and permits the use of either a full retrospective or retrospective with cumulative effect transition method. In August 2015, FASB issued ASU No. 2015-14, which defers the effective date of ASU No. 2014-09 one year, making it effective for annual reporting periods beginning after December 15, 2017. The Company has not yet selected a transition method and is currently evaluating the effects the standard will have on 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.

Argyle Security, Inc.

Notes to the Consolidated Financial Statements

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.

Contract Receivables

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

Inventory

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

Depreciation and Amortization

Property and equipment are stated at cost. Assets held under capital leases are recorded at the lower of the net present value of the minimum lease payments or the fair value of the leased asset at the inception of the lease. Depreciation and amortization are calculated on the straight-line method based on the following estimated useful lives: buildings – 10 to 40 years; furniture, fixtures, and equipment – 3 to 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 the entire carrying value of intangible assets totaled approximately \$3.6 million in 2014 (no impairment in 2015).

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.

Argyle Security, Inc.

Notes to the Consolidated Financial Statements

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.

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, 2015 and 2014.

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

Argyle Security, Inc.

Notes to the Consolidated Financial Statements

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 the deferred tax assets will not be realized.

The Company is subject to various state income taxes.

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 February 16, 2016, the date the consolidated financial statements were available to be issued.

Reclassification

Certain reclassifications have been made in the prior year's consolidated financial statements to conform to the current year's presentation. The presentation of the Company's Series B Preferred Stock was reclassified to be consistent with the presentation of the Company's Series C Preferred Stock.

Argyle Security, Inc.

Notes to the Consolidated Financial Statements

2. Contract Receivables

Contract receivables consist of the following (in thousands):

	December 31,	
	2015	2014
Completed contracts and contracts in progress	\$ 12,782	\$ 12,293
Retainage	<u>3,045</u>	<u>1,563</u>
	15,827	13,856
Less allowance for doubtful accounts	<u>191</u>	<u>372</u>
Total contract receivables	<u>\$ 15,636</u>	<u>\$ 13,484</u>

3. Costs and Estimated Earnings on Contracts

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

	December 31,	
	2015	2014
Costs incurred to date	\$ 131,023	\$ 118,370
Estimated earnings	<u>21,164</u>	<u>20,577</u>
Revenue recognized to date	152,187	138,947
Less billings to date	<u>150,790</u>	<u>139,571</u>
	\$ <u>1,397</u>	\$ <u>(624)</u>
Costs and estimated earnings in excess of billings on incomplete contracts	\$ 5,153	\$ 2,467
Billings in excess of costs and estimated earnings on incomplete contracts	<u>(3,756)</u>	<u>(3,091)</u>
	<u>\$ 1,397</u>	<u>\$ (624)</u>

Argyle Security, Inc.

Notes to the Consolidated Financial Statements

4. Inventory

Inventory consists of the following (in thousands):

	December 31,	
	2015	2014
Raw materials	\$ 219	\$ 103
Work in process	217	78
Finished goods	<u>573</u>	<u>713</u>
	<u>\$ 1,009</u>	<u>\$ 894</u>

5. Property and Equipment

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

	December 31,	
	2015	2014
Buildings	\$ 3,622	\$ 3,622
Leasehold improvements	1,575	1,524
Furniture, fixtures, and equipment	4,710	4,798
Vehicles	1,841	1,661
Website development costs	<u>46</u>	<u>46</u>
	11,794	11,651
Less accumulated depreciation and amortization	<u>9,024</u>	<u>8,523</u>
	<u>\$ 2,770</u>	<u>\$ 3,128</u>

Depreciation expense related to property and equipment totaled approximately \$0.9 million for the years ended December 31, 2015 and 2014. These amounts include amortization of assets held under capital leases.

Argyle Security, Inc.

Notes to the Consolidated Financial Statements

6. Intangible Assets

At December 31, 2015 and 2014, intangible assets consisted of the following (in thousands):

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

7. Long-Term Debt

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

	<u>December 31, 2015</u>	<u>2014</u>
Notes payable:		
Unsecured convertible debt – stockholders (A)	\$ 1,250	\$ 8,438
Line of credit and senior secured credit facility (B)	<u>8,500</u>	<u>3,700</u>
	9,750	12,138
Less current maturities	<u>-</u>	<u>12,138</u>
	<u><u>\$ 9,750</u></u>	<u><u>\$ -</u></u>

- (A) During 2015 and 2014, the Company issued convertible subordinated promissory notes in the aggregate principal amount of \$10.44 million (\$8.44 million at December 31, 2014), which bore interest at 16% per annum. Upon conversion of the \$10.44 million convertible notes in 2015, along with \$1.15 million in paid-in-kind interest, 26,945,980 shares of a new Series C Convertible Preferred Stock were issued at a conversion price of \$0.4302.

In 2015, the Company issued, in exchange for cash, convertible subordinated promissory notes in the aggregate principle amount of \$1.25 million, which bear interest at 20% per annum. The principal and any unpaid interest matures on July 14, 2020. Each dollar of outstanding principal and accrued interest is convertible into shares of common stock, at the option of the holders at a price of \$0.4302 per share. At December 31, 2105, the outstanding principal and unpaid interest is convertible into 3,181,417 shares of common stock. There are financial covenants related to the convertible subordinated promissory notes.

Argyle Security, Inc.

Notes to the Consolidated Financial Statements

In 2015, the Company's majority stockholder pledged \$4 million of its cash to support a \$4 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 stockholder 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 stockholder so long as the letter of credit remains effective.

- (B) The Company has a line of credit facility for a secured revolving line of credit in the amount of \$10 million with a \$5 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. 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 5.8% at December 31, 2015 (5.5% at December 31, 2014). 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, 2015 and 2014, the line of credit facility had an outstanding balance of \$8.5 million and \$3.7 million, respectively. The line of credit matures on April 29, 2017.

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 leases in 2006 and 2008 on another property owned by Green Wing. The Company is responsible for real estate taxes, building insurance, and maintenance for all three leases, which are accounted for as capital leases. The Company made lease payments of \$274,000 to Green Wing for each of the years ended December 31, 2015 and 2014.

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,	
	2015	2014
Buildings	\$ 3,622	\$ 3,622
Vehicles	<u>1,588</u>	<u>1,407</u>
	5,210	5,029
Less accumulated amortization	<u>3,407</u>	<u>2,928</u>
	<u>\$ 1,803</u>	<u>\$ 2,101</u>

Argyle Security, Inc.

Notes to the Consolidated Financial Statements

The Company leases equipment and a portion of its facilities pursuant to noncancellable operating lease agreements expiring through 2020. Rental expense totaled approximately \$0.9 million and \$0.8 million for the years ended December 31, 2015 and 2014, respectively.

Future minimum lease payments under noncancellable operating leases and future minimum lease payments under capital leases together as of December 31, 2015 were as follows (in thousands):

	<u>Capital Leases</u>	<u>Operating Leases</u>
Year ending December 31,		
2016	\$ 722	\$ 595
2017	599	359
2018	545	166
2019	380	33
2020	<u>-</u>	<u>10</u>
Future minimum lease payments	2,246	<u><u>\$ 1,163</u></u>
Less amount attributable to interest	<u>274</u>	
Present value of net minimum lease payments	1,972	
Current portion of capitalized lease obligations	<u>596</u>	
Long-term portion of capitalized lease obligations	<u><u>\$ 1,376</u></u>	

9. Self-Insurance

During 2015 and 2014, 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 2015 and 2014. 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 \$300,000 and \$180,000 at December 31, 2015 and 2014, 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 forth the assumptions used in arriving at the fair value of the options granted during the years ended December 31, 2015 and 2014:

Grant Date	Grant Date Fair Value (Dollars (In Thousands))	Assumptions			
		Risk-Free Interest Rate	Dividend Yield	Expected Volatility	Expected Life (Years)
July 2014	\$ 7	0.87%	-	25%	4

The following is a summary of option activity as of December 31, 2015 and 2014, and changes during the years then ended:

Options	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term
Outstanding at December 31, 2013	3,779,194	\$ 0.19	
Granted	3,513,883	0.02	
Outstanding at December 31, 2014	7,293,077	0.11	
Granted	-	-	
Outstanding at December 31, 2015	<u>7,293,077</u>		8.4
Exercisable at December 31, 2015	<u>3,051,306</u>		

Argyle Security, Inc.

Notes to the Consolidated Financial Statements

The following is a summary of the status of the Company's nonvested shares as of December 31, 2015 and 2014 and changes during the years then ended:

<u>Nonvested Shares</u>	<u>Shares</u>
Nonvested at December 31, 2013	3,624,194
Granted	3,513,883
Vested	<u>(779,721)</u>
Nonvested at December 31, 2014	6,358,356
Vested	<u>(219,617)</u>
Nonvested at December 31, 2015	<u><u>6,138,739</u></u>

At December 31, 2015, 3,181,418 shares of common stock are issuable upon conversion of \$1.2 million aggregate principal amount plus interest of 20% convertible subordinated promissory note of the Company.

At December 31, 2015, 39,038,944 shares of common stock were reserved for issuance pursuant to the preferred stock conversion options described in note 11.

11. Preferred Stock

The Company is authorized to issue 30,000,000 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 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.

Series C Preferred Stock

Each share of Series C Convertible Preferred Stock ("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. The shares of Series C Preferred Stock accrue dividends at 20% per annum and have

Argyle Security, Inc.

Notes to the Consolidated Financial Statements

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 C Preferred Stock may also designate one individual to serve on the Company's Board.

12. Income Taxes

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

	Years Ended December 31,	
	2015	2014
Current – state	\$ 91	\$ 72
Deferred – federal	-	5,869
	<u>\$ 91</u>	<u>\$ 5,941</u>

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

	Years Ended December 31,	
	2015	2014
Computed at the expected statutory rate of 34%	\$ 1,958	\$ 3,485
Increase resulting from:		
Permanent differences	(633)	(13)
State income tax – net of federal tax benefit	60	(45)
Change in valuation allowance	(1,059)	(9,764)
Other	(417)	396
	<u>\$ (91)</u>	<u>\$ (5,941)</u>

Argyle Security, Inc.

Notes to the Consolidated Financial Statements

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 (in thousands):

	December 31,	
	2015	2014
Deferred tax assets:		
Net operating loss	\$ 8,668	\$ 6,673
Allowance for doubtful accounts	73	142
Intangibles (nonamortizable)	1,774	2,024
Capital leases	195	209
Deferred rent	-	-
Accrued interest	-	603
Other	214	249
Total deferred tax assets	10,924	9,900
Deferred tax liabilities:		
Property and equipment	32	88
Contract receivables	58	37
Other	11	11
Total deferred tax liabilities	101	136
Net deferred tax assets	10,823	9,764
Less valuation allowance	10,823	9,764
Net deferred tax asset	\$ -	\$ -

At December 31 2015, the Company had a valuation allowance of approximately \$10.8 million against its deferred tax assets in excess of reversing taxable temporary differences (deferred tax liabilities). The valuation allowance increased by approximately \$1.1 million and \$9.8 million during 2015 and 2014, 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, 2015, the Company had net operating loss carryovers of approximately \$25.4 million that begin to expire December 31, 2029.

The Company files a consolidated United States federal income tax return. The Company's federal income tax return for the 2013 tax year is currently under examination. The examination is in the preliminary stages and no findings have been identified. The Company does not expect any tax assessment to result from the examination.

Argyle Security, Inc.

Notes to the Consolidated Financial Statements

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.

Surety Bonds

The Company, as a condition for entering into some of its construction contracts, had outstanding surety bonds as of December 31, 2015 and 2014.

14. Credit Risk

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

15. 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 negative cash flows from operations. The Company experienced growth in revenues in the latter half of 2015, and management anticipates continued growth during 2016. Because of the cash flow requirements related to this growth phase, the Company may need to seek financing through issuance of additional debt and equity. If the Company raises additional capital, there are still uncertainties that the capital infusion will be sufficient to enable the Company to generate positive cash flow. Management intends to evaluate the availability of additional capital funding throughout the year and alter its business plan if needed to alleviate negative cash flows.

Consolidating Information



Padgett Stratemann

Independent Auditor's Report on Consolidating 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 year ended December 31, 2015, and have issued our report thereon dated February 16, 2016, 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 consolidating 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
February 16, 2016

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Argyle Security, Inc.

Consolidating Balance Sheet

December 31, 2015

(Dollars in Thousands, Except Share Data)

	ASI	ISI	Eliminations	Total
Current Assets				
Cash and cash equivalents	\$ 2	\$ 701	\$ -	\$ 703
Contract receivables – net of allowance for doubtful accounts of \$191	-	15,636	-	15,636
Costs and estimated earnings in excess of billings on incomplete contracts	-	5,153	-	5,153
Inventory	-	1,009	-	1,009
Prepaid expenses and other current assets	2	638	-	640
Refundable income taxes	6	-	-	6
Total current assets	10	23,137	-	23,147
Property and Equipment – net	1	2,769	-	2,770
Other Assets				
Investment in subsidiary	12,988	-	(12,988)	-
Deposits and other assets	-	780	-	780
Total other assets	12,988	780	(12,988)	780
Total assets	<u>\$ 12,999</u>	<u>\$ 26,686</u>	<u>\$ (12,988)</u>	<u>\$ 26,697</u>
Current Liabilities				
Accounts payable and accrued liabilities	\$ 5	\$ 9,010	\$ -	\$ 9,015
Billings in excess of costs and estimated earnings on incomplete contracts	-	3,756	-	3,756
Dividends payable	1,242	-	-	1,242
Current portion of capitalized lease obligations	-	596	-	596
Income tax payable	-	32	-	32
Total current liabilities	1,247	13,394	-	14,641
Long-Term Liabilities				
Long-term debt – less current maturities	1,250	8,500	-	9,750
Interest payable	583	-	-	583
Long-term capitalized lease obligations – less current portion	-	1,376	-	1,376
Total long-term liabilities	1,833	9,876	-	11,709
Total liabilities	3,080	23,270	-	26,350
Stockholders' Equity (Deficit)				
Preferred stock – Argyle Security, Inc. – \$0.0001 par value; 30,000,000 shares authorized; 16,337 Series B shares and 26,945,980 of Series C shares issued and outstanding	3	-	-	3
Common stock – Argyle Security, Inc. – \$0.0001 par value; 120,000,000 shares authorized; 29,381,819 shares issued; 28,436,271 shares outstanding	3	-	-	3
Treasury stock – par value; 945,548 common shares	-	-	-	-
Additional paid-in capital	71,476	32,534	(32,534)	71,476
Accumulated deficit	(61,563)	(29,118)	19,546	(71,135)
Total stockholders' equity	9,919	3,416	(12,988)	347
Total liabilities and stockholders' equity	<u>\$ 12,999</u>	<u>\$ 26,686</u>	<u>\$ (12,988)</u>	<u>\$ 26,697</u>

See independent auditor's report on consolidating information.

Argyle Security, Inc.

Consolidating Statement of Operations

Year Ended December 31, 2015

(Dollars in Thousands)

	ASI	ISI	Eliminations	Total
Revenues:				
Contract revenues	\$ -	\$ 58,602	\$ -	\$ 58,602
Service, manufacturing, and other revenues	-	15,920	-	15,920
Total revenues	-	74,522	-	74,522
Cost of revenues:				
Contract costs	-	50,868	-	50,868
Service, manufacturing, and other costs, including \$22 of depreciation	-	11,306	-	11,306
Total cost of revenues	-	62,174	-	62,174
Gross profit	-	12,348	-	12,348
Operating expenses:				
Salaries and related expense	-	8,458	-	8,458
Professional fees and outside services	-	1,186	-	1,186
General and administrative expenses	-	5,615	-	5,615
Depreciation	3	850	-	853
Total operating expenses	3	16,109	-	16,112
Operating loss	(3)	(3,761)	-	(3,764)
Other income (expense):				
Other – net	-	38	-	38
Interest expense	(1,451)	(583)	-	(2,034)
Total other expense – net	(1,451)	(545)	-	(1,996)
Loss before provision for income taxes	(1,454)	(4,306)	-	(5,760)
Income tax expense	-	91	-	91
Net loss	(1,454)	(4,397)	-	(5,851)
Dividends on redeemable preferred stock	(1,161)	-	-	(1,161)
Net loss allocable to holders of common stock	\$ (2,615)	\$ (4,397)	\$ -	\$ (7,012)

See independent auditor's report on consolidating information.

Argyle Security, Inc.

Consolidating Statement of Changes in Stockholders' Equity (Deficit)

Year Ended December 31, 2015

(Dollars in Thousands)

	<u>ASI</u>	<u>ISI</u>	<u>Eliminations</u>	<u>Total</u>
Balance at December 31, 2014	\$ 932	\$ 4,553	\$ (9,728)	\$ (4,243)
Net loss	(1,454)	(4,397)	-	(5,851)
Conversion of debt	11,592	-	-	11,592
Contributions	-	3,260	(3,260)	-
Stock options granted	10	-	-	10
Dividends on preferred stock	<u>(1,161)</u>	<u>-</u>	<u>-</u>	<u>(1,161)</u>
Balance at December 31, 2015	<u>\$ 9,919</u>	<u>\$ 3,416</u>	<u>\$ (12,988)</u>	<u>\$ 347</u>

See independent auditor's report on consolidating information.

Argyle Security, Inc.

Consolidating Statement of Cash Flows

Year Ended December 31, 2015
(Dollars in Thousands)

	ASI	ISI	Eliminations	Total
Cash Flows From Operating Activities				
Net loss	\$ (1,454)	\$ (4,397)	\$ -	\$ (5,851)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:				
Bad debt expense	-	63	-	63
Depreciation	3	872	-	875
Stock-based compensation	10	-	-	10
Gain on sale of property and equipment – net	-	(36)	-	(36)
Changes in operating assets and liabilities:				
Contract receivables	-	(2,215)	-	(2,215)
Costs and estimated earnings in excess of billings on incomplete contracts	-	(2,685)	-	(2,685)
Inventory, prepaid expenses, deposits, and other assets	-	(731)	-	(731)
Accounts payable and accrued liabilities	1,451	1,784	-	3,235
Billings in excess of costs and estimated earnings on incomplete contracts	-	665	-	665
Income taxes refundable/payable	-	88	-	88
Net cash provided by (used in) operating activities	10	(6,592)	-	(6,582)
Cash Flows From Investing Activities				
Proceeds from disposal of property and equipment	-	3	-	3
Investment in affiliate	(3,260)	-	3,260	-
Purchase of property and equipment	-	(303)	-	(303)
Net cash used in investing activities	(3,260)	(300)	3,260	(300)
Cash Flows From Financing Activities				
Contributions	-	3,260	(3,260)	-
Principal payments on long-term debt	-	(2,850)	-	(2,850)
Proceeds from long-term debt	3,250	7,650	-	10,900
Payments on capitalized lease obligations	-	(620)	-	(620)
Net cash provided by financing activities	3,250	7,440	(3,260)	7,430
Net increase in cash and cash equivalents	-	548	-	548
Cash and cash equivalents at beginning of year	2	153	-	155
Cash and cash equivalents at end of year	\$ 2	\$ 701	\$ -	\$ 703
Supplemental Disclosures of Cash Flow Information				
Cash paid for interest	\$ -	\$ 583	\$ -	\$ 583
Cash paid for income taxes	\$ -	\$ 3	\$ -	\$ 3
Supplemental Disclosures of Noncash Flow Information				
Dividends accrued	\$ 1,161	\$ -	\$ -	\$ 1,161
Vehicles financed with capital lease	\$ -	\$ 181	\$ -	\$ 181
Conversion of debt to Series C Preferred Stock	\$ 11,592	\$ -	\$ -	\$ 11,592

See independent auditor's report on consolidating information.