TRI-S SECURITY CORP
Form S-1/A
February 10, 2006

AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON FEBRUARY 9, 2006

REGISTRATION NO. 333-131468

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

Pre-Effective Amendment

No. 1

on

FORM S-1/A

REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

TRI-S SECURITY CORPORATION

(Exact name of registrant as specified in its charter)

Georgia	**7381**	**30-0016962**
(State or other jurisdiction of incorporation or organization)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification Number)

Tri-S Security Corporation

Royal Centre One

11675 Great Oaks Way, Suite 120

Alpharetta, Georgia 30022

(678) 808-1540

(Address, including zip code, and telephone number, including area code, of registrant s principal executive offices)

Ronald G. Farrell

Chairman of the Board

and Chief Executive Officer

Royal Centre One

11675 Great Oaks Way, Suite 120

Alpharetta, Georgia 30022

(678) 808-1540

(Name, address, including zip code, and telephone number, including area code, of agent for service)

with copies to:

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Approximate date of commencement of proposed sale to the public: From time to time after the effective date of this registration statement as determined by market conditions.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box. x

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If delivery of the prospectus is expected to be made pursuant to Rule 434, check the following box. o

Calculation of Registration Fee

Title of Each Class of Securities to Be Registered	**Amount to be Registered(1)**	**Proposed Maximum Offering Price Per Unit**	**Proposed Maximum Aggregate Offering Price(2)**	**Amount of Registration Fee(3)**
Common Stock, par value $.001 per share	2,930,184 shares	$ 4.08	$ 11,955,150.72	$ 1,279.20

(1) This registration statement also covers and indeterminate number of shares of the registrant s common stock that may be issuable by reason of stock splits, stock dividends or other adjustments under certain conditions in accordance with Rule 416 of the Securities Act of 1933, as amended.

(2) Estimated solely for the purposes of calculating the registration fee pursuant to Section 6(b) of the Securities Act of 1933, as amended, and computed pursuant to Rule 457(c) promulgated under the Securities Act of 1933, as amended, based upon the average of the high and low prices of the registrant s common stock on January 31, 2006, on The Nasdaq SmallCap Market.

(3) Previously paid with the initial filing of this registration statement.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, as amended or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

INFORMATION IN THIS PROSPECTUS IS NOT COMPLETE AND MAY BE CHANGED. THE SELLING SHAREHOLDERS MAY NOT SELL THESE SECURITIES OFFERED HEREBY UNTIL THE REGISTRATION STATEMENT TRI-S SECURITY CORPORATION FILED WITH THE SECURITIES AND EXCHANGE COMMISSION IS EFFECTIVE. THIS PROSPECTUS IS NOT AN OFFER TO SELL THESE SECURITIES, AND WE ARE NOT SOLICITING OFFERS TO BUY THESE SECURITIES, IN ANY STATE WHERE THE OFFER OR SALE IS NOT PERMITTED.

PROSPECTUS (Subject to Completion)

Issued February 9, 2006

2,930,184 SHARES

TRI-S SECURITY CORPORATION

COMMON STOCK

This prospectus covers the sale of up to 2,930,184 shares of common stock of Tri-S Security Corporation (Tri-S , the Company or we) by the selling shareholders identified in this prospectus under Selling Shareholders. We will not receive any proceeds from the sale of the shares by any selling shareholder. We agreed to bear all expenses of registration of the common stock offered hereby under Federal and state securities laws.

Our common stock is listed on The Nasdaq SmallCap Market under the symbol TRIS. The last reported sale price of the common stock as reported on The Nasdaq SmallCap Market on January 30, 2006 was $4.15 per share.

The selling shareholders, directly or through agents, brokers or dealers designated from time to time, may sell the shares of common stock offered hereby from time to time on terms to be determined at the time of sale. See Plan of Distribution.

See Risk Factors beginning on page 7 for certain factors relating to an investment in the shares of common stock offered hereby.

Neither the Securities and Exchange Commission nor any other state securities commission has approved or disapproved of the common stock offered hereby or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.

The date of this prospectus is [ ], 2006.

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PROSPECTUS SUMMARY

The following summary highlights information contained elsewhere in this prospectus and should be read in conjunction with, and is qualified in its entirety by, the more detailed information and financial statements, including the notes thereto, appearing elsewhere in this prospectus. This summary may not contain all the information you should consider before purchasing the shares of common stock offered hereby. We urge you to read this entire prospectus carefully.

About Tri-S Security Corporation

Tri-S is an aggregator of elite guard services companies. Through our two direct, wholly-owned subsidiaries, Paragon Systems, Inc. (Paragon Systems), and The Cornwall Group, Inc. (Cornwall), we provide security services to government agencies and the private sector. Our services include uniformed guards, electronic monitoring systems, personnel protection, access control, crowd control and the prevention of sabotage, terrorist and criminal activities. Our government customers include local, state and Federal government agencies. Our private sector customers include commercial customers, such as universities, public school systems, corporate complexes and hospitals, and residential customers, such as condominiums, high-end apartments and high-security homes.

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

In addition to our core business of providing security services, we have a non-core business interest of providing logistics services. Through Paragon Systems, we own a 10% equity interest in Army Fleet Support, LLC (Army Fleet Support or the joint venture), which provides logistics support for U.S. Army aviation training at Fort Rucker, Alabama.

We were incorporated in Georgia in October 2001 under the name Diversified Security Corporation and changed our name to Tri-S Security Corporation in August 2004. We were formed for the purpose of acquiring and consolidating electronic and physical security companies in order to take advantage of the operating efficiencies created by a larger company. Our acquisition strategy involves the acquisition and integration of complementary businesses in order to increase our density within certain geographic areas, capture market share in the markets in which we operate and improve our profitability. We intend to pursue acquisition opportunities in the contract guard services and system integration services segments of the security industry. We frequently evaluate acquisition opportunities and, at any given time, may be in various stages of due diligence or preliminary discussions with respect to a number of potential acquisitions. From time to time, we may enter into non-binding letters of intent, but we are not currently subject to any definitive agreement with respect to any acquisition material to our operations or otherwise so far advanced in any discussions as to make an acquisition material to our operations reasonably certain.

We made our first acquisition on February 27, 2004, when we acquired all of the outstanding capital stock of Paragon Systems, a contract guard services and logistics provider, for a purchase price of approximately $16,000,000 (the Paragon Acquisition). See Business.

On February 8, 2005, pursuant to an Exchange and Recapitalization Agreement between Tri-S and all the holders of our common stock, Series A Convertible Preferred Stock and Series B Convertible Preferred Stock, and all holders of rights to acquire our common stock (the Exchange and Recapitalization Agreement), we effected an exchange and recapitalization of our outstanding common stock, Series A Convertible Preferred Stock and Series B Convertible Preferred Stock and rights to acquire our common stock. Pursuant to the Exchange and Recapitalization Agreement, all of our outstanding

(i) common stock, Series A Convertible Preferred Stock and Series B Convertible Preferred Stock was exchanged for an aggregate of 1,200,000 shares of common stock and (ii) rights to acquire our common stock were exchanged for rights to purchase an aggregate of 113,269 shares of common stock (together, the Exchange and Recapitalization).

On February 9, 2005, we commenced an underwritten initial public offering of 1,800,000 units (plus an additional 270,000 units upon exercise of the underwriters over-allotment option), with each unit consisting of one share of common stock and a warrant to purchase one share of common stock (referred to in this prospectus as a publicly-traded warrant), at an initial offering price per unit of $6.00 (the Initial Public Offering). In connection with the Initial Public Offering, our units commenced trading on The Nasdaq SmallCap Stock Market under the symbol TRISU on February 9, 2005. The Initial Public Offering closed with respect to the initial 1,800,000 units on February 14, 2005 and with respect to the additional 270,000 units on March 17, 2005. The units separated and ceased trading as units on April 9, 2005, and the common stock and publicly-traded warrants commenced trading separately on The Nasdaq SmallCap Market on April 11, 2005 under the symbols TRIS and TRISW, respectively.

We made our second acquisition on October 18, 2005, when we acquired all of the outstanding capital stock of Cornwall, a provider of security and investigative services, including armed and unarmed uniform guards, video and alarm monitoring, alarm installation, and GPS monitoring, to government and private sector customers in the Miami, Florida area, for a total purchase price of $13.5 million (the Cornwall Acquisition). See Recent Developments and Business .

Our principal executive offices are located at Royal Centre One, 11675 Great Oaks Way, Suite 120, Alpharetta, Georgia 30022. Our telephone number at that address is (678) 808-1540. In this prospectus, we , us and our refer to Tri-S Security Corporation and our wholly-owned subsidiaries, and not to the selling shareholders or to any other person.

The Offering and This Prospectus

This prospectus covers the resale of up to 2,93,0184 shares of common stock by the selling shareholders identified in this prospectus under Selling Shareholders. We will not receive any proceeds from the resale of shares by any selling shareholder. See Use of Proceeds. We have agreed to bear all expenses of registration of the common stock offered by this prospectus.

This prospectus is part of a registration statement that we have filed with the Securities and Exchange Commission (the SEC) utilizing a shelf registration process. Under the shelf registration process, the selling shareholders may, from time to time, sell the common stock described in this prospectus. We may prepare a prospectus supplement at any time to add, update or change the information contained in this prospectus. This prospectus does not contain all the information you can find in the registration statement or the exhibits filed with, or incorporated by reference into, the registration statement. Before making an investment decision with respect to the common stock, you should read this prospectus and any prospectus supplement together with the registration statement, the exhibits filed with, or incorporated by reference into, the registration statement, and the additional information described under Where You can Find More Information.

Risk Factors

See Risk Factors beginning on page 7 for a discussion of certain factors that you should consider before you make any investment decision with respect to the common stock.

Recent Developments

Private Placement

In September and October 2005, we issued 10% Callable, Convertible Promissory Notes with an aggregate principal amount of $8,015,000 (the Notes) and warrants to purchase 834,890 shares of common stock (the Investor Warrants) in a private placement financing (the Private Placement). In connection with the Private Placement, we also issued warrants to purchase 250,468 shares of common stock to our placement agent and such agent s employees (the Broker Warrants).

The Notes, Investor Warrants and Broker Warrants were issued without registration under the Securities Act of 1933, as amended (the Securities Act), in reliance upon the exemption from registration set forth in Rule 506 of Regulation D promulgated pursuant to Section 4(2) of the Securities Act. We agreed to register the resale of the shares of common stock issuable upon conversion of the Notes and exercise of the Investor Warrants and Broker Warrants, and this prospectus forms a part of the registration statement we have filed with the SEC to register such shares, among others. See Recent Developments Private Placement.

Entry into Credit Agreement

On October 18, 2005, we entered into a Credit Agreement with LSQ Funding Group, L.C. (LSQ) and BRE LLC, our primary lenders (BRE and, together with LSQ, the Lenders), which we amended on December 31, 2005 (as so amended, the Credit Agreement), pursuant to which we borrowed $1,650,000 under a term loan with a maturity date of October 1, 2007 and $3,500,000 under a term loan with a maturity date of October 1, 2009 (referred to in this prospectus as the term loans). Also pursuant to the Credit Agreement, we entered into a Factoring and Security Agreement with the Lenders, under which the Lenders will purchase from us from time to time certain accounts receivable at a discount and provide us with a professional accounts receivable management service for a funds usage fee on the funds advanced on the outstanding accounts receivable purchased (referred to in this prospectus as the factoring facility). The factoring facility has a $12,000,000 initial purchase limit and a four-year term which will automatically renew unless we provide notice of our intent to terminate. Our obligations, indebtedness and liabilities to the Lenders, whether currently existing or subsequently arising, are secured by a lien on substantially all our assets and a lien on all of the outstanding capital stock of Paragon Systems. The lien on the capital stock of Paragon Systems is subject to the prior interest of the former shareholders of Paragon Systems, to whom we have pledged 40% of the outstanding capital stock of Paragon Systems to secure our payment obligations with respect to the Series C Redeemable Preferred Stock.

Pursuant to the Credit Agreement, we must pay the Lenders a fee in the amount of $250,000 no later than April 18, 2006. We may satisfy our obligation to pay the fee to the Lenders by delivering to the Lenders warrants to purchase 175,000 shares of common stock, subject to customary anti-dilution adjustments (the Lender Warrants). We agreed to register the resale of the shares of common stock issuable upon exercise of the Lender Warrants, and this prospectus forms a part of the registration statement we have filed with the SEC to register such shares, among others. See Recent Developments Entry into Credit Agreement.

Acquisition of The Cornwall Group, Inc.

On October 18, 2005, we acquired all of the outstanding capital stock of Cornwall from its shareholders, for a purchase price of $13,500,000. Cornwall, through its subsidiaries, is engaged in the business of providing a full range of security and investigative services, including armed and unarmed uniform guards, video and alarm monitoring, alarm installation, and GPS monitoring, to governmental and private sector customers in the Miami, Florida area. See Recent Developments Acquisition of The Cornwall, Group, Inc.

Summary Historical and Pro Forma Financial Information

The following table sets forth our summary historical and unaudited pro forma consolidated financial information for the periods ended and the dates indicated. We derived the summary historical and unaudited pro forma consolidated financial information from our audited financial statements and from information included elsewhere in this prospectus.

The accompanying historical and pro forma financial table presents the (i) historical financial information of Paragon Systems as the Predecessor Company for periods prior to the Paragon Acquisition and the financial information of Tri-S as the Successor Company for periods prior to the Paragon Acquisition and consolidated with Paragon Systems for the nine months ended September 30, 2004, the year ended December 31, 2004 and the nine months ended September 30, 2005; and (ii) the pro forma information for Tri-S consolidated with Cornwall for the year ended December 31, 2004 and the nine months ended September 30, 2005. The pro forma information is derived from the audited and unaudited financial statements of Tri-S and Cornwall and is determined by (a) the mathematical combination of the results of operations for Tri-S and Cornwall for the relevant periods; and (b) the financing transactions and purchase accounting adjustments related to the Cornwall Acquisition.

The Predecessor Company was formerly a subchapter S corporation; consequently, pro forma tax and pro forma income per share are presented for the periods presented as the Predecessor Company. The necessary adjustments include only taxes at a statutory rate of 38% for each period presented. The pro forma income per share calculation of the Predecessor Company operations is based on the weighted average number of common shares outstanding of Tri-S, which acquired the Predecessor Company in February 2004.

Tri-S was incorporated during the fourth quarter of 2001. For purposes of calculating the weighted average shares outstanding for the pro forma income per share calculation for the year ended December 31, 2001 and prior years, we assumed that Tri-S was incorporated on January 1, 1999. Pro forma income per share information also includes the effects of the Exchange and Recapitalization discussed elsewhere in this prospectus.

The following summary historical and unaudited pro forma consolidated financial information should be read in conjunction with Selected Consolidated Historical Financial and Operating Data, Management s Discussion and Analysis of Financial Condition and Results of Operations, Unaudited Pro Forma Condensed Financial Statements and our historical consolidated financial statements and notes thereto appearing elsewhere in this prospectus.

Tri-S Security Corporation Summary Historical and Pro Forma Financial Information

	Predecessor Basis Paragon Systems, Inc. Year Ended December 31, 1999 (In thousands, except per share data)	Year Ended December 31, 2000	Year Ended December 31, 2001	Year Ended December 31, 2002	Year Ended December 31, 2003	Jan. 1, 2004 to Feb. 27, 2004
Statement of Operations Data:						
Revenues	$ 5,691	$ 7,698	$ 16,491	$ 21,364	$ 29,395	$ 4,705
Direct labor	2,023	3,076	9,092	11,983	16,070	2,481
% of revenues	35.55 %	39.96 %	55.13 %	56.09 %	54.67 %	52.73 %
Indirect labor and other contract support costs	2,442	3,417	6,000	7,615	11,151	2,113
% of revenues	42.91 %	44.39 %	36.38 %	35.64 %	37.94 %	44.91 %
Selling, general and administrative expenses	588	652	896	1,179	1,466	230
% of revenues	10.33 %	8.47 %	5.43 %	5.52 %	4.99 %	4.89 %
Amortization of intangible assets						
Operating income (loss)	638	553	503	587	708	(119)
% of revenues	11.2 %	7.2 %	3.1 %	2.7 %	2.4 %	(2.5)%
Depreciation and amortization expense	50	62	88	68	175	28
Interest income			28	23	12	
Interest expense	(8)	(14)	(11)	(7)	(30)	(11)
Interest on redeemable preferred stock						
Income (loss) before taxes	630	539	520	603	690	(130)
Pro forma income tax expense (benefit)	239	205	198	229	262	(49)
Pro forma net (loss) income	391	334	322	374	428	(81)
Pro forma basic net income (loss) per common share	0.48	0.41	0.40	0.46	0.52	(0.10)
Pro forma diluted net income (loss) per common share	0.48	0.41	0.40	0.40	0.39	(0.10)
Balance Sheet Data at Period End:						
Cash	$ 127	$ 239	$ 647	$ 877	$ 846	$ 275
Current assets	2,124	3,005	5,003	5,911	5,713	6,803
Total assets	2,237	3,201	5,147	6,114	6,883	7,230
Long term obligations					185	175
Total liabilities	782	1,207	2,760	3,124	3,243	3,720
Stockholder s equity	1,455	1,994	2,387	2,990	3,640	3,510
Other Data:						
Capital expenditures	$ 58	$ 147	$ 36	$ 127	$ 427	$
Number of Federal contracts in place	6	7	10	13	12	12

Tri-S Security Corporation Summary Historical and Pro Forma Financial Information

	Successor Basis							
	Tri-S Security Corporation			Tri-S Security Corporation and Subsidiary Consolidated	Actual		Combined Pro Forma Statement of Operations	
	Year Ended December 31, 2001	Year Ended December 31, 2002	Year Ended December 31, 2003	Nine Months Ended September 30, 2004 Consolidated	Year Ended December 31, 2004	Nine Months Ended September 30, 2005	Year Ended December 31, 2004	Nine Months Ended September 30, 2005
	(In thousands, except per share data)							
Statement of Operations Data:								
Revenues	$	$	$	$ 17,728	$ 25,425	$ 23,787	$ 64,610	$ 52,672
Direct labor				9,506	13,810	12,741	45,319	36,423
% of revenues				53.6 %	54.3 %	53.6 %	70.1 %	69.2 %
Indirect labor and other contract support costs				6,792	10,521	9,574	10,521	9,574
% of revenues				38.3 %	41.4 %	40.2 %	16.3 %	18.2 %
Selling, general and administrative expenses	100	216	347	1,097	1,653	2,551	8,265	7,596
% of revenues				6.2 %	6.5 %	10.7 %	12.8 %	14.4 %
Amortization of intangible assets				252	462	206	1,882	1,271
Operating income (loss)	(100)	(216)	(347)	81	(1,021)	(1,285)	(1,377)	(2,192)
% of revenues				0.5 %	(4.0)%	(5.4)%	(21)%	(4.2)%
Income from investment in Joint Venture					1,637	1,451	1,637	1,451
Interest income				3	3	35	6	35
Interest expense				(1,018)	(1,380)	(543)	(3,458)	(2,167)
Interest on redeemable preferred stock				(175)	(250)	(225)	(250)	(225)
Income (loss) before taxes	(100)	(216)	(347)	(1,109)	(1,011)	(567)	(3,442)	(3,091)
Pro forma income tax expense (benefit)	(38)	(82)	(130)	(424)				
Income tax expense					(384)	(215)	(384)	(382)
Pro forma net income (loss)	(62)	(134)	(217)	(685)				
Net income					(627)	(352)	(3,058)	(2,709)
Pro forma basic net income (loss) per common share	(0.08)	(0.16)	(0.26)	(0.83)				
Basic net income (loss) per common share					(0.76)	(0.11)	(3.69)	(0.84)
Pro forma diluted net income (loss) per common share	(0.08)	(0.16)	(0.26)	(0.83)				
Diluted net income (loss) per common share					(0.76)	(0.11)	(3.69)	(0.84)
Balance Sheet Data at Period End:								
Cash	$	$ 93	$ 102	$ 310	$ 313	$ 2,430	N/A	$
Current assets		93	102	5,030	6,636	8,750	N/A	12,045
Total assets		213	362	21,007	24,618	27,092	N/A	43,324
Long term obligations				8,563	10,446	11,632	N/A	22,144
Total liabilities		2	3	21,333	24,886	17,084	N/A	31,941
Stockholder's equity		211	359	(326)	(268)	10,008	N/A	11,383

RISK FACTORS

An investment in our common stock involves a high degree of risk. You should carefully consider the risks described below before making an investment decision with respect to the common stock. Additional risks not presently known to us or that we currently deem immaterial may also impair our business operations. Our business, results of operation and financial condition could be materially and adversely affected by any of these risks. The market value of the common stock could decline due to any of these risks, and you could lose all or part of your investment.

Risks Relating to Our Indebtedness

We have substantial debt.

As of September 30, 2005, on a pro forma basis after giving effect to the Cornwall Acquisition, the Private Placement and the transactions pursuant to our Credit Agreement, we had approximately $18.4 million of outstanding debt (excluding obligations to trade creditors). We may incur substantial additional debt in the future, including additional debt under our factoring facility. As of September 30, 2005, on a pro forma basis after giving effect to Cornwall Acquisition, the Private Placement and the transactions pursuant to our Credit Agreement, we would have had $0.5 million of unused borrowing availability under our factoring facility. It may be difficult for us to satisfy our payment obligations. Our considerable indebtedness could have important consequences to you, including, but not limited to, the following:

- our ability to obtain additional financing for working capital, capital expenditures, acquisitions or general corporate purposes may be impaired;
- we must use a substantial portion of our cash flow from operations to make debt service payments on the term loans, Notes and factoring facility, which will reduce the funds available to us for other purposes such as working capital, capital expenditures and acquisitions;
- we are exposed to fluctuations in interest rates because our factoring facility and term loans have variable rates of interest;
- we may have more debt than some of our competitors, which may put us at a competitive disadvantage and reduce our flexibility in planning for, or responding to, changing conditions in our industry, including increased competition; and
- we are more vulnerable to general economic downturns and adverse developments in our business.

We may not be able to generate sufficient cash to service all of our indebtedness, and we may be forced to take other actions to satisfy our payment obligations, which actions may not be successful.

Our ability to make scheduled debt service depends on our financial and operating performance, which is subject to prevailing economic and competitive industry conditions and to certain financial, business and other factors beyond our control. These factors include, but are not limited to:

- interest rates and general economic conditions;
- competitive conditions in our industry;
- operating difficulties, operating costs or pricing pressures that we may experience;
- passage of legislation or other regulatory developments that affect us adversely; and
- delays or difficulties in implementing our business strategies.

We cannot assure you that we will maintain a level of cash flows from operating activities sufficient to permit us to make our scheduled debt service payments or otherwise satisfy indebtedness. If our cash flows

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and capital resources are insufficient to fund our debt service obligations, we may be forced to reduce or delay capital expenditures, seek additional capital, sell assets or restructure or refinance our indebtedness. These alternative measures may not be successful and may not permit us to meet our scheduled debt service payments. If our cash flows and capital resources are insufficient to fund our debt service obligation, then we could face substantial liquidity problems and might be required to scale back our operations or dispose of material assets to meet our debt service obligations. Our Credit Agreement restricts our ability to dispose of our assets and, except under certain circumstances, requires that all proceeds from any such disposition be used to reduce our obligations under the Credit Agreement. Even if we are able to dispose of certain assets, we may not be able to make such dispositions at prices that we believe are fair or use the proceeds from such dispositions to make payments on our indebtedness, other than under the Credit Agreement.

Our Credit Agreement imposes significant restrictions on us, which may prevent us from capitalizing on business opportunities and taking certain corporate actions.

The Credit Agreement imposes significant operating and financial restrictions on us. These restrictions limit our ability to:

- incur or guarantee additional indebtedness;
- pay dividends and make distributions;
- make certain investments;
- repurchase stock;
- incur liens;
- enter into certain transactions with affiliates;
- enter into sale and leaseback transactions;
- merge or consolidate; and
- transfer or sell assets.

These covenants may adversely affect our ability to finance our future operations or capital needs, pursue available business opportunities or take certain corporate actions.

Risks Relating to Our Industry and Business

We depend on the factoring facility to meet our cash flow needs, which reduces our profit margin.

Pursuant to our factor facility, the Lenders from time to time purchase certain accounts receivable from us at a discount of 0.7% with a funds usage fee of prime plus 1.0% on the outstanding funds advanced on the accounts receivable purchased. This discount and usage fee reduces our profit margins. We cannot, however, cease factoring our receivables because the funds provided by the Lenders are necessary to satisfy our cash flow needs. In fact, we generally utilize the factoring facility to the maximum extent permitted by the Lenders which historically has allowed us to factor substantially all of our accounts receivable. During the nine months ended September 30, 2005, we have borrowed approximately $22.3 million, repaid approximately $24.1 million and owe at September 30, 2005 approximately $1.7 million. We believe that if our factoring facility with the Lenders were to terminate, then we would need to obtain a new factoring facility. Our obligations to the Lenders are secured by a lien on all of our assets; consequently, if we are liquidated, then there may not be any assets available for distribution to shareholders or creditors other than the Lenders.

Our service contracts often provide for fixed hourly bill rates or permit limited fee adjustments, and our business, financial condition and results of operations will be materially and adversely affected if increases in our costs cannot be charged to our customers.

Our largest expenses are payroll, payroll taxes and employee related benefits. Most of our service contracts provide for a fixed hourly bill rate and some of our service contracts provide for payments of either fixed fees or fees that increase by only small amounts during the terms of such service contracts or not at all. Competitive pressures also may prevent us from raising our fees or hourly bill rates when contracts are renewed. If, due to inflation or other causes, including increases in statutory payroll taxes, we must increase the wages, salaries and related taxes and benefits of our employees at rates faster than we can increase the fees charged under our service contracts, then our profitability will be adversely affected.

If we lose our executive officers or operation employees, our operations could be materially and adversely affected.

Our success is dependent to a significant extent upon the continuing efforts, abilities and business generation capabilities of our executive officers and senior operation employees. We have programs in place to motivate, reward and retain our executive officers and senior operation employees, including cash bonus and equity incentive plans. However, the loss or unavailability of any of our executive officers or senior operation employees could harm our ability to properly service or retain existing clients or operate new businesses. Our success and plans for future growth will also depend on our ability to hire and retain our executive officers and senior operation employees.

If we are unable to attract, retain and manage security guards and administrative staff, then our business, financial condition and results of operation will be materially affected.

Our business involves the labor-intensive delivery of contract security services. We derive our revenues largely from contract security guard services performed by our security guards. Our future performance depends in large part upon our ability to attract, develop, motivate and retain skilled security guards and administrative staff. Qualified security guards and administrative staff are in demand, particularly after the terrorist activity of September 11, 2001, and there is significant competition for these individuals from other security firms, government agencies and other similar enterprises. As a result, we may not be able to attract and retain sufficient numbers of these qualified individuals in the future, which may adversely affect our business.

Turnover of contract security guards is significant. The loss of the services of, or the failure to recruit, a significant number of skilled security guards and administrative staff would have a materially adverse affect on our business, financial condition and results of operations, including our ability to secure and complete service contracts. Furthermore, if we do not successfully manage our existing security guards and administrative staff, we may not be able to achieve the anticipated billing rates, engagement quality, level of overtime and other performance measures that are important to our business, financial condition and results of operations.

Organized labor action or occupational health and safety laws and regulations could have a material adverse effect on our business, financial condition and results of operations.

Our industry has been the subject of campaigns to increase the number of unionized employees. Although we believe that our relationships with our employees are good, we cannot provide you with any assurances that organized labor action at one or more of our facilities will not occur, or that any such activities, or any other labor difficulties at our facilities or the facilities of any of our customers, would not materially affect our business, financial condition and results of operations.

In addition, we are subject to, among other laws and regulations, comprehensive U.S. occupational health and safety laws and regulations. Such laws and regulations may become more stringent and result in necessary modifications to our current practices and facilities that could force us to incur additional costs that could materially affect our business, financial conditions and results of operations.

If we cannot successfully compete with new or existing security service providers, then our business, results of operations and financial condition will be adversely affected.

The contract security guard services industry is intensely competitive. We directly compete with companies that are national and international in scope and some of our competitors have significantly greater personnel, financial, technical and marketing resources than we do, generate greater revenues than we do and have greater name recognition than we do. The recent trend toward consolidation in our industry will likely lead to increased competition from these companies. We also compete with smaller local and regional companies that may have better knowledge of the local conditions in their regions, are better known locally and are better able to gain customers in their regions. There are relatively low barriers to entry into the contract security services industry, and we have faced and expect to continue to face additional competition from new entrants into the contract security officer services industry. In addition, some of our competitors may be willing to provide services at lower prices, accept a lower profit margin or expend more capital in order to obtain or retain business. If we cannot successfully compete with new or existing security service providers, then our business, financial condition and results of operations will be adversely affected.

Changes in available security technology may have an adverse effect on our business, results of operations and financial condition.

Our business involves the labor intensive delivery of contract security services performed by our security guards. Changes in technologies that provide alternatives to security guard services or that decrease the number of security guards required to effectively perform their services may decrease our customers demand for our security guard services. In addition, if such technologies become available for use in the industry, these technologies may be proprietary in nature and not be available for use by us in servicing our customers. Even if these technologies are available for use by us, we may not be able to successfully integrate such technologies into our business model or may be less successful in doing so than our competitors or new entrants in the industry. A decrease in demand for our security guard services or our inability to effectively utilize such technologies may adversely affect our business, financial condition and results of operations.

The security services we provide may subject us to liability for substantial damages not covered by insurance which could have a material adverse affect on our business, financial condition and results of operations.

We provide security services at various customer locations. We may be held liable for the negligent acts or misconduct of our security guards or other employees performed while on duty and in the course and scope of their employment. We experience a significant volume of claims and litigation asserting that we are liable for damages as a result of the conduct of our security guards or other employees. We may from time to time be subject to claims that our security guards have physically or emotionally harmed individuals in the course of providing these services, or members of the public may be otherwise injured by events occurring on client premises, including events that are not under the immediate control of our security officers. Individuals may bring personal injury lawsuits against us seeking substantial damages based on alleged negligence or other theories of liability in our provision of security services, including with respect to injuries not directly caused by, or within the control of, our security officers. Under principles of common law, we can generally be held liable for wrongful acts or omissions to act of our agents or employees during the course, and within the scope, of their agency or employment with us.

In many cases, our security service contracts also require us to indemnify our clients or may otherwise subject us to additional liability for events occurring on client premises. In addition, some states have adopted statutes that make us responsible for the conduct of our agents and employees. While we maintain insurance programs that provide coverage for certain liability risks, including personal injury, death and property damage, the laws of many states limit or prohibit insurance coverage for punitive damages arising from willful or grossly negligent conduct. Consequently, insurance may not be adequate to cover all potential claims or damages. If a plaintiff brings a successful claim against us for punitive damages in excess of our insurance coverage, then we could incur substantial liabilities which would have a material adverse affect on our business, results of operations and financial condition.

Terrorist activity at locations where we provide security services could have a material adverse effect on our business by subjecting us to liability. Whether or not terrorist activity occurs at a client location, our insurance costs could increase, and we could be required to comply with more burdensome regulations.

If any locations where we provide security related services are attacked by terrorists, then liabilities resulting from such attacks may not be covered by insurance and could have a material adverse effect on our business, financial condition and results of operations by requiring us to incur additional personnel costs as a result of compliance with expanded security rules and regulations. In addition, terrorist attacks that do not directly involve locations serviced by us could have a material impact on us by increasing our insurance coverage costs or making insurance coverage unavailable altogether.

We may be unable to obtain liability insurance at a reasonable cost, which would increase our exposure to catastrophic claims.

Insurance premiums have increased substantially since the terrorist attacks on September 11, 2001. If certain coverages are unavailable at premiums deemed reasonable by management, then our exposure for catastrophic claims would be increased.

We are subject to government regulation, and our failure or inability to comply with these regulations could materially restrict our operations and subject us to substantial penalties.

We are subject to a large number of city, county and state occupational licensing laws and regulations that apply to security officers. Most states have laws, or legislation pending, requiring qualification, training and registration of security officers, regulating the use of identification cards, badges and uniforms and imposing minimum bond surety or insurance standards. Any liability we may have from our failure to comply with these regulations may materially and adversely affect our business by restricting our operations and subjecting us to substantial penalties. In addition, our current and future operations may be subject to additional regulation as a result of, among other factors, new statutes and regulations and changes in the manner in which existing statutes and regulations are or may be interpreted.

We may not be successful in identifying suitable acquisition opportunities, and, if we do identify such opportunities, then we may not be able to obtain acceptable financing for the acquisition, reach agreeable terms with acquisition targets or successfully integrate acquired businesses.

An element of our growth strategy is the acquisition and integration of complementary businesses in order to increase our density within certain geographic areas, capture market share in the markets in which we operate and improve our profitability. We will not be able to acquire other businesses if we cannot identify suitable acquisition opportunities, obtain financing on acceptable terms or reach mutually agreeable terms with acquisition targets. In addition, to the extent that consolidation becomes more prevalent in our industry, the prices for suitable acquisition targets may increase to unacceptable levels thereby limiting our ability to grow.

Our growth through selective acquisitions may place significant demands on our management, operational and financial resources. Acquisitions involve numerous risks, including the diversion of our management s attention from other business concerns, the possibility that current operating and financial systems and controls may be inadequate to deal with our growth, and the potential loss of key employees.

We also may encounter difficulties in integrating any businesses we may acquire with our existing operations. The success of these transactions depends on our ability to:

- successfully merge corporate cultures and operational and financial systems;
- integrate and retain the customer base of the acquired business;
- realize cost reduction synergies, including those cost reduction synergies that we expect to realize; and
- as necessary, retain key management members and technical personnel of acquired companies.

If we fail to integrate acquired businesses successfully or to manage our growth, it could have a material adverse effect on our business. Further, we may be unable to maintain or enhance the profitability of any acquired business, consolidate its operations to achieve cost savings, or maintain or renew any of its contracts.

In addition, there may be liabilities that we fail, or are unable, to discover in the course of performing due diligence investigations on any company that we may acquire, or have recently acquired. Also, there may be additional costs relating to acquisitions including, but not limited to, possible purchase price adjustments. Any of our rights to indemnification from sellers to us, even if obtained, may not be enforceable, collectible or sufficient in amount, scope or duration to fully offset the possible liabilities associated with the business or property acquired. Any such liabilities, individually or in the aggregate, could have a material adverse effect on our business.

We may not have, or be able to obtain, sufficient capital to pursue our acquisition strategy.

Our acquisition strategy will require substantial capital. Such capital may be obtained by borrowings under credit facilities, through the issuance of long-term or short-term indebtedness or through the issuance of equity securities in private or public transactions. Our Credit Agreement restricts our ability to incur additional debt without the approval of the Lenders. If we are able to incur additional debt to pursue our acquisition strategy, then our interest expense will increase. Furthermore, we may not be able to obtain financing for future acquisitions on suitable terms, if at all.

In addition, executing our acquisition strategy may be more expensive than we anticipate because the purchase price for acquisition targets may increase due to mergers and other transactions recently completed in the security industry, and the growing interest in future mergers and consolidations. If the purchase price for acquisition targets we find appealing increases, then we will need more capital than we anticipate to execute our acquisition strategy, or we may not be able to execute our acquisition strategy at all.

We may not be able to obtain additional financing that may be necessary to fund our operations.

In order to fund our operations and increase revenues, additional financing may be required, which additional financing may not be available to us on commercially reasonable terms, if at all. We may not be successful in raising additional capital, and the proceeds of any future financings may not be sufficient to meet our future capital needs. We may need to seek additional financing sooner than we anticipate as a result of any of changes in operating plans, lower than anticipated sales, or increased operating costs.

Compliance with the corporate governance requirements to which we are subject as a public company will cause us to incur significant costs, and the failure to comply with such requirements will expose us to investigations and sanctions by regulatory authorities.

We face corporate governance requirements under the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley), as well as new rules and regulations subsequently adopted by the SEC, the Public Company Accounting Oversight Board and The Nasdaq Stock Market, Inc. (the Nasdaq). In particular, we will be required to include the management and auditor reports on internal control as part of our annual report for the year ending December 31, 2006 pursuant to Section 404 of Sarbanes-Oxley. Although we believe we have adequate internal control procedures in place, we are in the process of evaluating our internal controls systems in order (i) to allow management to report on, and our independent auditors to attest to, our internal controls, as required by these laws, rules and regulations, (ii) to provide reasonable assurance that our public disclosure will be accurate and complete, and (iii) to help ensure that we will be able to comply with the other provisions of Section 404 of Sarbanes-Oxley. We cannot be certain as to the timing of the completion of our evaluation, testing and remediation actions or the impact of the same on our operations. If we are not able to implement the requirements relating to internal controls and all other provisions of Section 404 in a timely fashion or otherwise achieve adequate compliance with such requirements, then we might be subject to sanctions or investigation by regulatory authorities, such as the SEC or Nasdaq. Any such action may materially adversely affect our reputation, financial condition and the value of our securities, including the common stock. In addition, we expect that these laws, rules and regulations will increase our legal and financial compliance costs and make certain corporate governance activities more difficult, time-consuming and costly. We also expect that these new requirements will make it more difficult and expensive for us to maintain director and officer liability insurance.

If our professional reputation is harmed, then we will have difficulty obtaining new customers and retaining existing customers, either of which would adversely affect our revenues.

We depend upon our reputation and the individual reputations of our senior professionals to obtain new customers and retain existing customers. Any factor that diminishes our reputation or the individual reputations of our senior professionals, including an ineffective response to terrorist activity or breach of security at any location we service, will make it more difficult for us to compete successfully for new customers or to retain existing customers and, therefore, would adversely affect our revenues.

Economic downturns or recessions may dampen the demand for our services, which will reduce our revenues.

During economic declines, some decisions to implement security programs and install systems may be deferred or cancelled. In other cases, customers may increase their purchases of security systems because they fear more inventory shrinkage and theft will occur due to increasing economic need. We are not able accurately to predict to what extent an economic slowdown will decrease the demand for our services. If demand for our services decreases, then our revenues will decline.

Risks Related to Government Contracting

We derive a significant portion of our revenue from Federal government contracts which the government may terminate at any time or determine not to extend after their scheduled expiration. If we are unable to replace any contract which is not extended or is terminated, then our revenues will decline.

We derive approximately 46% of our consolidated revenue from contracts with the Federal government. Federal government contracts typically span one or more base years and one or more option years. The option periods may cover more than half of the contract s potential duration. Federal government agencies generally have the right not to exercise these option periods. In addition, our contracts typically also contain provisions permitting a government customer to terminate the contract for its convenience, as well as for our default. A decision by a government agency not to exercise option periods or to terminate contracts could result in significant revenue shortfalls.

If the government terminates a contract for convenience, then we may recover only our incurred or committed costs, settlement expenses and profit on work completed prior to the termination. We cannot recover anticipated profit on terminated work. If the government terminates a contract for default, then we may not recover even those amounts, and instead may be liable for excess costs incurred by the government in procuring undelivered items and services from another source. We cannot predict if the government will terminate or choose not to extend our Federal government contracts. The government has never terminated any of our contracts; however, it may do so at any time.

Because we have a highly concentrated customer base, the loss of any of our Federal government customers could have a significant effect on our revenues.

We derive approximately 46% of our consolidated revenue from contracts with our Federal government agencies. If any of our current Federal government customers determines not to renew or terminate its contract, then our revenues may significantly decline.

The Federal government has rights and remedies under its contracts not typically found in commercial contracts that may reduce or eliminate our revenue under these contracts, as well as our ability to enter into other government contracts.

Federal government contracts contain provisions and are subject to laws and regulations that give the government rights and remedies not typically found in commercial contracts. The government may terminate its contracts for convenience or decline to exercise an option to renew. The government may also:

- reduce or modify its contracts or subcontracts;

- cancel multi-year contracts and related orders if funds for contract performance for any subsequent year become unavailable; and

- suspend or bar us from doing business with the Federal government.

If the Federal government were to exercise any of these rights or remedies, then our revenues would decline.

Our failure to comply with complex procurement laws and regulations could result in the termination of our Federal government contracts or our failure to be awarded any new contracts, and changes in laws and regulations could impose added costs on our business.

We must comply with and are affected by laws and regulations relating to the formation, administration and performance of Federal government contracts, which affect how we do business with our customers and may impose added costs on our business. Among the most significant regulations are:

- the Federal Acquisition Regulations and other agency regulations supplemental to the Federal Acquisition Regulations, which comprehensively regulate the formation, administration and performance of government contracts;

- the Truth in Negotiations Act, which requires certification and disclosure of all cost and pricing data in connection with contract negotiations;

- the Cost Accounting Standards and Cost Principles, which impose accounting requirements that govern our right to reimbursement under certain cost-based government contracts; and

- laws, regulations and executive orders restricting the use and dissemination of information classified for national security purposes and the exportation of certain products and technical data.

Moreover, we are subject to industrial security regulations of the Department of Defense and other Federal agencies that are designed to safeguard against foreigners access to classified information. If we were to come under foreign ownership, control or influence, then our Federal government customers could terminate or decide not to renew our contracts, and it could impair our ability to obtain new contracts.

If we do not comply with the procurement laws and regulations discussed above, then we may be fined, we may not be reimbursed for costs incurred by us in servicing our contracts, our contracts may be terminated and we may be unable to obtain new contracts, any of which would cause our revenues to decline.

Our status as a General Services Administration (GSA) Federal Supply Schedule Contractor may be withdrawn, which would make us ineligible to obtain certain Federal government contracts and would result in a significant decrease in our revenues.

The GSA secures the buildings, products, services, technology and other workplace essentials which Federal agencies need to operate. GSA Federal Supply Schedule contracts are contract vehicles under which Federal government agencies may purchase professional services or products. Federal government agencies may choose to award contracts only to GSA Federal Supply Schedule contractors to reduce the number of qualified bidders and to expedite the bidding process. Paragon Systems has been approved by the GSA as a GSA Federal Supply Schedule contractor and, therefore, is able to bid on Federal government contracts awarded using the GSA Federal Supply Schedule. Currently, two of our contracts with annualized revenues of approximately $18 million have been procured under the GSA Federal Supply Schedule. During the nine months ended September 30, 2005, the revenues on our contracts procured under the GSA Federal Supply Schedule totaled approximately 27% of our consolidated revenues for such period.

Our status as a GSA Federal Supply Schedule contractor may be withdrawn if we do not comply with the complex procurement laws and regulations applicable to us. We continually review and monitor our compliance with these laws and regulations as well as modifications to the GSA Federal Supply Schedule affecting our business. We believe that we are currently in material compliance with these laws, regulations and modifications; however, if we are not in compliance and our status as a GSA Federal Supply Schedule contractor is withdrawn, then we may not be able to obtain new contracts with Federal government agencies or renew our existing contracts which have been procured under the GSA Federal Supply Schedule. If we are unable to obtain new Federal government contracts or renew our existing contracts, then our revenues will decline significantly.

All of our contracts with the Federal government are subject to audits and cost adjustments by the Federal government that could result in decreased revenues and the imposition on us of civil or criminal penalties or administrative remedies.

We generate a significant portion of our revenue from Federal government contracts, each of which is subject to audit by the Federal government. In these audits, the Federal government audits and reviews our performance, pricing practices, cost structure and compliance with applicable laws, regulations and standards. Like most government contractors, our direct and indirect contract costs are audited and reviewed on a continual basis. Many of the audits for costs incurred or work performed in recent years remain ongoing or have not yet commenced. In addition, non-audit reviews by the government may still be conducted on all our government contracts. An audit of our work, including an audit of work performed by companies we may acquire, could result in a substantial adjustment to our revenue because any costs found to be improperly allocated to a specific contract will not be reimbursed and revenue we have already recognized may need to be refunded. If a government review or investigation uncovers improper or illegal activities, then we may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of claims and profits, suspension of payments, treble damages, statutory penalties, fines and suspension or barment from doing business with Federal government agencies, any of which would cause a significant decline in our revenue.

Our participation in the competitive bidding process, pursuant to which we obtain most of our Federal government contracts, presents a number of risks.

During the nine months ended September 30, 2005, we derived substantially all of our revenue from Federal government contracts that were awarded through a competitive bidding process. Most of the business that we expect to seek from the Federal government in the foreseeable future likely will be awarded through competitive bidding. Competitive bidding presents a number of risks, including the:

- need to bid on programs in advance of finalizing the services to be provided, which may result in unforeseen difficulties and cost overruns;

- substantial cost and managerial time and effort that we spend to prepare bids and proposals for contracts that may not be awarded to us;

- need to accurately estimate the resources and cost structure that will be required to service any contract we are awarded; and

- expense and delay that may arise if our competitors protest or challenge contract awards made to us pursuant to competitive bidding, which could result in the resubmission of bids on modified specifications or in termination, reduction or modification of the awarded contract.

If we are unable to win particular contracts that are awarded through the competitive bidding process, we may not be able to operate in the market for services that are provided under those contracts for a number of years. If we are unable to consistently win new contract awards over any extended period, then we will not be able to grow our business, and our business, financial condition and results of operations will be materially and adversely affected.

Our cash flow may be reduced due to significant expenses we may incur in connection with attempting to obtain Federal government contracts.

A significant portion of Federal government contracts for contract guard services is awarded through a competitive bid process. As stated above, substantial costs may be incurred in connection with preparing bids. In the past we have not, and most likely in the future will not, be awarded all the contracts on which we bid. Furthermore, if and when we do obtain a contract, we are generally required to start providing services pursuant to such contract no later than 30-45 days after the contract is awarded. As a result, we may incur significant start-up expenses. The costs of bidding on contracts and the start-up costs associated with new contracts we may obtain may significantly reduce our cash flow and liquidity.

The long sales cycles of Federal government contracts make it difficult for us to predict our financial results and cause us to expend a significant amount of effort and funds in bidding on contracts that are not awarded to us.

The sales cycle of a Federal government contract is often lengthy due to the protracted bid and approval process. Typically, many months may elapse between the time the Federal government solicits a bid for a contract and the time the contract is awarded. The lengthy sales cycles of our contracts make forecasting the volume and timing of contracts we may obtain difficult. During this period, we will generally expend substantial funds and management resources but recognize no associated revenue.

We may not receive the full amount authorized under contracts into which we have entered; consequently, our backlog may not accurately estimate our revenue.

The maximum contract value specified under a government contract that we enter into is not necessarily indicative of revenue that we will realize under that contract. In fact, even if we enter into a Federal government contract, we will not be paid for our services unless the Federal government has appropriated or budgeted the funds for such contract. Congress often appropriates funds for a particular program on a yearly basis, even though the contract may call for performance that is expected to take a number of years. As a result, contracts typically are only partially funded at any point during their term, and all or some of the work to be performed under the contracts may remain unfunded unless and until Congress makes subsequent appropriations and the procuring agency allocates funding to the contract. As described above, most of our existing contracts are subject to modification and termination at the Federal government s discretion. Moreover, there is no assurance that any contract included in our estimated contract value that generates revenue will be profitable. Nevertheless, we look at these contract values, including values based on the assumed exercise of options relating to these contracts, in estimating the amount of our backlog. Because we may not receive the full amount we expect under a contract, our backlog may not accurately estimate our revenue.

If we are unable to obtain and maintain security clearances for our employees, then we will not be able to satisfy existing contracts or obtain new contracts.

Many of our Federal government contracts require our employees to maintain various levels of security clearances, and we are required to maintain certain facility security clearances complying with Federal government requirements. Obtaining and maintaining security clearances for employees involve a lengthy process, and it is difficult to identify, recruit and retain employees who already hold security clearances. If our employees are unable to obtain or retain security clearances or if our employees who hold security clearances terminate employment with us, then the customer whose work requires cleared employees could terminate the contract or decide not to renew it upon its expiration. In addition, we expect that many of the contracts on which we will bid will require us to demonstrate our ability to obtain facility security clearances and perform work with employees who hold specified types of security clearances. To the extent we are not able to obtain facility security clearances or engage employees with the required security clearances for a particular contract, we may not be able to satisfy our existing contracts, bid on or win new contracts or effectively re-compete on expiring contracts or follow-on task orders. To the extent we are unable to do any of the foregoing, our existing contracts may be terminated, we will not be able to grow our business and our revenues may decline.

Risks Relating to Our Securities

Management beneficially owns a significant percentage of the common stock and has the ability to influence all matters requiring the approval of our board of directors and our shareholders.

Management owns shares of the common stock which represent approximately 24% of the combined voting power of our outstanding capital stock. Management has the power to influence the election of our directors and all decisions made by our shareholders and, in general, to influence the outcome of any corporate transaction or other matter submitted to the shareholders for approval, including mergers, consolidations and the sale of all or substantially all of our assets. The interests of management may conflict with the interests of our other shareholders.

Provisions of our articles of incorporation and Georgia law may have anti-takeover effects that could prevent a change in control which the shareholders consider favorable and could negatively affect your investment.

Provisions in our articles of incorporation and our bylaws could delay or prevent a change of control of the Company or a change in our management that would provide shareholders with a premium to the market price of their common stock. Our articles of incorporation currently authorize the issuance of 10,000,000 shares of our preferred stock. Our board of directors has the power to issue any or all of these additional shares without shareholder approval, and such shares can be issued with such rights, preferences and limitations as may be determined by our board of directors. The rights of the holders of common stock will be subject to, and may be adversely affected by, the rights of any holders of preferred stock that may be issued in the future. We presently have no commitments or contracts to issue any shares of preferred stock. Authorized and unissued preferred stock could delay, discourage, hinder or preclude an unsolicited acquisition of the Company, could make it less likely that shareholders receive a premium for their shares as a result of any such attempt and could adversely affect the market price of, and the voting and other rights, of the holders of outstanding shares of common stock. Currently, we have outstanding 100 shares of our Series C Redeemable Preferred Stock. Our articles of incorporation and bylaws also contain provisions that:

- create a classified board of directors that prevents a majority of the board from being elected at one time;
- prohibit cumulative voting in the election of directors, which would otherwise allow less than a majority of shareholders to elect director candidates;
- limit the ability of shareholders to call special meetings of shareholders; and
- establish advance notice requirements for nominations for election to the board of directors or for proposing matters that can be acted upon by shareholders at shareholder meetings.

We may experience significant volatility in the price of the common stock even if our business is doing well, which could cause you to lose all or part of your investment.

The stock markets have experienced extreme price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many companies. These fluctuations often have been unrelated or disproportionate to the operating performance of those companies. The market price of the common stock may also fluctuate as a result of variations in our operating results. Due to the nature of our business, the market price of the common stock may fall in response to a number of factors, some of which are beyond our control, including:

- announcements of competitive developments by us or others;
- changes in estimates of our financial performance or changes in recommendations by securities analysts;
- any loss by us of a major customer;
- additions or departures of key management or other personnel;
- our failure to meet financial analysts   performance expectations or
- guidance we provide;
- future sales of the common stock or preferred stock;
- volume fluctuations;
- acquisitions or strategic alliances by us or our competitors;

- our historical and anticipated operating results;
- quarterly fluctuations in our financial and operating results;
- changes in market valuations of other companies that operate in our
- business markets or in our industry; and
- general market and economic conditions.

Accordingly, market fluctuations, as well as general economic, political and market conditions such as recessions and interest rate changes, may negatively impact the market price of the common stock, and you may not be able to sell your shares without incurring a loss.

We do not intend to pay dividends on the common stock, and you may not experience a return on investment without selling your securities.

We have never declared or paid, nor do we intend in the foreseeable future to declare or pay, any cash dividends on the common stock. Because we intend to retain all future earnings to finance the operation and growth of our business, you will likely need to sell your shares in order to realize a return on your investment, if any. Further, our Credit Agreement restricts our ability to pay dividends on our capital stock. We are obligated to pay dividends on our outstanding shares of Series C Redeemable Preferred Stock equal to 5% of the redemption value per annum (or $300,000 per year on 100 shares of Series C Redeemable Preferred Stock).

FORWARD-LOOKING STATEMENTS

We have made forward-looking statements in this prospectus, included under Prospectus Summary, Risk Factors, Management s Discussion and Analysis of Financial Condition and Results of Operations and Business, that are based on our management s beliefs and assumptions and on information currently available to management. Forward-looking statements include the information concerning our possible or assumed future results of operations, business strategies, financing plans, competitive position, potential growth opportunities, the effects of future regulation and the effects of competition.

Forward-looking statements include all statements that are not historical facts. Words such as believes, expects, anticipates, intends, seeks, could, will, predicts, potential, continue, may, plans, estimates and similar expressions, or the negative of these and similar expressi intended to identify such forward-looking statements. Examples of forward-looking statements in this prospectus include statements regarding:

- our substantial debt and our ability to make scheduled debt service payments;
- our dependance on our factoring facility;
- the restrictions imposed on us by our Credit Agreement;
- the impact of terrorist activity or breach of security on our business;
- our ability to retain and manage our guards;
- our plans for expansion and growth of our business;
- our ability to compete effectively in our industry;
- our expectations regarding the likelihood of introduction of new regulations that would adversely affect our business;
- our estimates of our capital requirements and needs for additional financing;
- risks related to Federal government contracts, Federal government audits and cost adjustments;
- differences between authorized amounts and amounts received by us under Federal government contracts;
- changes in Federal government (or other applicable) procurement laws, regulations, policies and budgets; and
- the other factors that we describe in this prospectus under Risk Factors.

Forward-looking statements involve risks, uncertainties and assumptions. Actual results may differ materially from those expressed in these forward-looking statements. You should not put undue reliance on any forward-looking statements. You should understand that many important factors, in addition to those discussed in Risk Factors and elsewhere in this prospectus, could cause our results to differ materially from those expressed in forward-looking statements. These factors include our competitive environment, economic and other conditions in the markets in which we operate and governmental regulations.

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

RECENT DEVELOPMENTS

Private Placement

In the Private Placement, we issued Notes with an aggregate principal amount of $8,015,000 and Investor Warrants for a total purchase price of $8,015,000. In connection with the Private Placement, we also issued the Broker Warrants to the placement agent and such agent s employees. The Notes are convertible into, and the Investor Warrants and Broker Warrants are exercisable for, 1,669,826 shares, 834,890 shares, and 250,468 shares of common stock, respectively, subject to certain conversion and exercise restrictions and anti-dilution adjustments. The Private Placement was completed in four closings, occurring on September 2, 2005, September 30, 2005, October 12, 2005 and October 14, 2005. The principal amount of the Notes and the number of shares of common stock issuable upon conversion of the Notes and exercise of the Investor Warrants issued in each closing of the Private Placement are set forth in the table below. We issued the Broker Warrants on December 21, 2005.

Private Placement Closing	Principal Amount of Notes	Number of Shares of Common Stock Issuable Upon Conversion of Notes*	Number of Shares of Common Stock Issuable upon Exercise of Investor Warrants*
September 2, 2005	$ 1,015,000	211,465	105,728
September 30, 2005	$ 1,100,000	229,176	114,581
October 12, 2005	$ 4,325,000	901,059	450,519
October 14, 2005	$ 1,575,000	328,126	164,062
Total	$ 8,015,000	1,669,826	834,890

* Does not include an indeterminate number of additional shares of common stock that may become issuable upon conversion of the Notes and exercise of the Investor Warrants due to anti-dilution adjustments.

Interest on the principal amount of the Notes accrues at a rate of 10% per annum. All accrued interest is payable monthly on the last business day of each month. The outstanding principal amount of the Notes and all unpaid, accrued interest thereon is payable on the third anniversary of the date of issuance of the Notes. We may prepay all or any part of the outstanding principal under any Note at any time after the first anniversary of the issue date of the Note upon 30-days prior notice to the holder of the Note, provided that the resale of the shares of common stock issuable upon conversion of the Note has been registered with the SEC pursuant to the Securities Act of 1933.

The outstanding principal amount of any Note may be converted at the option of the holder at any time after we obtain shareholder approval of the issuance of common stock in connection with the Private Placement for purposes of complying with the rules governing the Nasdaq and prior to the maturity of the Note into shares of common stock at an initial conversion price of $4.80 per share. Notwithstanding the foregoing, a holder of a Note may not convert the Note if such conversion would cause the holder to beneficially own more than (i) 4.99% of the outstanding common stock (for holders of Notes issued in the first closing of the Private Placement) or (ii) 9.99% of the outstanding common stock (for holders of Notes issued in the second, third or fourth closings of the Private Placement). The initial conversion price of the Notes is subject to proportional adjustment for stock splits, stock dividends, recapitalizations, reclassifications and similar corporate events but not for any other dilutive issuances of equity securities we may make.

The Investor Warrants and Broker Warrants are exercisable at the option of the holder at any time after we obtain shareholder approval of the issuance of common stock in connection with the Private Placement for purposes of complying with the rules governing the Nasdaq and prior to the third anniversary of the issuance of such warrants into shares of common stock at an exercise price of $4.80 per share. Notwithstanding the foregoing, a holder of an Investor Warrant or a Broker Warrant may not exercise such warrant if such exercise would cause the holder to beneficially own more than (i) 4.99% of the outstanding common stock (for holders of Investor Warrants issued in the first closing of the Private Placement) or (ii) 9.99% of the outstanding common stock (for holders of Investor Warrants issued in the second, third or fourth closings of the Private Placement and holders of Broker Warrants). The initial exercise price of the Investor Warrants and Broker Warrants and the number of shares issuable upon exercise of the Investor Warrants and Broker Warrants is subject to proportional adjustment for stock splits, stock dividends, recapitalizations, reclassifications and similar corporate events but not for any other dilutive issuances of equity securities we may make.

In accordance with the Notes, Investor Warrants and Broker Warrants, we filed with the SEC a preliminary proxy statement pursuant to the Securities Exchange Act of 1934, as amended (the Exchange Act), in connection with a Special Meeting of Shareholders of Tri-S to be held on February 28, 2006, at which our shareholders shall consider and vote upon, among other things, a proposal to approve the issuance of common stock upon conversion of the Notes and exercise of the Investor Warrants and Broker Warrants for purposes of complying with the rules governing the Nasdaq. Ronald G. Farrell, our Chairman of the Board and Chief Executive Officer, has agreed to vote all shares of common stock beneficially owned by him in favor of such proposal. As of the record date for the Special Meeting of Shareholders, Mr. Farrell beneficially owned approximately 24% of the outstanding common stock.

Under the terms of the Registration Rights Agreements we entered into in connection with the Private Placement (collectively, the Registration Rights Agreement), we have filed with the SEC a registration statement of which this prospectus is a part to register pursuant to the Securities Act, the resale of the shares of common stock issuable upon conversion of the Notes and exercise of the Investor Warrants and Broker Warrants, among other shares. We agreed to use our best efforts to cause the registration statement to become effective as soon as practicable following the filing thereof. We has also agreed to make such filings as necessary to keep the registration statement effective until the earlier of such time as (i) all of the securities which we are required to register pursuant to the Registration Rights Agreement have been sold either pursuant to the registration statement or Rule 144 of the Securities Act; (ii) the date on which all such securities remaining to be sold under the registration statement may be immediately sold to the public under Rule 144(k) or any successor provision; and (iii) the date which is 120 days after the date the registration statement becomes effective.

The foregoing description summarizes the material terms of the Private Placement. You are urged to carefully read the forms of Notes, Investor Warrants and Broker Warrants we issued, and the forms of Registration Rights Agreements we entered into, in connection with the Private Placement, each of which is incorporated by reference as exhibits to the registration statement of which this prospectus is a part.

Entry into Credit Agreement

On October 18, 2005, we entered into the Credit Agreement with our Lenders, pursuant to which we borrowed $1,650,000 under a term loan with a maturity date of October 1, 2007 and $3,500,000 under a term loan with a maturity date of October 1, 2009. We are obligated to pay to the Lenders the principal amount of (i) the $1,650,000 term loan in equal quarterly payments on the first day of each calendar quarter commencing on January 1, 2006; and (ii) the $3,500,000 term loan in equal installments of (a) $98,612 on each of October 1, 2006, November 1, 2006 and December 1, 2006 and (b) $295,836 on the first day of each calendar quarter commencing on April 1, 2007. Interest shall accrue under the term loans at the variable rate of interest published by the Wall Street Journal as its prime rate plus 4.0%, and we shall pay the Lenders all interest accrued under the term loans on the first day of each month. All remaining unpaid principal under the term loans and accrued interest thereon is payable no later than the respective maturity dates thereof.

In connection with the Credit Agreement, we entered into a Factoring and Security Agreement, which provides for our factoring facility, pursuant to which the Lenders will purchase from us from time to time certain accounts receivable at a discount of 0.7% and provide us with a professional accounts receivable management service for a funds usage fee of the prime rate plus 1.0% on the funds advanced on the outstanding accounts receivable purchased. The factoring facility has a $12,000,000 initial purchase limit and a four-year term which will automatically renew unless we provide notice of our intent to terminate. The factoring facility amends and restates the prior factoring arrangement between the Lenders and Paragon Systems, which was entered into in connection with the Paragon Acquisition.

In connection with the Credit Agreement, we also entered into with the Lenders: (i) a Guaranty Agreement, pursuant to which we unconditionally and irrevocably guarantee to the Lenders the prompt payment and performance of all of our obligations, indebtedness and liabilities to the Lenders, whether currently existing or subsequently arising; and (ii) a Security Agreement, pursuant to which we granted to the Lenders a security interest in substantially all of our assets to secure all of such obligations, indebtedness and liabilities. Additionally, we entered into a Pledge Agreement pursuant to which we have pledged to the Lenders all the capital stock of Paragon Systems to secure all of our obligations under the Credit Agreement and related documents. Pursuant to the Credit Agreement, we must pledge to the Lenders our interest in Army Fleet Support upon notice from the Lenders.

In December 2005, we amended the Credit Agreement and the Pledge Agreement to modify certain affirmative covenants thereof and to permit us to incur debt to repay the term loans under the Credit Agreement.

Pursuant to the Credit Agreement, we must pay to the Lenders a fee of $250,000 no later than April 18, 2006. We may satisfy our obligation to pay the fee to the Lenders by delivering to the Lenders the Lender Warrants, provided that our shareholders have approved the Lender Warrants. If issued and delivered, the Lender Warrants will be exercisable for 175,000 shares of common stock for a three-year period from their date of issuance at an initial exercise price of $4.80 per share. Notwithstanding the foregoing, the Lenders may not exercise the Lender Warrants if such exercise would cause the Lenders to beneficially own more than 9.99% of the outstanding common stock.

The initial exercise price and the number of shares of common stock issuable upon exercise of the Lender Warrants are subject to adjustment for stock splits, stock dividends, recapitalizations, reclassifications, similar corporate events and dilutive issuances made by us of common stock or options or other rights to subscribe for common stock or securities convertible into or exchangeable for common stock.

The shares issuable upon exercise of the Lender Warrants shall have the same registration rights as the shares of common stock issuable in connection with the Private Placement under the Registration Rights Agreement. This prospectus forms a part of the registration statement we have filed with the SEC to register the shares of common stock issuable upon exercise of the Lender Warrants, among other shares.

The preliminary proxy statement we filed with the SEC pursuant to the Exchange Act in connection with a Special Meeting of Shareholders to be held on February 28, 2006 also includes a proposal for our shareholders to approve the issuance of the Lender Warrants and the issuance of common stock upon exercise of the Lender Warrants by the Lenders for purposes of complying with the Credit Agreement and the rules governing the Nasdaq.

Acquisition of Cornwall

On October 18, 2005, we acquired all of the outstanding capital stock of Cornwall from the shareholders thereof, for an aggregate purchase price of $13,500,000, pursuant to that certain Stock Purchase Agreement between us and such shareholders dated as of August 30, 2005, as amended by that certain Amendment No. 1 to Stock Purchase Agreement dated as of October 18, 2005 (as so amended, the Cornwall Purchase Agreement). At closing of the Cornwall Acquisition, we (i) paid $12,825,000 in cash; (ii) delivered to the representative of the Cornwall shareholders a promissory note in the amount of $250,000 (the Cornwall Acquisition Note); and (iii) deposited with an escrow agent $425,000 to secure the indemnification obligations of the Cornwall shareholders under the Cornwall Purchase Agreement.

The principal amount under the Cornwall Acquisition Note accrues interest at a rate of 5% per annum with all principal and interest accrued thereon payable no later than the 18-month anniversary after the closing of the Cornwall Acquisition; provided that, if prior to the maturity of the Cornwall Acquisition Note, we collect any amounts owed to us with respect to certain specified accounts receivable, then we shall cause such amounts to be paid as prepayment under the Cornwall Acquisition Note no later than five business days after the collection thereof. All amounts paid by us under the Cornwall Acquisition Note shall be paid to the escrow agent for the Cornwall Acquisition and be held, along with the $425,000 deposited by us to the escrow agent at the closing of the Cornwall Acquisition, as a reserve for indemnification claims made by us against the shareholders pursuant to that certain Escrow Agreement dated as of October 18, 2005, among us, the shareholder representative and the Escrow Agent. Notwithstanding anything in the Cornwall Acquisition Note to the contrary, we have the right, at our election and upon written notice to the shareholder representative, to set-off against and deduct from the amount owed by us under the Cornwall Acquisition Note any amounts owed to us with respect to losses incurred by us for which the shareholders have agreed to indemnify us pursuant to the Cornwall Purchase Agreement.

We financed the purchase price for the Cornwall Acquisition, net of certain working capital adjustments, by: (i) using approximately $5,000,000 from the proceeds of the term loans; (ii) using approximately $400,000 from the proceeds of the factoring facility; (iii) delivering the Cornwall Acquisition Note; and (iv) using approximately $6,600,000 from the proceeds of the Private Placement.

USE OF PROCEEDS

We will not receive any of the proceeds of any sale by any Selling Shareholder of any shares of common stock offered by this prospectus.

BUSINESS

Overview

Tri-S Security is an aggregator of elite guard services companies. Through our two direct, wholly-owned subsidiaries, Paragon Systems and Cornwall, we provide equipment and security services to various government agencies and the private sector. Our government customers include local, state and Federal government agencies. Our private sector customers include commercial customers, such as universities, public school systems, corporate complexes and hospitals, and residential customers, such as condominiums, high-end apartments and high-security homes.

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

In addition to our core business of providing equipment and security services, we have a non-core business interest relating to logistics services. Through Paragon Systems, we own a 10% equity interest in Army Fleet Support, which provides logistics support for U.S. Army aviation training at Fort Rucker, Alabama.

We were incorporated in Georgia in October 2001 under the name Diversified Security Corporation and changed our name to Tri-S Security Corporation in August 2004. We were formed for the purpose of acquiring and consolidating electronic and physical security companies in order to take advantage of the operating efficiencies created by a larger company. Our acquisition strategy involves the acquisition and integration of complementary businesses in order to increase our scale within certain geographic areas, capture market share in the markets in which we operate and improve our profitability. We intend to pursue acquisition opportunities in the contract guard services and system integration services segments of the security industry. We frequently evaluate acquisition opportunities and, at any given time, may be in various stages of due diligence or preliminary discussions with respect to a number of potential acquisitions. From time to time, we may enter into non-binding letters of intent, but we are not currently subject to any definitive agreement with respect to any acquisition material to our operations or otherwise so far advanced in any discussions as to make an acquisition material to our operations reasonably certain.

We made our first acquisition on February 27, 2004, when we acquired all of the outstanding capital stock of Paragon Systems, a contract guard services and logistics provider for a purchase price of $16,000,000. At the closing of the Paragon Acquisition, we: (i) paid $10 million, of which $2.3 million was paid in cash and $7.7 million was paid through issuance of promissory notes to the former shareholders of Paragon Systems; and (ii) issued to the former shareholders an aggregate of 100 shares of our Series C Redeemable Preferred Stock, with an aggregate redemption value of $6.0 million. We must redeem the Series C Redeemable Preferred Stock no later than February 27, 2007. Our payment obligations under the Series C Redeemable Preferred Stock are secured by a pledge of 40% of the outstanding capital stock of Paragon Systems.

On February 8, 2005, pursuant to the Exchange and Recapitalization Agreement, we effected an exchange and recapitalization of our outstanding common stock, Series A Convertible Preferred Stock and Series B Convertible Preferred Stock and rights to acquire our common stock. Pursuant to the Exchange and Recapitalization Agreement, all of our outstanding (i) common stock, Series A Convertible Preferred Stock and Series B Convertible Preferred Stock was exchanged for an aggregate of 1,200,000 shares of common stock and (ii) rights to acquire our common stock were exchanged for rights to purchase an aggregate of 113,269 shares of common stock.

On February 9, 2005, we commenced our Initial Public Offering of 1,800,000 units (plus up to additional 270,000 units upon the exercise of the underwriters over-allotment option), with each unit consisting of one share of common stock and a publicly-traded warrant to purchase one share of common stock, at an initial offering price per unit of $6.00. In connection with the Initial Public Offering, our units commenced trading on The Nasdaq SmallCap Stock Market under the symbol TRISU on February 9, 2005. The Initial Public Offering closed with respect to the initial 1,800,000 units on February 14, 2005 and with respect to the additional 270,000 units on March 17, 2005. Our units separated and ceased trading as units on April 9, 2005, and the common stock and publicly-traded warrants commenced trading on The Nasdaq SmallCap Market on April 11, 2005, under the symbols TRIS and TRISW, respectively.

On October 18, 2005, we made our second acquisition. We acquired Cornwall, a provider of security and investigative services, including armed and unarmed uniform guards, video and alarm monitoring, alarm installation, and GPS monitoring, to government and private sector customers in the Miami, Florida area. Cornwall has nine wholly-owned subsidiaries: International Monitoring, Inc.; Protection Technologies Corporation; Vanguard Security, Inc.; Armor Security, Inc.; Forestville Corporation; Vanguard of Broward County, Inc.; On Guard Security and Investigations, Inc., Guardsource Corp. and Virtual Guard Service, Inc. At the closing of the Cornwall Acquisition, we paid a total purchase price of $13,500,000 payable as follows: (i) payment of $12,825,000 in cash; (ii) delivery of the Cornwall Acquisition Note in principal amount of $250,000; and (iii) deposit of $425,000 with an escrow agent to secure the indemnification obligations of the Cornwall shareholders under the Purchase Agreement. After adjusting for certain working capital items, the net purchase price was $12,753,000. In addition, we repaid $1,915,000 of the outstanding balance on Cornwall s line of credit.

Our principal executive offices are located at Royal Centre One, 11675 Great Oaks Way, Suite 120, Alpharetta, Georgia 30022. Our telephone number at that address is (678) 808-1540.

Our Contract Guard Services Operations

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

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

Paragon Systems

Paragon Systems was incorporated in 1987 in Alabama and has provided contract guard services to Federal government agencies since 1994. Initially, Paragon Systems was established as an engineering company to service contracts with the Federal government agencies and with the U.S. Army Missile Command in both space and defense related areas of business. Paragon Systems has participated in high level engineering projects for the U.S. Army, the National Aeronautics and Space Administration (NASA), other government agencies and local industry.

While serving as an engineering company, Paragon Systems contracted with Lockheed Martin to furnish assistance in Federal contract administration on a sub-contract for construction at the NASA missile plant located in Iuka, Mississippi. Paragon Systems also provided engineering and technical support for contract cost management to NASA s Orbital Maneuvering Vehicle program, which developed an orbital vehicle that would be carried aloft by the space shuttle and maintained in orbit to perform specific tasks for the International Space Station. Paragon Systems also performed a number of high level engineering projects for Control Dynamics Corporation, including conducting preliminary design tasks for development of a heavy launch lift vehicle, which was at that time planned to be a robotic successor for the space shuttle.

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

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

Through Paragon Systems, we employ over 750 persons in the course of providing contract guard services and maintain field offices located in Birmingham, Alabama; Mobile, Alabama; Montgomery, Alabama; Louisville, Kentucky; Baltimore, Maryland; Glynco, Georgia; the Stennis Space Center in Vicksburg, Mississippi; and Gulfport, Mississippi. Paragon Systems moved its Huntsville, Alabama offices to Chantilly, Virginia in December 2005. A full staff supports the majority of field operations in the Chantilly, Virginia office, including human resources, accounting, payroll, quality control, logistics, computer services, training, and other supporting functions as needed. Accounts payable support is now managed in Tri-S s headquarters in Alpharetta, Georgia.

The following table sets forth the number of our Federal government contracts serviced by Paragon Systems during the time periods and within the revenue ranges indicated:

Annual Revenues	**Year Ended September 30, 2005**	**Year Ended December 31, 2004**	**Year Ended December 31, 2003**
Less than $1.0 Million per Contract	1	5	5
$1.0 to $2.0 Million per Contract	2	3	6
$2.0 to $3.0	0	0	0
Greater than $3.0 Million per Contract	6	5	4

Cornwall

The Cornwall Acquisition diversified our customer base and allowed us to enter the private sector of contract guard services, including commercial and residential outlets.

Cornwall offers comprehensive, state-of-the-art customized electronic and manned security systems for commercial, residential and government outlets. Cornwall provides armed and unarmed uniformed

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security services as well as video, alarm monitoring and investigative services to a variety of customers. In addition, Cornwall provides security system integration products (security systems which combine the features of security products) to its customers. Cornwall s communication systems leverage specialized software in order to improve overall security system performance. In response to client needs, Cornwall can combine these integrated security systems with trained professional security guards in order to provide a higher level of security.

Cornwall was incorporated in 1980 and today employs over 1,500 employees in five offices throughout the Miami/Dade, Broward and Palm Beach counties of Florida. Each of Cornwall s security professionals undergo extensive training, and many have prior military or government training.

Our Logistics Contracts

In 2000, Paragon Systems entered into a contract to provide logistics services by developing and executing plans for improved logistics systems in support of U.S. Army facilities located at Fort Bliss, Texas and Fort Sill, Oklahoma. Pursuant to this contract, Paragon Systems provides expertise in support of the U.S. Army s Velocity Management initiatives, known as the Logistics Centers of Excellence (LCOE) programs, by developing and executing plans for improved logistics systems in terms of readiness and cost reduction. Paragon Systems designs and operates LCOEs at Fort Bliss, Texas and Fort Sill, Oklahoma to support the Army s Material Command weapon programs. Paragon Systems provides the essential and critical interfaces and lines of technical communications between the various U.S. Army Aviation and Missile Command Project Offices, the end user and the weapons prime contractors.

Our Equity Interest in Army Fleet Support, LLC

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

L-3 Communications Integrated Systems owns the majority equity interest in Army Fleet Support. L-3 Communications Integrated Systems provides comprehensive logistics support and services, including extensive rotary-wing aircraft systems integration, modification and maintenance. Additionally, through its recent acquisition of Vertex Aerospace LLC, they have the capabilities for aviation and aerospace technical services, managing and servicing rotary-wing aircraft, as well as other equipment, primarily for government customers.

In December 2003, Paragon Systems made an initial capital contribution to Army Fleet Support of $715,000. Since such time through September 30, 2005, Paragon Systems has received approximately $3.2 million in cash distributions with respect to its equity interest in Army Fleet Support.

Sales and Marketing

Our sales and marketing approach is designed to develop business with respect to government and private sector customers. Sales promotions are managed through the offices of our subsidiaries, Paragon Systems and Cornwall, located in the Washington DC area and Miami/Palm Beach area, respectively. Our company-wide marketing strategy is developed and implemented at Tri-S s headquarters in Alpharetta, Georgia, where we have a dedicated marketing employee whose responsibilities include developing our market presence within the investment and security industries. This individual also develops an overall marketing plan designed to achieve higher name recognition and, accordingly, increased contract bid invitations and opportunities. Our key marketing vehicles are our website, trade and industry media publications, email marketing, Federal government bulletin board sites on the Internet, word of mouth, customer referrals and potentially direct marketing.

Employees

As of December 31, 2005, we employed approximately 2,500 individuals, consisting of security guards, managerial and administrative employees. Our business is labor intensive and, as a result, is affected by the availability of qualified personnel and the cost of labor. Although the contract guard services industry is characterized by high turnover, we believe our experience compares favorably with that of the industry. We have not experienced any material difficulty in employing suitable numbers of qualified security guards, although when labor has been in short supply, we have been required to pay higher wages and incur overtime charges.

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

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

Unionized employees account for approximately 14% of our employees and work under collective bargaining agreements with the United Union of Security Guards and the Security Police and Fire Professionals of America. These collective bargaining agreements do not permit work stoppages, and we have experienced no work stoppages attributable to labor disputes. Our relations with our employees have generally been satisfactory. Guards and other personnel supplied by us to its customers are our employees, even though they may be stationed regularly at the customer s premises.

Insurance

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

Customers

Since the Cornwall Acquisition, we have provided our contract guard services to almost 20 customers in ten states. We provide contract guard services for the following Federal government agencies: (i) the Department of Homeland Security; (ii) the Social Security Administration; (iii) the Army Corps of Engineers; (iv) the U.S. Coast Guard; (v) the Federal Law Enforcement Training Center; (vi) the NASA John C. Stennis Space Center; and (vii) the U.S. Food and Drug Administration. We also provide contract guard services to the following state and local government agencies and private sector organizations: (i) Miami/Dade local government (municipal government); (ii) Florida Department of Transportation; (iii) Citicorp of North America; (iv) Miami/Dade County Public Schools; (v) The University of Miami; (vi) Miami Free Zone; (vii) Eagle Logistics; (viii) Citibank; (ix) JobForce; and (x) DHL Danzas.

Our typical customer contract may provide for an hourly or monthly billing rate used for all security guards at a site or variable hourly billing rates for different guards. Our contracts are usually multi-year contracts with renewal options. For the nine months ended September 30, 2005, five contracts represented more than 44% of our revenues. For the nine months ended September 30, 2005, our contracts with (i) the Social Security Administration (Baltimore) accounted for approximately 15% of our revenue for such period; (ii) Miami/Dade County accounted for approximately 13% of our revenue for such period; (iii) GSA (Alabama) accounted for approximately 6% of our revenue for such period; (iv) GSA (Kentucky) accounted for approximately 6%; and (v) the NASA John C. Stennis Space Center accounted for approximately 5% of our revenue for such period.

Competition in Contract Guard Services

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

In the bidding process for our Federal government contracts, there are typically five to ten other bidders. In the bidding process for our private sector contracts, there are typically five to seven other bidders. In each bidding process, we compete primarily on price, the quality of our service and our history of providing contract guard services in the Southeast for over a decade.

Our largest competitors in the contract guard services market include contract security service providers such as Coastal International Security and Wackenhut/Alletug. These competitors are much larger than we are and have significantly greater resources with which to target our markets, including name recognition. The guard industry also contains a large number of smaller regional and local security service providers in the United States in addition to those listed above which also directly compete with us, including Alpha Protective Services, Inter-Con Security, Knight Protective Services, Inc., Capital Consulting Group, MVM, Akal Security and Security Consultants Group.

We believe that we have highly skilled accounting and cost management personnel and an excellent reputation for providing services to our customers on time and within budget. These competitive advantages contribute to our ability to obtain contracts through the competitive bidding process and negotiated contracting. Another competitive advantage is our capability to leverage our field offices in conjunction with our two management offices and one corporate headquarters to maximize efficiency throughout our operations.

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

Government Regulation

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

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

The Security Industry

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

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

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

Contract Guard Service

The contract guard services segment of the security industry includes security and patrol services, as well as various types of investigation services, including background, undercover, insurance claims and financial fraud. Contract guard services are provided under contracts in which the guard company agrees to recruit, hire, train, supervise, schedule and pay security guards deployed to certain specified sites, as well as to provide firearms, uniforms and equipment. Typical functions for security guards include patrolling the premises, checking identification for access control, staffing a security control center, monitoring activities on CCTV and responding to emergency requests for assistance. Contract guard services are customarily charged to the customer at an hourly or monthly rate (which can be fixed or variable). A contract guard company s profit is based on the spread of the hourly or monthly rate over the cost of the guard.

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

Security System Integration

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

As a result of the Cornwall Acquisition, we acquired capabilities, operations and contracts in the system integration segment of the security industry. Cornwall services system integration contracts in the Miami, Florida, area providing monitoring systems. We believe that offering system integration services will increasingly complement, and create synergies with, the contract guard services we currently offer. In the course of providing contract guard services under our current and past contracts, for example, our security guards monitor and operate integrated systems sold and installed by providers of integrated systems. Now with our capabilities through Cornwall, we are able to sell and install integrated systems to our clients, in addition to monitoring and operating such systems, we are able to grow our business organically through complementary products and services. We also believe that offering system integration products and services will increase our profitability because contracts for system integration products and services generally have higher profit margins than contracts for guard services and the system integration segment is anticipated to grow more rapidly than the contract guard segment.

Our Strategy

Operations

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

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

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

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

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

- developing our consolidated operating infrastructure for all acquired companies accounts payable to leverage larger company efficiencies.

Federal Government Contracts

Typically, a service provider is awarded a multi-year contract through a Federal government facility with renewal options each year of the contract in order to comport with Congressional funding as well as performance reviews. With our standard Federal government contracts, we are awarded a multi-year contract, then an extension for each of the subsequent years of the contract and the opportunity to bid for the overall contract renewal.

A significant number of our current contracts for contract guard services were awarded by the Federal government through a competitive bid process. We intend to grow our business by obtaining new Federal government contracts through the competitive bidding process and by providing additional services under our current Federal government contracts.

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

We have hired full-time employees to provide business development and marketing services for us. These job responsibilities focus on identifying new contract opportunities with Federal government agencies and preparing and submitting bids for such contracts.

We intend to bid on Federal government contracts for contract guard services valued between an aggregate of $5 million and $100 million over the next five-years. Our ability to bid on larger contracts is constrained because we do not currently have sufficient capital to cover the substantial start-up costs we would incur if awarded a significant number of contracts with higher values.

Private Sector Contracts

Private sector contracts are awarded through a competitive bidding process and through a negotiating process. Unlike the Federal government contracts, the terms of private sector contracts can vary based on individual client situations. Price is not the only key element in winning contracts with this market segment. Other elements such as service quality, responsiveness and various peripheral offerings other than traditional guard services come into consideration. We believe that the private sector represents our largest growth potential.

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

As a result of the Cornwall Acquisition, we obtained a number of contracts for commercial and residential customers. We intend to expand our business in the private sector by bidding and negotiating contracts for guard services for commercial and residential customers.

We have dedicated employees to provide business development and proposal submissions for us. Job responsibilities of these individuals focus on identifying new bidding opportunities, bid proposal development and competitive negotiations.

We intend to bid on private sector contracts for guard services valued between an aggregate of $500,000 to $10 million over the next five years.

Acquisitions

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

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

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

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

PROPERTIES

Our corporate headquarters and principal executive offices are located in Alpharetta, Georgia, and our contract guard services operations are located at the offices of our wholly-owned subsidiaries, Paragon Systems and Cornwall, in Chantilly, Virginia and Miami, Florida, respectively. We lease space at each of the foregoing locations. We are obligated to pay rent on the (i) Alpharetta, Georgia facility of approximately $4,124 per month, with 3% annual increases, through November 2008; (ii) Chantilly, Virginia facility of approximately $5,880 per month, with 3% annual increases, through August 2008; and (iii) the Miami, Florida facility of approximately $7,321 per month, with 3% annual increases, through April 2008.

We believe our leased facilities are adequate to meet our needs and that additional facilities are available to us to meet our expansion needs for the foreseeable future on commercially reasonable terms.

LEGAL PROCEEDINGS

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

On or about October 5, 2005, Robert Luther and Charles Keathley, officers and shareholders of Paragon Systems prior to the Paragon Acquisition, filed a compliant against Paragon Systems in the Circuit Court for Madison County, Alabama claiming breach of contract and seeking recovery of unspecified damages. Messrs. Keathley and Luther allege that Paragon Systems owes to them unpaid compensation for accrued, vested benefits earned pursuant to their employment agreements with Paragon Systems and certain amounts as reimbursement for taxes incurred by them in 2003. We do not expect the outcome of this proceeding to have a materially adverse effect on our financial position or results of operations.

MANAGEMENT

Our executive officers and directors, as of January 25, 2006, are as follows:

Name	Age	Position
Ronald G. Farrell	62	Chairman of the Board, President and Chief Executive Officer
Robert K. Mills	42	Chief Financial Officer
James M. Logsdon	58	Director
Lee K. Toole	69	Director
James A. Verbrugge.	64	Director

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

Ronald G. Farrell serves as our Chief Executive Officer and President and as a director of the Company. He served as our sole director and officer from our formation in October 2001 to the Initial Public Offering. From December 1998 to December 2001, Mr. Farrell served as Chairman of the Board and Chief Executive Officer of Golf Entertainment, Inc. At various times from 1986 through 1998, Mr. Farrell founded and served as Chairman of the Board and Chief Executive Officer of Computer Integration Corporation, Sports Leisure, Inc., Automotive Industries, Inc. and Builders Design, Inc.

Robert K. Mills has served as our Chief Financial Officer since August 2005. From 1999 to 2005, Mr. Mills served as Chief Financial Officer for Knology, Inc., a publicly-traded broadband telecommunications services provider which filed for protection under Chapter 11 of the United States Bankruptcy Code in 2002. From 1994 through 1999, Mr. Mills served as Treasurer of Powertel, Inc., a provider of wireless telecommunications services. From 1987 to 1994, Mr. Mills was an auditor with an international accounting firm. Mr. Mills is a Certified Public Accountant.

James M. Logsdon has served as a member of our board of directors, our audit committee and our compensation committee since the Initial Public Offering. Mr. Logsdon is a consultant with The Logsdon Group, which Mr. Logsdon founded in March 2004. The Logsdon Group provides tactical and strategic consulting services to business organizations. He served as President, Chief Operating Officer and a director of Verso Technologies, Inc., a publicly-held technology company, from January 2000 until March 2004. From January 1998 to January 2000, Mr. Logsdon served as Vice President and General Manager of Branch Operations East for the Network Services division of GTE Corporation, a global telecommunications company. From January 1991 to December 1997, he served as GTE s Vice President, Sales & Marketing Commercial Markets.

Lee K. Toole has served as a member of our board of directors, our audit committee and our compensation committee since the Initial Public Offering. Mr. Toole founded Toole Consulting Company in 1997, which provides consulting services to Lucent Technologies, Inc. and GTE Corporation, among other clients. Mr. Toole retired in 1997 as a senior vice president of GTE Corporation, concluding a 36 year career in the telecommunications industry. During his career, which included 15 years with AT&T, Inc., Mr. Toole served in various executive capacities, including President of GTE China, Senior Vice President Asia Pacific, Vice President Business Development worldwide for wireless networks, and Chairman of the Board of Directors of a joint venture in Argentina which built a nationwide wireless network.

Dr. James A. Verbrugge has served as a member of our board of directors, our audit committee and our compensation committee since the Initial Public Offering. Dr. Verbrugge is Emeritus Professor of Finance in the Terry College of Business at the University of Georgia. From 1976 to 2001, he was the Chairman of the Department of Banking and Finance in the Terry College of Business, where he held the Chair of Banking from 1992 to 2002. He is a member of the board of directors of each of eResource

Capital Group, Inc., Crown Crafts, Inc. and Verso Technologies, Inc. and also serves on the boards of two private companies.

Board of Directors

Our bylaws provide that our board of directors shall consist of between one member and nine members. Our board of directors currently consists of four members, Messrs. Farrell, Toole and Logsdon and Dr. Verbrugge. If we have more than two directors, our articles of incorporation provide for a classified board of directors consisting of three classes of directors, each serving staggered three-year terms. As a result, approximately one-third of our board of directors will be elected each year. Dr. Verbrugge and Messrs. Farrell, Toole and Logsdon serve as directors of the Company as follows: Mr. Logsdon serves as a Class I Director until the 2006 annual meeting of shareholders; Dr. Verbrugge serves as a Class II Director until the 2007 annual meeting of shareholders; and Messrs. Farrell and Toole each serve as Class III Directors until the 2008 annual meeting of shareholders. Messrs. Farrell, Toole and Logsdon and Dr. Verbrugge will serve as directors until the expiration of their applicable terms and until their successors have been elected and qualified or until their earlier death, resignation or removal. This classification of the board of directors may delay or prevent a change in control of the Company. See Description of Securities.

Executive Officers

Our board of directors appoints our executive officers on an annual basis to serve until their successors have been elected and qualified, subject to applicable employment agreements. See Management Director and Executive Compensation Employment Agreements. There are no family relationships among any of our directors or officers.

Board Committees

Compensation Committee. Our compensation consists of Dr. Verbrugge and Messrs. Toole and Logsdon. The responsibilities of the compensation committee include reviewing and recommending to the board of directors the compensation of all of our officers and directors, including stock compensation and loans, establishing and reviewing general policies relating to the compensation and benefits of our employees and administering our 2004 Stock Incentive Plan.

Audit Committee. Our audit committee consists of Dr. Verbrugge and Messrs. Toole and Logsdon. The responsibilities of the audit committee include reviewing our internal accounting procedures and consulting with and reviewing the services provided by our independent auditors.

Director Compensation

We compensate each member of our board of directors for their service on our board of directors at an annual rate of $10,000 per year. We will also compensate each member of our board of directors who serves on a committee of the board at an annual rate of $2,500 for each committee on which such member serves and reimburse our board of directors members for reasonable expenses incurred by them in attending such meetings of the board of directors and any committees of the board of directors of which they are members. Members of our board of directors are also eligible to receive stock options granted pursuant to our 2004 Stock Incentive Plan.

Executive Compensation

The following table sets forth the cash and non-cash compensation for each of the last three fiscal years awarded to or earned by each person who served as our Chief Executive Officer during the year ended December 31, 2005, as well as for our other executive officers whose salary and bonus exceeded $100,000 during the year ended December 31, 2005 (the Named Executive Officers).

Summary Compensation Table

Name and Principal Position	Annual Compensation Year	Salary ($)		Bonus($)	Long-Term Compensation Securities Underlying Options (#)(1)	All Other Compensation($)	
Ronald G. Farrell Chief Executive Officer	2005	301,244	(1)	82,650		56,797	(2)
	2004	273,538	(1)	145,000		45,627	(3)
	2003	248,769	(1)			45,000	(3)
Robert K. Mills Chief Financial Officer	2005	71,178				2,436	
	2004						
	2003						
E. Wayne Stallings Former Chief Financial Officer	2005	66,376		12,915		37,464	(4)
	2004	30,880					
	2003						

(1) Includes $30,693, $19,538 and $17,769 for payments made with respect to accrued but unused vacation for 2005, 2004 and 2003, respectively.

(2) Includes $17,901 for automobile expenses and $22,160 for medical benefits.

(3) Includes $18,000 for automobile expenses and $15,000 for medical and dental benefits.

(4) Includes $30,375 of severance payments and $7,089 of medical benefits payable to Mr. Stallings pursuant to a severance agreement between Mr. Stallings and the Company. See Management Executive Compensation Employment Agreements.

Option Grants in Last Fiscal Year

We did not grant any options to purchase our common stock during the year ended December 31, 2005 to our Named Executive Officers.

Aggregated Option Exercises and Year-End Option Values

The following table sets forth information concerning the value at December 31, 2005, of the unexercised options held by each of the Named Executive Officers. The value of unexercised options reflects the increase in market value of the common stock from the date of grant through December 31, 2005. No Named Executive Officer exercised any options during the year ended December 31, 2005.

	Number of Securities Underlying Unexercised Options at Fiscal Year-End (1)		Value of Unexercised In-The-Money Options at Fiscal Year-End (2)	
Name	Exercisable	Unexercisable	Exercisable	Unexercisable
Ronald G. Farrell	97,087		$ 415,532	

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Employment Agreements

We have entered into an employment agreement with Mr. Farrell pursuant to which Mr. Farrell has agreed to serve as Chief Executive Officer and President of the Company until December 31, 2008. The agreement provides for (i) payment of a specified base salary which increases by 10% per year; (ii) payment of an annual incentive bonus equal to 5% of our operating income for such year (which income includes dividends and distributions made to us with respect to our interest in the joint venture), provided that such bonus may not exceed 100% of Mr. Farrell s base salary for such year; (iii) prohibitions against Mr. Farrell s disclosure of confidential information, solicitation of our employees and participation in a business competitive with our business during his employment and for a period of one year following the termination of his employment; (iv) payment of an acquisition bonus equal to 2% of the value of all acquisitions made by us; and (v) continuation of Mr. Farrell s compensation and benefits for the remainder of the term of his employment agreement if his employment is terminated by the Company without cause or by Mr. Farrell for good reason or upon a change of control of the Company. Pursuant to Mr. Farrell s employment agreement, we also provide certain other benefits and expense reimbursements to Mr. Farrell which are consistent with his position as the chief executive officer of the Company. Mr. Farrell is also entitled to participate in any employee benefit plan, stock option plan and other fringe benefit plan at the discretion of our board of directors. For the year ended December 31, 2005, Mr. Farrell s base salary under his employment agreement was $279,510.

Mr. Mills has agreed to serve as our Chief Financial Office for a term of three years commencing in August 2005 and, in consideration therefor, we have agreed to pay to Mr. Mills: (i) a base salary at a rate of $175,000.00 per year; (ii) an annual retention bonus equal to $25,000.00 per year; and (ii) an annual performance bonus equal to 2% of our earnings before interest, income taxes, depreciation and amortization for such year, provided that the annual performance bonus may not exceed 100% of the base salary for such year. In January 2006, we granted to Mr. Mills pursuant to our 2004 Stock Incentive Plan a qualified stock option to purchase 100,000 shares of common stock at an exercise price of $4.05 per share, which option will vest over a three-year period commencing in August 2006.

On August 12, 2005, we entered into an agreement with E. Wayne Stallings in connection with Mr. Stallings resignation from his position as our Chief Financial Officer on such date (the Resignation Date). Pursuant to the agreement, Mr. Stallings provided to us on a full-time basis through September 30, 2005 such services as we reasonably requested, and we have paid or shall pay to Mr. Stallings: (i) from the Resignation Date through August 1, 2006 (the Continuation Period), his base salary at the rate in effect immediately prior to the Resignation Date, subject to all withholdings required pursuant to applicable law; (ii) on September 30, 2005, a retention incentive payment in the amount of $12,000.00, subject to applicable withholdings; and (iii) during the Continuation Period and in lieu of health insurance benefits, an amount equal to $1,181.00 per month.

Compensation Committee Interlocks and Insider Participation

Our compensation committee consists of Messrs. Toole and Logsdon and Dr. Verbrugge. None of the members of our compensation committee has ever been, at any time since the time of our formation, one of our officers or employees. None of our executive officers currently serves or in the past has served as a member of the board of directors or compensation committee of any entity that has one or more executive officers serving on our board of directors or compensation committee.

CERTAIN TRANSACTIONS

Employment Agreements

A description of the employment agreements between each of the Named Executive Officers and us is set forth in Management Executive Compensation Employment Agreements.

Indebtedness of Management

Pursuant to Mr. Farrell s employment agreement with us, Mr. Farrell, our Chief Executive Officer and President, would have otherwise been entitled to receive during 2004 an aggregate bonus of $435,000; however, in order to improve the financial position of the Company prior to the Initial Public Offering, he agreed to forfeit $290,000 of such bonus and accept a cash bonus of $145,000. At the time Mr. Farrell agreed to such change in his compensation, we had already paid to Mr. Farrell $245,000 with respect to his 2004 bonus. Accordingly, Mr. Farrell has agreed to repay to us $100,000 pursuant to the terms of a promissory note issued by Mr. Farrell to us dated December 31, 2004, which bears interest at a rate of 2.48% per year and is payable on December 31, 2006. The note may be prepaid at any time without penalty and may be paid, at the election of Mr. Farrell, in cash or shares of common stock or any combination thereof.

Exchange and Recapitalization

Pursuant to the Exchange and Recapitalization, R.G.F. Investments, Inc. (of which Mr. Farrell is the sole director, officer and shareholder) and its affiliates exchanged 2,500,000 shares of common stock held by them immediately prior to the recapitalization for 809,061 shares of common stock upon completion of the Exchange and Recapitalization. In connection with the Exchange and Recapitalization, Mr. Farrell also exchanged an option to purchase 300,000 shares of common stock at an exercise price of $0.04 per share for an option to purchase 97,087 shares of common stock at an exercise price of $0.12 per share.

Indemnification Agreements

We have entered into indemnification agreements with our directors pursuant to which we will indemnify them to the fullest extent permitted by applicable law if they are involved or become involved or are threatened to be involved in any investigation, action, claim suit or proceeding, whether civil, criminal, administrative or investigative, by reason of that fact that they were or are serving as an officer or director of the Company or were or are serving at our request as an agent of any other entity.

Private Placement

Robert K. Mills, our Chief Financial Officer, invested $25,000 in the Private Placement and was issued a Note in principal amount of $25,000 and an Investor Warrant to purchase 2,604 shares of common stock.

Michael F. Bennett, who owns more than 5% of the outstanding shares of common stock, invested $100,000 in the Private Placement through Southwick Capital LLC, which is controlled by Mr. Bennett. In the Private Placement, we issued to Southwick Capital LLC a Note in principal amount of $100,000 and an Investor Warrant to purchase 10,416 shares of common stock.

SECURITY OWNERSHIP

The following table sets forth information regarding the beneficial ownership of the common stock as of January 25, 2006 by (i) each person or group of persons known to us to beneficially own more than 5% of the outstanding shares of common stock; (ii) each of our directors; (iii) each of our Named Executive Officers; and (iv) all our executive officers and directors as a group. All beneficial ownership information reported below is based upon publicly available information and certain additional information known to us.

Name of Beneficial Owner	Common Stock(1) Number of Shares Beneficially Owned	Percent of Class (2)
Ronald G. Farrell	906,149 (3)	26.4 %
Michael F. Bennett	194,984 (4)	5.8
James A. Logsdon	0	
Robert K. Mills (5)	0	
L. K. Toole	0	
James A. Verbrugge	0	
E. Wayne Stallings(6)	0	
All directors and executive officers as a group (5 persons)	906,149	26.4

Director of the Company

Officer of the Company

* Less than 1% of the issued and outstanding shares of the common stock.

(1) Unless otherwise noted, all of the shares shown are held by individuals or entities processing sole voting and investment power with respect to such shares. Shares not outstanding but deemed beneficially owned by virtue of the right of a person or member of a group to acquire them within 60 days of January 25, 2006, are treated outstanding only when determining the amount and percentage owned by such individual or group.

(2) In accordance with regulations of the SEC, the percentage calculations are based on 3,338,700 shares of common stock issued and outstanding as of January 25, 2006, plus shares of common stock which may be acquired within 60 days of January 25, 2006 by each individual or group listed.

(3) Includes (i) 711,974 shares of common stock held by R.G.F. Investments, Inc., a corporation in which Mr. Farrell is the sole shareholder, officer and director, over which shares Mr. Farrell may be deemed to have sole investment and voting power; (ii) 97,087 shares of common stock held by Mr. Farrell s spouse, over which shares Mr. Farrell may be deemed to have shared investment and voting power; and (iii) 97,087 shares of common stock issuable upon exercise of an option held by Mr. Farrell.

(4) Includes 36,408 shares of common stock held by Southwick Capital, LLC, a limited liability company controlled by Mr. Bennett, over which shares Mr. Bennett may be deemed to have shared investment and voting power.

(5) Robert K. Mills commenced serving as our Chief Financial Officer in August 2005.

(6) E. Wayne Stallings served as our Chief Financial Officer from October 2004 until August 2005.

SELECTED CONSOLIDATED HISTORICAL FINANCIAL AND OPERATING DATA

We did not have an operating business before the Paragon Acquisition. Consequently, the historical selected financial data set forth in the accompanying summary of historical and selected financial data presents the historical selected financial data of Paragon Systems prior to the Paragon Acquisition and the financial information of Tri-S for periods prior to the Paragon Acquisition and Tri-S consolidated with Paragon Systems for the nine months ended September 30, 2004, the year ended December 31, 2004 and the nine months ended September 30, 2005. The selected historical financial data should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations, and our historical consolidated financial statements included elsewhere in this prospectus.

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

The Predecessor Company was formerly a subchapter S corporation; consequently, pro forma income tax expense, pro forma net income and pro forma income per share are presented on the face of the summary of historical selected financial data for the periods presented as the Predecessor Company. The necessary adjustments include only taxes at a statutory rate of 38% for each period presented. The pro forma income per share calculation of the Predecessor Company operations is based on the weighted average number of common shares outstanding, after giving effect to the Exchange and Recapitalization, which acquired the Predecessor Company in February 2004.

Tri-S was incorporated during the fourth quarter of 2001. For purposes of calculating the weighted average shares outstanding for the pro forma income per share calculation for the year ended December 31, 2001 and prior periods, it is assumed that Tri-S was incorporated on January 1, 1999.

Historical Selected Financial Data

	Predecessor Basis Paragon Systems, Inc. Year Ended December 31, 1999	Year Ended December 31, 2000	Year Ended December 31, 2001	Year Ended December 31, 2002	Nine Months Ended 9/30/03	Year Ended December 31 2003	Jan. 1, 2004 to Feb. 27, 2004
	(In thousands, except per share data)						
Statement of Operations Data:							
Revenues	$ 5,691	$ 7,698	$ 16,491	$ 21,364	$ 21,766	$ 29,395	$ 4,705
Direct labor	2,023	3,076	9,092	11,983	11,872	16,070	2,481
% of revenues	35.55 %	39.96 %	55.13 %	56.09 %	54.54 %	54.67 %	52.73 %
Indirect labor and other contract support costs	2,442	3,417	6,000	7,615	8,137	11,151	2,113
% of revenues	42.91 %	44.39 %	36.38 %	35.64 %	37.38 %	37.94 %	44.91 %
Selling, general and administrative expenses	588	652	896	1,179	977	1,466	230
% of revenues	10.33 %	8.47 %	5.43 %	5.52 %	4.49 %	4.99 %	4.89 %
Amortization of intangible assets							
Operating income (loss)	638	553	503	587	780	708	(119)
% of revenues	11.2 %	7.2 %	3.1 %	2.7 %	3.6 %	2.4 %	-2.5 %
Depreciation and amortization expense	50	62	88	68	46	175	28
Interest income			28	23	8	12	
Interest expense	(8)	(14)	(11)	(7)	(20)	(30)	(11)
Interest on redeemable preferred stock							
Income (loss) before taxes	630	539	520	603	768	690	(130)
Pro forma income tax expense (benefit)	239	205	198	229	292	262	(49)
Pro forma net income (loss)	391	334	322	374	476	428	(81)
Pro forma basic net income (loss) per common share	0.48	0.41	0.40	0.46	0.58	0.52	(0.10)
Pro forma diluted net income (loss) per common share	0.48	0.41	0.40	0.40	0.45	0.39	(0.10)
Balance Sheet Data (at Period End):							
Cash	$ 127	$ 239	$ 647	$ 877	$ 1,206	$ 846	$ 275
Current assets	2,124	3,005	5,003	5,911	6,408	5,713	6,803
Total assets	2,237	3,201	5,147	6,114	6,830	6,883	7,230
Long term obligations						185	175
Total liabilities	782	1,207	2,760	3,124	3,072	3,058	3,720
Cash dividends							

Historical Selected Financial Data

	Successor Basis						
	Tri-S Security Corporation				Tri-S Security Corporation and Subsidiary Consolidated		
	Year Ended December 31, 2001	Year Ended December 31, 2002	Nine Months Ended 9/30/03	Year Ended December 31, 2003	Nine Months Ended September 30, 2004 Consolidated	Year Ended December 31, 2004	Nine Months Ended September 30, 2005
	(In thousands, except per share data)						
Statement of Operations Data:							
Revenues	$	$	$	$	$ 17,728	$ 25,425	$ 23,787
Direct labor					9,506	13,810	12,741
% of revenues			53.62%	54.3%	53.6%	54.3%	53.6%
Indirect labor and other contract support costs					6,792	10,521	9,574
% of revenues			38.31%	40.2%	36.6%	40.2%	40.2%
Selling, general and administrative expenses	100	216	210	347	1,097	1,653	2,551
% of revenues			6.19%	8.3%	10.8%	6.5%	10.7%
Amortization of intangible assets					252	462	206
Operating income (loss)	(100)	(216)	(210)	(347)	81	(1,021)	(1,285)
% of revenues			0.5%			(4.0)%	(5.4)%
Income from investment in Joint Venture						1,637	1,451
Interest income					3	3	35
Interest expense					(1,018)	(1,380)	(543)
Interest on redeemable preferred stock					(175)	(250)	(225)
Income (loss) before taxes	(100)	(216)	(210)	(347)	(1,109)	(1,011)	(567)
Pro forma income tax expense (benefit)	(38)	(82)	(80)	(130)	(424)		
Income tax expense (benefit)						(384)	(215)
Pro forma net income (loss)	(62)	(134)	(130)	(217)	(685)		
Net income (loss)						(627)	(352)
Pro forma basic net income (loss) per common share	(0.08)	(0.16)	(0.16)	(0.26)	(0.83)		
Basic net income (loss) per common share						(0.76)	(0.11)
Pro forma diluted net income (loss) per common share	(0.08)	(0.16)	(0.16)	(0.26)	(0.83)		
Diluted net income (loss) per common share						(0.76)	(0.11)
Balance Sheet Data (at Period End):							
Cash	$	$ 93	$ 239	$ 102	$ 310	$ 313	$ 2,430
Current assets		93	239	102	5,030	6,636	8,750
Total assets		213	244	362	21,007	24,618	27,092
Long term obligations					8,563	10,446	11,632
Total liabilities		2	3	3	21,333	24,886	17,084
Cash dividends						(268)	10,008

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The results of operations set forth below for the quarter ended September 30, 2005, and the years ended December 31, 2004, 2003 and 2002, are based on historical results for the Company. Historical amounts for the nine months ended September 30, 2004 and the period January 1, 2004 to February 27, 2004 for Paragon Systems prior to the Paragon Acquisition are combined for presentation and discussion purposes.

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

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

Overview

We are an aggregator of elite guard services companies. Through our two direct, wholly-owned subsidiaries, Paragon Systems and Cornwall, we provide equipment and security services to various government agencies and the private sector. Our services include uniformed guards, electronic monitoring systems, personnel protection, access control, crowd control and the prevention of sabotage, terrorist and criminal activities. In connection with providing these services, we assume responsibility for a variety of functions, including recruiting, hiring, training, arming and supervising guards deployed to the customers we serve as well as paying all guards and providing them with uniforms, fringe benefits and workers compensation insurance.

Our government customers include local, state and Federal government agencies. Our private sector customers include commercial customers, such as universities, public school systems, corporate complexes and hospitals, and residential customers, such as condominiums, high-end apartments and high-security homes.

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

In addition to our core business of providing equipment and security services, we have a non-core business interest of providing logistics services. Through Paragon Systems, we own a 10% equity interest in Army Fleet Support, which provides logistics support for U.S. Army aviation training at Fort Rucker, Alabama.

We were incorporated in Georgia in October 2001 under the name Diversified Security Corporation and changed our name to Tri-S Security Corporation in August 2004. We were formed for the purpose of acquiring and consolidating electronic and physical security companies in order to take advantage of the operating efficiencies created by a larger company. Our acquisition strategy involves the acquisition and integration of complementary businesses in order to increase our scale within certain geographic areas, capture market shares in the markets in which we operate and improve our profitability. We intend to pursue acquisition opportunities in the contract guard services and system integration services segments of the security industry. We frequently evaluate acquisition opportunities and, at any given time, may be in various stages of due diligence or preliminary discussions with respect to a number of potential acquisitions. From time to time, we may enter into non-binding letters of intent, but we are not currently subject to any definitive agreement with respect to any acquisition material to our operations or otherwise so far advanced in any discussions as to make an acquisition material to our operations reasonably certain.

We made our first acquisition on February 27, 2004, when we acquired all of the outstanding capital stock of Paragon Systems, a contract guard services and logistics provider for a purchase price of $16,000,000. We made our second acquisition on October 18, 2005, when we acquired all of the outstanding capital stock of Cornwall, a provider of security and investigative services, including armed and unarmed uniform guards, video and alarm monitoring, alarm installation, and GPS monitoring, to government and private sector customers in the Miami, Florida area, for a total purchase price of $13,500,000.

Renewing and extending existing contracts and obtaining new contracts are crucial to our ability to generate revenue and manage cash flow. Our Federal government contracts, which generate a significant portion of our revenue, may be terminated at any time by the Federal government, or the Federal government may determine not to renew or extend any of such contracts upon their scheduled expiration. The Cornwall Acquisition has allowed us to diversify our customer base to include commercial customers. We must continue to sell commercial services to commercial customers in order to maintain our revenue system and to grow our business.

Results of Operations for the Three Months Ended September 30, 2005 Compared to Three Months Ended September 30, 2004

Revenue increased $381,000 to $8.1 million, or 5.0%, for the three months ended September 30, 2005 compared to revenue of $7.7 million for the three months ended September 30, 2004. The increase in revenue was due to (i) additional services provided to the Federal Emergency Management Agency (FEMA) in connection with a contract we manage for the Department of Homeland Security, (ii) a new contract that began service in October 2004, and (iii) other additional billings to existing contracts.

Cost of revenue increased $438,000 to $7.7 million, or 6.0%, for the three months ended September 30, 2005, compared to cost of revenue of $7.3 million for the three months ended September 30, 2004. Our cost of revenues increased for the following reasons: (i) additional man hours required to support the additional revenue mentioned above, (ii) training of new employees to support the additional revenue, (iii) two new office locations to support FEMA, and (iv) increase travel due to support the FEMA contract and increase in gasoline prices.

Our gross profit decreased by $57,000 for the three months ended September 30, 2005 to $371,000 compared to gross profit for the three months ended September 30, 2004 of $428,000. Our gross profit declined because our cost of revenues increased more than our revenues as mentioned above.

Selling, general and administrative expenses increased $830,000 to $1,286,000, or 182%, for the three months ended September 30, 2005 compared to $456,000 for the three months ended September 30, 2004. The increase in selling, general, and administrative costs is due to increased office space, public company costs, investor relation costs, and increased marketing and accounting costs. We had approximately $150,000 of expense related to the recruitment and severance costs related to the change of management personnel. Also, the Company recorded approximately $240,000 of bad debt provision for certain invoices over 120 days old.

Income from the joint venture decreased $1,019,000 for the three months ended September 30, 2005 as compared to the three months ended September 30, 2004. For the three months ended September 30, 2005, we recognized $609,000 of net earnings from the joint venture less $206,000 of amortization expense related to the joint venture, for a net result of $403,000 of income from the joint venture. For the three months ended September 30, 2004, we recognized $1,422,000 of income from the joint venture, which was comprised of $1,628,000 net earnings from joint venture and $206,000 of amortization expense.

Net interest expense decreased $277,000, or 58.7%, to $195,000 for the three months ended September 30, 2005 compared to interest expense of $472,000 for the three months ended September 30, 2004. The primary reasons for the decrease in interest expense was due to the repayment of the promissory notes issued to the former shareholders of Paragon Systems in connection with the Paragon Acquisition (the Paragon Notes) and lower amounts of interest paid to our lenders. We do anticipate an increase in interest expense for the three months ending December 31, 2005 as compared to the three months ended September 30, 2005. This increase is due to the interest with respect to the convertible promissory notes issued in September and October 2005.

Income taxes are provided at 38% of income (loss) before income taxes. The 38% rate equals federal income taxes at 34% plus 4% for state income taxes net of the Federal effect. Even though the Company has a net operating loss carry forward, the Company has recognized a deferred income tax benefit for the net operating loss carry forward because the Company anticipates reporting income before income taxes in future periods. In addition, cash distributions received by the Company with respect to its equity interest in the joint venture are taxable.

Results of Operations for the Nine Months Ended September 30, 2005 Compared to Nine Months Ended September 30, 2004

Revenue increased $1,354,000 to $23.8 million, or 6.0%, for the nine months ended September 30, 2005 compared to revenue of $22.4 million for the nine months ended September 30, 2004. The increase in revenue was generated primarily from: (i) additional services provided to the FEMA in connection with a contract we manage for the Department of Homeland Security, (ii) a new contract that began service in October 2004 and (iii) other additional billings to existing contracts.

Cost of revenue increased $1,171,000 to $22.3 million, or 5.5%, for the nine months ended September 30, 2005 compared to cost of revenue of $21.1 million for the nine months ended September 30, 2004. The increase in cost of revenue is due to many factors. We had higher amortization costs with respect to our government contracts, higher personnel costs to support the additional revenue mentioned above, and higher personnel costs to support our existing contracts.

Our gross profit increased by $183,000 for the nine months ended September 30, 2005 to $1.5 million compared to the gross profit for nine months ended September 30, 2004 of $1.3 million. This increase was due to our revenue increasing more than our costs of revenue, as mentioned above.

Selling, general and administrative expenses increased $1,430,000 to $2.8 million, or 107.8%, for the nine months ended September 30, 2005 compared to $1.3 million for the nine months ended September 30, 2004. The increase in costs for 2005 is attributable primarily to costs associated with the additional office space, additional staff costs, legal costs, accounting costs and other professional fees associated with being a public company. There were no similar costs incurred for the nine months ended September 30, 2004. The Company incurred over $150,000 of costs associated with the replacement of management personnel in the three months ended September 30, 2005, and $240,000 of bad debt for certain invoices over 120 days old.

Income from the joint venture decreased $66,000 for the nine months ended September 30, 2005 as compared to the nine months ended September 30, 2004. For the nine months ended September 30, 2005, we recognized $2,069,000 of net earnings from the joint venture less $618,000 of amortization expense related to the joint venture, for a net result of $1,451,000 of income from the joint venture. For the nine months ended September 30, 2004, we recognized $1,517,000 of income from the joint venture, which was comprised of $1,998,000 net earnings from joint venture and $481,000 of amortization expense.

Net interest expense decreased $436,000 to $768,000 for the nine months ended September 30, 2005 compared to interest expense of $1,204,000 for the nine months ended September 30, 2004. In February 2005, we completed the Initial Public Offering and received proceeds from the offering before expenses of the offering of $11.1 million. We used the proceeds from the Initial Public Offering to repay the Paragon Notes and to pay down Paragon Systems liability to the Lenders. Repayment of the Paragon Notes and the reduction of Paragon Systems obligation to the Lenders significantly reduced interest expense for the nine months ended September 30, 2005 compared to the nine months ended September 30, 2004. We anticipate interest expense to rise in the future due to the interest with respect to the Notes issued in the Private Placement.

Income taxes are provided at 38% of income (loss) before income taxes. The 38% rate equals Federal income taxes at 34% plus 4% for state income taxes net of the Federal effect. Paragon Systems used the cash basis of accounting for income taxes prior to the Paragon Acquisition. Pro forma income tax benefit at 38% is presented for comparative purposes. Even though Tri-S has a net operating loss carry forward, the Company has recognized a deferred income tax benefit for the net operating loss carry forward because the Company anticipates reporting income before income taxes in future periods.

Results of Operations for the Years Ended December 31, 2004, 2003 and 2002

The following table sets forth absolute dollar and percentage changes in our selected financial data from period to period for the periods described below. The table below combines results of Paragon Systems with Tri-S for periods prior to the Paragon Acquisition (dollars in thousands):

	Change from Year Ended December 31, 2003 to Year Ended December 31, 2004		**Change from Year Ended December 31, 2002 to Year Ended December 31, 2003**		**Change from Year Ended December 31, 2001 to Year Ended December 31, 2002**	
	$ (restated)	**%**	**$**	**%**	**$**	**%**
Revenues	735	2.50 %	8,031	37.59 %	4,873	29.55 %
Operating Expenses:						
Direct labor	221	1.38 %	4,087	34.11 %	2,891	31.80 %
Indirect labor and other contract support costs	1,185	10.63 %	3,536	46.43 %	1,615	26.92 %
Selling, general and administrative	879	29.34 %	418	29.96 %	399	40.06 %
Amortization of intangible assets	298					
Operating income (loss)	(1,848)	(415.79)%	(10)	(2.70)%	(32)	(7.94)%
Income from investment in joint venture	1,637	N/A				
Interest income	(9)	(75.00)%	(11)	(47.83)%	(5)	(17.86)%
Interest expense	(1,361)	(4,536.67)%	(23)	328.57 %	4	(36.36)%
Interest on mandatory redeemable preferred stock	(250)					
Income (loss) before income taxes	(1,831)	(265.96)%	(87)	(14.42)%	(33)	(7.86)%

Revenues

The increase in our revenues from period to period is directly attributable to the number and size of our contacts during successive periods. Generally, the revenue generated by a contract is dependent upon the number of labor hours required to service such contract. Substantially all of our revenues are generated by Federal government contracts awarded to us through a competitive bidding process. Prior to 2001, we primarily bid on Federal government contracts set aside for small, disadvantaged businesses certified as 8(a) firms by the SBA. In 2001, we began bidding on larger contracts not specifically set aside for certified 8(a) firms. From December 31, 2001 to December 31, 2002, the net number of our Federal government contracts grew from nine to 13. We obtained four new Federal government contracts in 2002. In 2003, five of our Federal government contracts expired, and we obtained four new Federal government contracts for a net reduction of one contract between December 31, 2002 and December 31, 2003. Our revenues continued to increase from 2002 to 2003 despite having one less contract because the average revenue from each of our contracts increased between 2002 and 2003. In 2004, we obtained one new contract in the fourth quarter returning the number of managed contracts to thirteen. Revenue for 2004 increased by approximately $700,000 over 2003 primarily because the new contracts obtained in 2003 were included for a full year in 2004. Revenue in 2004 from the new contracts obtained in 2003 also more than offset the loss of two expired contracts in 2003. Also in 2004, we accrued and invoiced $699,000 on two Federal contracts to recover costs imposed on us in excess of our original bid that we fully expected to recover from one Federal agency based on meetings and negotiations with the Federal agency. Subsequent to December 31, 2004, the Federal agency denied all of our claims to recover these costs. While we continue to believe that we will ultimately prevail in recovery of these costs, we recorded a provision in the amount of $434,000 against our 2004 revenue in anticipation that we may not succeed with appeals that we plan to initiate.

The following table sets forth the number of our Federal government contracts during the periods and in the revenue ranges indicated in the table:

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

Of the four contracts generating annual revenue greater than $3.0 million per contract in 2003, two were awarded near the end of 2002, one was a continuing contract requiring substantially more service hours and one was modified from a metropolitan-area contract to a statewide contract. In 2005, the number of contracts generating revenue greater than $3.0 million per contract increased to five from four in 2004 due to one multiple location contract that was started in July 2003.

The following table sets forth the expiration years of our contracts existing as of December 31, 2004:

Number of Contracts	**Year Expiring**
3	2005
2	2006
4	2007
4	2008

We expect future revenues to increase as we continue to recognize revenues from our existing contracts and to the extent we obtain new contracts.

Costs of Revenues

We categorize our cost of revenues into three areas: (i) direct labor, (ii) indirect labor and other contract support costs and (iii) amortization of government contracts.

Direct Labor. Direct labor is the most significant expense in providing guard services on any contract. Direct labor was approximately 54% in 2004, 55% in 2003 and 56% for 2002. When bidding on contracts, we must anticipate labor rates during the contract term.

Indirect Labor and Other Contract Support Costs. This category of expenses consists primarily of indirect labor (guard supervisors), our portion of payroll taxes, employee benefit costs and other expenses, which are a relatively small portion of costs in this category. As with direct labor, when bidding on contracts, we must anticipate the cost of providing supervisory oversight of the guards performing the

actual guard services and the related payroll taxes and employee benefits that are provided to both guards and to supervisors. Indirect labor and other contract support costs was approximately 41% in 2004, 38% in 2003 and 36% in 2002.

Direct and Indirect Labor. Total wages and other payroll related expenses are the most significant and dominant expenses. In 2004 wages and other payroll related expenses were approximately 94% of all operating expenses.

Amortization of Government Contracts. Upon the Paragon Acquisition, Paragon Systems existing contracts were valued in accordance with purchase accounting rules and the resulting asset values are being amortized over the remaining term of each contract proportionate to estimated future discounted cash flows based on an independent appraisal.

General. Our ability to accurately anticipate the costs of providing guard services is critical to our profitability. Upon deciding to focus bidding on and obtaining larger contracts in 2001, we reduced our anticipated profit margins to be more competitive and to obtain more contracts. Thus, it is more important than ever that we correctly anticipate all of the above mentioned costs. When bidding on contracts in 2002, we failed to accurately anticipate the cost of providing supervisory oversight on two contracts which we subsequently obtained. The costs of providing the necessary oversight increased our indirect labor costs and reduced our profit margins in 2003 and 2004 with respect to these two contracts. These two contracts were different from our other contracts in that they covered multiple locations over wide geographic areas. We are currently negotiating with the responsible Federal agency to reach profitability on one of these contracts. In the third quarter of 2005, we will initiate negotiations to reach profitability on the other contract.

Our cost of revenue was 96.0% in 2004, 92.6% in 2003 and 91.7% in 2002. This increase in 2004 is primarily attributable to two factors: (i) we have reduced our profit margins in recent bids to be more competitive in the bidding process for larger contracts; and (ii) we failed to accurately anticipate the costs of providing supervisory oversight on two existing contracts as discussed above. We believe that reducing our profit margins is one of the reasons we have been successful in obtaining several of our larger contracts. We anticipate that we will continue to keep our profit margins low for the foreseeable future in order to obtain larger contracts and increase our presence in the contract guard market. As a result, we anticipate that our cost of sales will be not less than 92% of our revenues for the next several years.

Selling, General and Administrative Expenses

Selling, general and administrative expenses expressed as a percentage of revenue was 7.8% in 2004, 6.2% in 2003 and 6.5% in 2002. Selling, general and administrative expenses consist primarily of payroll and related expenses for administrative personnel in Paragon Systems corporate office located in Huntsville, Alabama and in the Tri-S corporate office located in Alpharetta, Georgia. It also includes occupancy costs at the two locations, consulting and professional fees, and certain miscellaneous office and corporation expenses. At Paragon Systems, selling, general and administrative expense has increased as a result of increased salaries and employee benefits. Approximately, $92,000 of the 2003 increase resulted from certain accounts receivable being written off as not collectible. Since our customers are Federal government agencies, we do not provide for bad debt allowances in the ordinary course of business. We write off account balances primarily for two reasons: (i) disagreements with a government agency relating to contract interpretations; and (ii) cessation of project funding at the end of a contract term. When there is a disagreement involving contract interpretation, the Company and the appropriate government agency mutually agree on a resolution. When an account is not collected due to cessation of project funding, we work with the appropriate government agency to attempt resolution. If the agency cannot resolve the funding issue, then we must write off the account balance. This only occurs at or near the expiration date of contracts. During 2004, 2003 and 2002, corporate overhead consisted primarily of salaries and professional fees totaling $947,000, $347,000 and $216,000, respectively.

Joint Venture

The Company owns 10% of Army Fleet Support. We recognize as income 10% of the joint venture s net earnings or net loss less the amortization of the difference between our cost and our share of the net equity of the joint venture. In 2004, we recognized as income $2,324,000 less amortization of $687,000 for income of $1,637,000 from joint venture.

Interest Income and Interest Expense

Prior to the Paragon Acquisition, Paragon Systems maintained a bank line of credit to meet its temporary cash flow needs. Paragon Systems invested cash exceeding its short term requirements on a temporary basis. Incident with the Paragon Acquisition, the line of credit was paid off and closed and a factoring arrangement was established with the Lenders. In addition, Tri-S executed $7.7 million in Paragon Notes payable to the former shareholders of Paragon Systems and issued to them an aggregate of 100 shares of our Series C Redeemable Preferred Stock with an aggregate redemption value of $6.0 million with 5% annual interest thereon. The increase in interest expense for 2004 over 2003 is entirely the result of (i) the issuance to the former shareholders of Paragon Systems of the Paragon Notes and the shares of Series C Redeemable Preferred Stock in connection with the Paragon Acquisition, and (ii) our factoring arrangement with the Lenders.

Pro Forma Income Tax Expense

Prior to the Paragon Acquisition, Paragon Systems only recognized income tax expense relating to built in gain taxes for periods before its subchapter S election. Income tax expense reported by Paragon Systems has been replaced with pro forma income tax expense at 38% in all periods. This includes federal income taxes at 34% and state income taxes at 4% which is net of the federal effect. For the year ended December 31, 2004, the results of operations of Tri-S consolidated with Paragon Systems shows a loss before income taxes of $2.8 million and an income tax benefit of $1.1 million. We will realize this benefit primarily because it is anticipated that future taxable distributions from Paragon Systems investment in Army Fleet Support will more than offset losses from operations.

Critical Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires us to make certain estimates and judgments that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosure of contingent assets and liabilities. We believe the following critical accounting policies affect our more significant estimates and judgments. Actual results may differ from these estimates under different assumptions or conditions.

Revenue Recognition. We record revenue monthly as guard services are provided to our customers under contracts with Federal government agencies. We bill guard services in arrears at hourly or monthly rates based on the number of hours worked under some contracts and as fixed monthly amounts under other contracts. Hourly and monthly rates are determined as a result of our bids submitted in response to formal specifications included in solicitations for bids from government agencies. Hourly and monthly billing rates are developed by accumulating the estimated labor, general and administrative expenses, our profit objective and other costs to service a contract over a five-year period.

The terms of our contracts with Federal government agencies are complex and may be subject to differing interpretations. We make estimates and judgments about terms of the contracts in providing services and in billing and recording revenue. Differences in interpretation are generally resolved on a mutual basis in discussions with the government agency involved. The resolution of differences may result in a determination that amounts previously billed are not in accordance with contract terms and adjustments of amounts initially recorded as revenue may be material.

Contracts with Federal government agencies may be subject to cessation of funding. Cessation of funding may result in amounts billed and recorded as revenue as being uncollectible. We work with the appropriate government agency to resolve funding issues. When funding issues become known, we make estimates and judgments about the extent of potential losses and adjust revenues accordingly. Actual amounts estimated could differ from amounts ultimately collected and these amounts could be material.

Cost of Revenues. Cost of revenues is primarily comprised of labor, related payroll taxes, employee benefits, workers compensation and liability insurance. Labor is recorded on an accrual basis. Direct and indirect labor, related payroll taxes and employee benefits account for over 90% of all cost of revenues and over 90% of all operating expenses. In 2004, labor and related payroll taxes and employee benefits approximated 94% of our total cost of revenues. The wages paid component of labor include regular pay, bonus, overtime, vacation, training, holiday and sick time. Total hours paid normally exceed total hours billed mainly due to vacation, training, supervisory holiday and sick time, which is generally not billable. This non-billable time, however, is included in the development of the billable rate. Medical benefits and workers compensation costs are based on premium-based plans and are expensed based on actual premiums paid. One time expenses, such as extra training required on starting a new contract, are expensed when incurred.

We make estimates and judgments of amounts recorded for accruals of labor related costs. Expenses most subject to estimation and judgment are accrued vacation and workers compensation costs. For some contracts, we assume existing liabilities for accrued vacation. The terms of vacation policies may be complex and subject to interpretation. Workers compensation insurance is subject to retroactive audit. Actual amounts could differ from the amounts initially recorded.

Goodwill and Other Intangible Assets. We account for goodwill and other intangible assets in accordance with Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and other Intangible Assets (SFAS No. 142), which requires goodwill and some intangible assets to no longer be amortized. Instead, goodwill will be subject to an annual impairment test. The goodwill impairment test involves a two-step approach. The first step of the test is to compare the fair value of the reporting unit, which is the business of Paragon Systems, to its book value, including goodwill. The fair value of the reporting unit is measured using discounted projected future cash flows. Cash flow estimates include projections of revenues from existing contracts with Federal government agencies, including projected renewals and extensions. The related costs of revenues are based on our historical costs. The projections are subject to the uncertainties of realizing contract renewals and extensions, the pricing of future contracts and reasonable estimates of future labor costs and other costs of revenues.

If the book value exceeds the fair value, then the second step of the goodwill impairment test, used to measure the amount of impairment loss, compares the implied fair value of the reporting unit goodwill with the book value of that goodwill. If the book value exceeds the implied fair value of that goodwill, then an impairment loss will be recognized to the extent of the excess. The implied fair value of goodwill will be determined in the same manner as the amount of goodwill recognized in the Paragon Acquisition; that is, the fair value of the reporting unit will be allocated to all of the assets and liabilities of that unit as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the price paid to acquire the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to its assets and liabilities is the implied fair value of goodwill. We completed our first goodwill impairment test as of December 31, 2004 and determined that the reported value of goodwill was not impaired.

Goodwill was valued at $7.7 million at the date of the Paragon Acquisition. Should an impairment test cause us to recognize an impairment loss, the book value of goodwill will be reduced by the amount of the impairment loss. An equal charge to expense will be made reducing our results of operations. We expect to record intangible assets and goodwill in conjunction with the Cornwall Acquisition which will be subject to an impairment test. These impairment tests may cause us to recognize impairment expense.

SFAS No. 142 also requires that intangible assets with definite lives be amortized over their estimated useful lives and reviewed for impairment whenever events or changes in circumstances indicate an asset s carrying value may not be recoverable in accordance with SFAS No. 144, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of. We are currently amortizing our acquired intangible assets with definite lives over periods ranging from five to nine years. Amortizable intangible assets consist of government contracts we acquired with the Paragon Acquisition and the non-compete agreements with certain of Paragon Systems former owners. We believe that no events or changes in circumstances have occurred that would require an impairment test for these assets.

Investment in Joint Venture. We account for our 10% interest in Army Fleet Support under the equity method. Accordingly, we increase the carrying amount of the joint venture asset for our share of the net earnings of the joint venture and reduce the carrying amount for cash received from the joint venture and amortization of the difference between our cost and our share of the net equity of the joint venture. We record income from investment in joint venture equal to our share of the net earnings of the joint venture less amortization of the difference between our cost and our share of the net equity of the joint venture. As part of the allocation of the purchase price for the Paragon Acquisition, fair value of the joint venture in excess of the net equity of joint venture was attributed to the value of the joint venture s contract with the federal government and is being amortized over the life of the contract, which is 10 years. In December 2003, Paragon Systems made an investment of $715,000 in the joint venture. The carrying value of the investment in the joint venture was increased to $8,102,000 as a result of the purchase accounting adjustments made in the Acquisition of Paragon Systems in February 2004.

Our portion of the net earnings, cash distributions received from the joint venture, and amortization of the excess of cost over our portion of the net equity of the joint venture during 2004 were as follows (in thousands):

	Earnings	Cash Distributions	Amortization
First quarter 2004	$ 59,000	$ 0	$ 69,000
Second quarter 2004	311,000	145,000	206,000
Third quarter 2004	1,628,000	185,000	206,000
Fourth quarter 2004	326,000	1,107,000	206,000
	$ 2,324,000	$ 1,437,000	$ 687,000

During 2005, we received $380,000 in cash distributions from the joint venture.

The timing and amount of distributions received from the joint venture vary widely and may not be predictable. These distributions may materially affect our cash flow.

Liquidity and Capital Resources

As of September 30, 2005, we had $2.4 million of cash on hand and approximately $500,000 of availability under our factoring facility. The cash balance at September 30, 2005 was primarily the result of the issuance of $1.9 million of convertible notes and warrants prior to September 30, 2005 in anticipation of the Cornwall Acquisition which closed in October 2005.

To finance the Cornwall Acquisition, we issued $8.1 million in Notes and Investor Warrants, borrowed $5.2 million in term loans, issued a $250,000 Cornwall Acquisition Note payable to the representatives of the former Cornwall shareholders, and increased borrowings under the factoring facility by $2.2 million. In addition, we used about $1.9 million of cash on hand to finance the Cornwall

Acquisition. Therefore, at September 30, 2005, giving effect to the Cornwall Acquisition, the Company had approximately $500,000 of cash on hand.

Availability under the factoring agreement is based on 90% of qualified accounts receivable less amounts drawn under the facility. Several factors effect the availability under the factoring agreement including the collections of customer billings, the timing of customer billings and the Company s need for cash to finance payroll and payments to vendors and creditors. Recently, the Federal government has been slow to pay certain invoices related to our services. Because of the delay in receiving payments for these invoices, our borrowings under the factoring facility has increased and certain of our invoices have been disqualified under the factoring agreement due to their past due status. As a result, at certain times the outstanding balance under the factoring facility has exceeded our availability as defined in the factoring agreement (referred to in this prospectus as over-advances).

The Lenders have historically allowed over-advances when the availability under the factoring facility is less than our cash needs. Based on our current liquidity position, we may need to continue to borrow under our factoring facility at a level that exceeds our defined availability. We plan to reduce the amount outstanding under the factoring facility in order to be within our availability limits by collecting payments from our customers on a timely basis. In addition, we may need to raise additional capital through debt and/or equity financings. No assurances can be given that the Lenders will continue to allow over-advances or that we will be able to raise additional debt or equity capital in the future.

Competitive Bidding Process

We generate substantially all of our revenue from Federal government contracts obtained through a competitive bidding process. We start the bidding process with a detailed review of the specifications contained in the solicitation for bid. We expend considerable management time on this process. We incur minimal cost other than management time to complete our bid. The process is lengthy and we may receive one or more revisions to contract specifications which may cause us to adjust our bid. There may also be considerable lapses of time between receipt of initial specifications, receipt of revised specifications, submission of our bid and contract award. It may take weeks or months after bids are submitted for a Federal government contract for it to be awarded. During this time, our only cost is management s time and out of pocket expenses.

Once a Federal government contract is awarded to us, we purchase uniforms, firearms, communications and other equipment needed to service the contract. For any number of reasons, including protest by our competitors, a contract may be rescinded. In 2003, one of our Federal government contracts was rescinded. We had purchased approximately $80,000 in firearms for use on this contract. We have been able to use a portion of these firearms on other contracts. We are also servicing one Federal government contract where contract specifications were changed by the government agency after the award was approved, requiring us to incur additional expenditures. Generally, when additional requirements are placed on the contractor by the government agency, the contractor is permitted to file a claim to recover these additional expenditures. In November and December 2004 we filed claims to recover in excess of $400,000 of such expenses. In addition, we are currently negotiating with the contracting government agency to renew this contract on a profitable basis. This process is lengthy and requires the use of our cash because we must fund the expenses during this process in order to properly service the contract. We have invoiced the agency to recover our cost associated with the foregoing. Because issues relating to our invoices to recover these costs will not be resolved until some time in the future, we have established a reserve to cover potential non-recovery of these costs. Our Federal government contracts are subject to audits and cost adjustments by the Federal government. We have never been required to reimburse the Federal government for any funds in connection with its audit of our Federal government contracts.

Twelve-Month Outlook

Paragon Systems historically funded its cash requirements during periods of negative cash flow by borrowing on a bank line of credit. The Paragon Acquisition created substantial cash requirements that we can not meet through our normal operations. We used approximately $7.8 million of the net proceeds of the Initial Public Offering to repay all of the Paragon Notes in aggregate principal amount of $7.7 million and pay all dividends then due on our Series C Redeemable Preferred Stock.

We will use a portion of the remaining proceeds from the Initial Public Offering to pay down our borrowing from the Lenders. As a result of paying down the borrowing from the Lenders, we will avoid substantial fees relating to over-advances from the Lenders mentioned above.

We believe that the cash remaining from the Initial Public Offering combined with cash distributions from the joint venture and cash flow from our operations will be sufficient to meet our obligations over the next twelve months.

Recent Accounting Pronouncements

In January 2003, the Financial Accounting Standards Board (FASB) issued FASB Interpretation (FIN) 46, Consolidation of Variable Interest Entities (FIN 46). FIN 46 expands upon existing accounting guidance that addresses when a company should include in its financial statements the assets, liabilities and activities of a variable interest entity. The consolidation requirements of FIN 46 apply immediately to variable interest entities created after January 31, 2003. The consolidation requirements apply to older entities in the first fiscal year or interim period beginning after June 15, 2003. The adoption of FIN 46 did not have any impact on our financial position or results of operations.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity (SFAS No. 150). The Statement specifies that instruments within its scope embody obligations of the issuer and that, therefore, the issuer must classify them as liabilities. SFAS No. 150 prohibits entities from restating financial statements for earlier years presented. SFAS No. 150 became effective for the Company at the beginning of the third quarter of 2003. We agreed to issue preferred shares subject to mandatory redemption in conjunction with the Paragon Acquisition as more fully discussed in Note 2 to our audited financial statements included elsewhere in this prospectus. The preferred shares subject to mandatory redemption are accounted for in accordance with SFAS No. 150.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), Share-Based Payment (SFAS No. 123R), which replaces SFAS No. 123, Accounting for Stock-Based Compensation, and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. SFAS No. 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values beginning with the first interim or annual period after June 15, 2005, with early adoption encouraged. The pro forma disclosures previously permitted under SFAS No. 123 no longer will be an alternative to financial statement recognition. The Company is required to adopt SFAS No. 123R in the third quarter of fiscal 2005, beginning July 1, 2005. Under SFAS 123R, the Company must determine the appropriate fair value model to be used for valuing share-based payments, the amortization method for compensation cost and the transition method to be used at date of adoption. The transition methods include prospective and retroactive adoption options. Under the retroactive option, prior periods may be restated either as of the beginning of the year of adoption or for all periods presented. The prospective method requires that compensation expense be recorded for all unvested stock options and restricted stock at the beginning of the first quarter of adoption of SFAS No. 123R, while the retroactive methods would record compensation expense for all unvested stock options and restricted stock beginning with the first period restated. The Company is evaluating the requirements of SFAS No. 123R and the effect that the adoption of SFAS No. 123R will have on the consolidated results of operations and earnings per share. The Company has not yet determined the method of adoption.

QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

We are exposed to various market risks, including changes in interest rates. Market risk is the potential loss arising from adverse changes in market rates and prices, such as interest rates and foreign currency exchange rates. We do not enter into derivatives or other financial instruments for trading or speculative purposes. We have not entered into financial instruments to manage and reduce the impact of changes in interest rates and foreign currency exchange rates, although we may enter into such transactions in the future.

The Notes carry interest rates which are fixed. The factoring facility has a funds usage fee, and the term loans have interest rates, which vary with the prime rate. Accordingly, if we sell our accounts receivable to the Lenders and such accounts remain unpaid, then any increase in the prime rate will increase the funds usage fee we owe on such unpaid accounts and, therefore, reduce our earnings.

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SELECTED QUARTERLY FINANCIAL DATA

The following table sets forth, for each quarter in the year ended December 31, 2004 and our three subsequent quarters selected data from our statement of operations as well as other financial data. We do not believe that our quarterly results are impacted materially by seasonal changes. The information for each of these quarters is unaudited and has been prepared on the same basis as the audited financial statements appearing elsewhere in this prospectus and, in the opinion of management, includes all adjustments, consisting only of normal recurring adjustments, that are necessary for a fair presentation of our results of operations for such periods. The months of January and February 2004 the Paragon Acquisition have been combined with Tri-S consolidated for the month ended March 2004 to obtain amounts presented for the quarter ended March 31, 2004. Expenses of Tri-S prior to the Paragon Acquisition have been combined with the expenses of Paragon Systems to arrive at the amounts reported for all quarters presented.

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

The accompanying quarterly financial statements present the financial statements of Paragon Systems as the Predecessor Company prior to the Paragon Acquisition and the consolidated financial statements of Tri-S as the Successor Company subsequent to the Paragon Acquisition. The Predecessor Company was formerly a subchapter S corporation; consequently, pro forma tax and pro forma income per share are presented on the face of the historical statements of operations for the periods presented as the Predecessor Company. The necessary adjustments include only taxes at a statutory rate of 38% for each period presented. The pro forma income per share calculation of the Predecessor Company operations is based on the weighted average number of common shares outstanding of Tri-S, which acquired the Predecessor Company in February 2004.

	March 31, 2005 (unaudited)	**June 30, 2005 (unaudited)**	**September 30, 2005 (unaudited)**
Revenues	$ 7,979	$ 7,745	$ 8,063
Gross profit	348	753	371
Selling, general and administrative	678	793	1,286
Operating income	(330)	(40)	(915)
Income from investment in joint venture	634	414	403
Interest income / (expense), net	(303)	(99)	(106)
Interest on preferred shares subject to mandatory redemption	(75)	(75)	(75)
Income (loss) before income taxes	(74)	200	(693)
Income tax expense (benefit)	(28)	76	(263)
Net income (loss)	$ (46)	$ 124	$ (430)
Basic pro forma income (loss) per share	$ (0.02)	$ 0.04	$ (0.13)
Diluted pro forma income (loss) per share	$ (0.02)	$ 0.04	$ (0.13)
Basic weighted average shares	2,358	3.315	3,324
Diluted weighted average shares	2,459	3,376	3,324

	Tri-S and Paragon Systems Combined For the Three Months Ended March 31, 2004 (unaudited)	**June 30, 2004 (unaudited)**	**September 30, 2004 (unaudited)**	**December 31, 2004 (unaudited)**
	(In thousands, except per share data)			
Revenues	$ 7,283	$ 7,468	$ 7,682	$ 7,697
Gross profit	565	322	428	(110)
Selling, general and administrative	443	454	456	992
Operating income	122	(132)	(28)	(1,102)
Income from investment in joint venture	(10)	105	1,422	120
Interest income / (expense), net	(184)	(444)	(364)	(385)
Interest on preferred shares subject to mandatory redemption	(25)	(75)	(108)	(42)
Income (loss) before income taxes	(97)	(546)	922)	(1,420)
Pro forma income tax expense (benefit)	(36)	(207)	350)	(491)
Pro forma net income (loss)	$ (61)	$ (339)	$ 572)	(929)
Basic pro forma income (loss) per share	$ (0.07)	$ (0.41)	$ 0.69)	$ (1.12)
Diluted pro forma income (loss) per share	$ (0.05)	$ (0.41)	$ 0.45)	$ (0.73)
Basic weighted average shares	825	828	828	828
Diluted weighted average shares	1,262	1,265	1,276	1,276
Pro forma income tax rate	38 %	38 %	38 %	38 %

UNAUDITED PROFORMA CONDENSED FINANCIAL STATEMENTS

The following unaudited pro forma condensed financial statements are presented to illustrate the effects of the Cornwall Acquisition and the financing transactions associated therewith the acquisition.

Tri-S did not have an operating business prior to the Paragon Acquisition in February 2004. Expenses consisted primarily of services performed and fees incurred associated with the creation and capitalization of Tri-S and the pursuit of acquisition opportunities. The financial statements of Paragon Systems, as an operating entity, are the more relevant information available prior to the Paragon Acquisition. Consequently, the accompanying unaudited pro forma condensed financial statements present the financial statements of Paragon Systems as the Predecessor Company prior to the Paragon Acquisition and the consolidated financial statements of Tri-S as the Successor Company subsequent to the Paragon Acquisition.

Historical amounts for the year ended December 31, 2003 are derived from audited 2003 financial statements for Paragon Systems combined with audited 2003 financial statements for Tri-S. Historical amounts as of September 30, 2004 and for the nine months ended September 30, 2004, are derived from the unaudited consolidated financial statements of Tri-S for the nine months ended September 30, 2004 combined with the historical unaudited financial statements of Paragon Systems for the two months ended February 27, 2004.

The pro forma adjustments are based upon available information and certain assumptions that we believe are reasonable under the circumstances. These adjustments are more fully described in the notes to the pro forma condensed financial statements below.

The Unaudited Pro Forma Condensed Consolidated Balance Sheet at September 30, 2005 assumes that the Cornwall Acquisitions, the Private Placement and the transactions contemplated by the Credit Agreement took place on that date. The Unaudited Pro Forma Condensed Statement of Operations for the year ended December 31, 2004 and the nine months ended September 30, 2005 assume that the Cornwall Acquisition, the Private Placement and the transactions contemplated by the Credit Agreement took place on January 1, 2004, the beginning of the 2004 fiscal year. Such information is not necessarily indicative of the Company s financial position or results of operations that would have occurred if the foregoing events had been consummated as of the dates indicated, nor should it be construed as being a representation as to the Company s future financial position or results of operations.

The unaudited pro forma condensed consolidated financial statements should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements, the related notes and the other financial information included elsewhere in this prospectus.

TRI-S SECURITY AND SUBSIDIARIES
UNAUDITED PRO FORMA CONDENSED COMBINED CONSOLIDATED BALANCE SHEET
(IN THOUSANDS, ESCEPT SHARE DATA)
AS OF SEPTEMBER 30, 2005

	As of September 30, 2005 Historical Tri-S Security	Pro Forma Adjustments		Pro Forma As Adjusted
ASSETS				
CURRENT ASSETS:				
Cash and cash equivalents	$ 2,430	36	(2)	
		(1,919	)(1)	$ 547
Certificate of deposit		592	(2)	592
Trade accounts receivable, net	5,480	3,649	(2)	9,129
Billings in process		668	(2)	668
Deferred income taxes	250	104	(2)	354
Notes receivable related parties		335	(2)	335
Prepaid expenses and other	590	232	(2)	
		(402	)(1)	420
Total Current Assets	8,750	3,295		12,045
Property and equipment, less accumulated depreciation	237	1,216	(2)	1,453
Note receivable related parties	102			102
Investment in joint venture	8,660			8,660
Intangibles	1,596	8,515	(2)	10,111
Goodwill	7,747	2,701	(2)	10,448
Deposits and other		129	(2)	
		376	(3)	505
Total Assets	$ 27,092	$ 16,232		$ 43,324
LIABILITIES AND STOCKHOLDERS EQUITY				
CURRENT LIABILITIES:				
Trade accounts payable	$ 468	409	(2)	877
Accrued expenses	3,161	1,358	(2)	
		375	(2)	4,894
Accrued interest expense	25			25
Note payable to financial instution	1,673	2,203	(1)	3,876
Current portion of capital lease obligations	125			125
Total Current Liabilities	5,452	4,345		9,797
OTHER LIABILITIES				
Term loan		5,165	(1)	
		376	(3)	5,541
Convertible Notes	1,919	6,096	(1)	
		(1,375	)(3)	6,640
Note payable		250	(1)	250
Deferred income taxes	3,713			3,713
Series C preferred stock subject to mandatory redemption	6,000			6,000
Total Liabilities	17,084	14,857		31,941
STOCKHOLDERS EQUITY				
Common stock	3			3
Stock Warrants		1,375	(3)	1,375
Additional paid-in capital	11,394			11,394
Accumulated income (deficit)	(1,389)			(1,389)
Total Stockholders Equity	10,008	1,375		11,383
Total Liabilities and Stockholders Equity	$ 27,092	$ 16,232		$ 43,324

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TRI-S SECURITY AND SUBSIDIARIES
UNAUDITED PRO FORMA CONDENSED COMBINED CONSOLIDATED STATEMENT OF OPERATIONS
(IN THOUSANDS, EXCEPT SHARE DATA)
FOR THE YEAR ENDED DECEMBER 31, 2004

	Year Ended December 31, 2004 Historical Tri-S Security		Historical Cornwall		Pro Forma Adjustments		Pro Forma As Adjusted	
Revenues	$ 25,425		$ 39,185		$		$ 64,610	
Cost of revenues:								
Direct Labor	13,810		31,509				45,319	
Indirect labor and labor related costs	10,223						10,223	
Other contract support costs								
Amortization fo government contracts	298						298	
	24,331		31,509				55,840	
Gross Profit	1,094		7,676				8,770	
Selling, general and administrative	2,115		7,020		1,276	(4)		
					33	(5)		
					144	(6)		
					(441	)(7)	10,147	
Operating income(loss)	(1,021	)	656		(1,012	)	(1,377	)
Income from Investment in joint venture	1,637						1,637	
Other Income (expense):								
Interest income	3		3				6	
Interest expense	(1,380	)	(450	)	(1,628	)(8)	(3,458	)
Interest on preferred stock subject to mandatory redemption	(250	)					(250	)
	(1,627	)	(447	)	(1,628	)	(3,702	)
Loss before income taxes	(1,011	)	209		(2,640	)	(3,442	)
Income tax benefit	(384	)	169		(169	)(9)	(384	)
Net loss	(627	)	40		(2,471			