TRI-S SECURITY CORP
Form 10-Q/A
September 04, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

Amendment No. 1

on

FORM 10-Q/A

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2009

¨ **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT**
For the transition period from __________ to __________

Commission file number 0-51148

TRI-S SECURITY CORPORATION

(Exact name of registrant as specified in its charter)

GEORGIA	**30-0016962**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

11675 Great Oaks Way, Suite 120, Alpharetta, Georgia 30022

(Address of principal executive offices)

(678) 808-1540

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨

Indicate by check mark whether registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) Yes ¨ No x

Shares of the registrant s common stock, par value $0.001 per share, outstanding as of August 5, 2009: 4,203,280.

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EXPLANATORY NOTE

This Amendment No. 1 on Form 10-Q/A (this Amended Report) amends the Quarterly Report on Form 10-Q for the quarter ended June 30, 2009 (the Original Report) of Tri-S Security Corporation (the Company) to reflect the Company s $2.5 million term loan (due March 28, 2010) as a current liability instead of a non-current liability as reported in the Original Report (the Modification). Aside from the Modification, no other changes have been made to the consolidated financial statements included in the Original Report.

This Amended Report amends and restates Item 1 of Part I and Item 6 of Part II of the Original Report to the extent necessary to reflect the Modification. This Amended Report continues to describe conditions as of the date of the Original Report, and the Company has not modified or updated any disclosures presented in the Original Report (except for the Modification). Accordingly, this Amended Report should be read in conjunction with the Original Report and the Company s filings made with the Securities and Exchange Commission subsequent to the filing of the Original Report.

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TRI-S SECURITY CORPORATION

QUARTERLY REPORT ON FORM 10-Q FOR THE

JUNE 30, 2009

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Tri-S Security Corporation and Subsidiaries

Consolidated Balance Sheets

Unaudited

(In thousands, except per share data)

	June 30, 2009	December 31, 2008
Assets		
Current assets:		
Cash and cash equivalents	$	$ 1,246
Restricted cash	75	75
Unbilled revenues and trade accounts receivable	18,969	16,610
Escrow funds sale of Cornwall	629	
Prepaid expenses and other assets	1,114	903
Total current assets	20,787	18,834
Property and equipment, less accumulated depreciation	572	611
Goodwill	7,747	9,825
Intangibles, net		
Customer contracts		1,028
Deferred loan costs	583	797
Other		665
Total assets	$ 29,689	$ 31,760
Liabilities and Stockholders Deficit		
Current liabilities:		
Bank overdraft	$ 56	$
Trade accounts payable	2,658	1,885
Other accrued expenses	1,250	2,058
Accrued interest expense short term	1,379	534
Accrued salary and benefits	5,126	5,676
Income taxes payable	53	67
Asset-based lending facility	22,453	19,641
Term loan	2,500	
10% convertible notes	900	1,025
Total current liabilities	36,375	30,886
Other liabilities:		
14% convertible notes	6,629	6,470
Term loan		2,500
Accrued interest expense long term	240	277
Series D preferred stock subject to mandatory redemption	1,500	1,500
Total liabilities	44,744	41,633
Stockholders deficit:		
Common stock, $0.001 par value, 25,000,000 shares authorized; 4,248,704 shares issued at June 30, 2009 and December 31, 2008	4	4
Treasury stock 45,424 shares at cost	(105)	(105)

Additional paid-in capital	17,784	17,562
Deficit	(32,738)	(27,334)
Total stockholders deficit	(15,055)	(9,873)
Total liabilities and stockholders deficit	$ 29,689	$ 31,760

See accompanying notes to financial statements.

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Tri-S Security Corporation and Subsidiaries

Consolidated Statements of Operations

Unaudited

(In thousands, except per share data)

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Revenues	$ 33,698	$ 28,168	$ 63,020	$ 44,459
Cost of revenues				
Direct labor	21,246	17,630	39,719	27,526
Indirect labor and other support costs	10,528	8,893	20,457	14,519
Amortization of customer contracts		66	23	133
	31,774	26,589	60,199	42,178
Gross profit	1,924	1,579	2,821	2,281
Selling, general and administrative	2,013	1,596	4,056	3,286
Amortization of intangible assets	112	157	230	320
	2,125	1,753	4,286	3,606
Operating income (loss)	(201)	(174)	(1,465)	(1,325)
Other income (expense):				
Interest expense	(1,476)	(1,299)	(2,860)	(2,064)
Other income	7		12	5
	(1,469)	(1,299)	(2,848)	(2,059)
Loss before income taxes	(1,670)	(1,473)	(4,313)	(3,384)
Income tax expense (benefit)		(55)	2	(8)
Net loss from continuing operations	(1,670)	(1,418)	(4,315)	(3,376)
Loss from discontinued operations, net of tax	(515)	(397)	(1,089)	(568)
Net loss	$ (2,185)	$ (1,815)	$ (5,404)	$ (3,944)
Basic and diluted net loss per common share continuing operations	$ (0.40)	$ (0.34)	$ (1.03)	$ (0.80)
Basic and diluted net loss per common share discontinued operations	$ (0.12)	$ (0.09)	$ (0.26)	$ (0.14)
Basic and diluted weighted average number of common shares	4,203	4,203	4,203	4,203

See accompanying notes to financial statements.

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Tri-S Security Corporation and Subsidiaries

Consolidated Statements of Cash Flows

Unaudited

(In thousands)

	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Cash flow from operating activities:		
Net loss	$ (5,404)	$ (3,944)
Adjustments to reconcile net loss to net cash used by operating activities:		
Loss on sale of discontinued operations	54	
Bad debt expense	(7)	293
Depreciation and amortization	838	1,362
Non-cash employee stock-based compensation expense	213	463
Non-cash interest expense	43	111
Changes in operating assets and liabilities:		
Unbilled revenues and trade accounts receivable, net	(2,352)	(14,174)
Prepaid expenses and other assets	(225)	(984)
Trade accounts payable	773	(789)
Accrued liabilities	(550)	3,312
Income taxes payable	(14)	(402)
Net cash used by operating activities	(6,631)	(14,752)
Cash flow from investing activities:		
Restricted cash		273
Purchase of property and equipment	(218)	(552)
Net cash used by investing activities	(218)	(279)
Cash flow from financing activities:		
Bank overdraft	56	
Net proceeds from borrowing facility	5,557	15,128
Deferred financing costs	(1)	(26)
Issuance of convertible notes	(9)	
Net cash provided by financing activities	5,603	15,102
Net increase (decrease) in cash and cash equivalents	(1,246)	71
Cash and cash equivalents at beginning of period	1,246	465
Cash and cash equivalents at end of period	$	$ 536
Supplemental disclosures of cash flow information:		
Interest paid continuing operations	$ 2,107	$ 1,990
Income taxes paid	$ 16	$ 394
Tender of 10% convertible notes for 14% convertible notes	$ 116	$
Payment of deferred financing costs through issuance of warrants	$ 9	$

See accompanying notes to financial statements.

TRI-S SECURITY CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2009

1. Organization

Tri-S Security Corporation, a Georgia corporation (Tri-S , the Company or we), was incorporated in October 2001 under the name Diversified Security Corporation. We changed our name to Tri-S Security Corporation on August 16, 2004. We provide contract guard services to: (i) various Federal government agencies through our subsidiary, Paragon Systems, Inc., an Alabama corporation with its principal office located in Washington, DC (Paragon Systems), and a joint venture in which we are a 49% partner, Southeastern Paragon (SEP) and (ii) commercial and state and local government customers through our subsidiary, Florida Business I, Inc., formerly known as The Cornwall Group, a Florida corporation (Cornwall). The Company sold substantially all of the operating assets (except accounts receivable) of Cornwall and its subsidiaries on May 13, 2009.

Tri-S was 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 large company. Tri-S has acquired and continues to pursue acquisition opportunities in the contract guard services and system integration services segments of the security industry.

We 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 January 2006, Paragon Systems entered into a Joint Venture Agreement with Southeastern Protective Services, Inc. (Southeastern Protective Services) to form SEP. Paragon Systems owns 49% and Southeastern Protective Services owns 51% of SEP. SEP was formed to bid on certain contracts, and Paragon Systems will manage the contracts awarded to SEP. We are accounting for the joint venture in accordance with FASB Interpretation No. 46 (R) Variable Interest Entities because we believe that SEP is a VIE in which we are the primary beneficiary. In the first six months of 2009, Tri-S recorded revenue from SEP of $3.1 million.

In September, 2007, Paragon Systems formed On Duty Patrol Services LLC (ODPS), a joint venture between Paragon Systems and On Duty Patrol Services, Inc. ODPS has been certified by the U.S. Small Business Administration (the SBA) as a small and disadvantaged business (an 8(a) firm) and is therefore qualified to bid on security contracts specially designated for 8(a) firms. Paragon Systems owns 49% of ODPS. Since its formation, ODPS has not entered into any contracts.

All significant intercompany transactions have been eliminated.

2. Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (GAAP). The financial statements presented are unaudited and have been prepared by our management in accordance with the rules and regulations of the Securities and Exchange Commission (the SEC). In the opinion of our management, all adjustments, consisting of normal recurring accruals, necessary for the fair presentation of the financial position, results of operations and cash flows have been included. For further information, see our audited financial statements and footnotes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2008 (the Annual Report) filed with the SEC. Disclosure that substantially duplicates the disclosure contained in the footnotes to the audited financial statements included in the Annual Report has been omitted from these notes.

In the second quarter of 2009, the Company sold substantially all of the operating assets (except accounts receivable) of Cornwall and its subsidiaries. In accordance with Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, (SFAS No. 144), a business component that is disposed of or classified as held for sale is reported as discontinued operations if the cash flows of the component have been or will be eliminated from the ongoing operations of the Company, and the Company will no longer have any significant continuing involvement in the business component. The results of discontinued operations have been aggregated and presented separately in the consolidated statements of operations.

Amounts related to the discontinuance have been derived from the consolidated financial statements and accounting records of the Company using the historical basis of Cornwall s assets and liabilities to be disposed of and historical results of operations. See note 5 for more information on discontinued operations.

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3. Liquidity

The Company has historically incurred operating losses and has not yet generated sufficient levels of cash flows from operating activities to meet its scheduled debt service payments and other obligations. The Company has relied on its senior lenders, LSQ Funding Group, L.C. (LSQ) and BRE LLC (BRE and, together with LSQ, the Lenders), to fund operations in excess of the borrowing base formula. Our Lenders and the Company entered into a forbearance agreement dated December 12, 2008 that extends our forbearance agreement through January 1, 2010 and that allows for such funding over the Company s borrowing base and waives certain debt covenant defaults. If the balance outstanding under our agreements with our Lenders becomes immediately due and payable, as a result of the subjective acceleration clause or other provisions of the loan agreements, and we are unable to raise significant capital or obtain from our Lenders additional waivers or an additional forbearance agreement, then we will not be able to satisfy our obligations to our Lenders, and our Lenders may proceed to foreclose on the collateral and our business and financial condition will be materially and adversely affected.

Additionally, in November 2008, we completed our offer to exchange our outstanding 10% Convertible Promissory Notes due in 2008 (the 10% Notes) for our 14% Convertible Promissory Notes due 2010 (the New Notes) and warrants to purchase shares of our common stock (the Exchange Offer). The Exchange Offer was completed on the terms and conditions set forth in our tender offer statement on Schedule TO, initially filed with the Securities and Exchange Commission on August 20, 2008, as amended. In the Exchange Offer, approximately $6.6 million, or 86%, of the aggregate principal amount of the 10% Notes was tendered for New Notes and warrants.

The future success of the Company is dependent upon, among other things, our ability to: achieve and maintain satisfactory levels of profitable operations; obtain and maintain adequate levels of debt and/or equity financing; and generate sufficient cash flow from operations to meet current and future debt obligations. We anticipate that, with the recently awarded contracts to Paragon Systems, the board of directors approved initiatives to reduce expenses and the sale of our Cornwall business, along with the forbearance agreement with our Lenders, our cash flows will provide sufficient operating resources through December 31, 2009.

4. Stock-based Compensation

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standard No. 123 (revised 2004), *Share Based Payment* (SFAS No. 123(R)), using the modified prospective method and, therefore, reflects compensation expense in accordance with the SFAS No. 123(R) transition provisions. Under the modified prospective method, prior periods are not restated to reflect the impact of adopting the new standard at earlier dates.

In accordance with SFAS No. 123(R), the Company recorded $213,000 and $463,000 of stock-based compensation expense for the six months ended June 30, 2009 and 2008, respectively, related to employee stock options, restricted stock and warrants. After recording the expense through June 30, 2009, there remained approximately $282,000 of unrecognized compensation cost related to unvested employee stock options and restricted stock to be recognized over the next 1.8 years.

5. Sale of Cornwall

On May 13, 2009, the Company sold substantially all of the operating assets (except accounts receivable) of Cornwall and its subsidiaries for a purchase price of $3.6 million, of which $629,000 is being held in escrow as of June 30, 2009 to secure the continuation of certain contracts transferred as part of the sale. The decision to sell the Cornwall business was made so we could focus on growing our government business and reduce our overall debt load.

Revenues and loss from the discontinued operations were as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Operations:				
Revenues	$ 2,182	$ 10,178	$ 7,449	$ 20,352

Operating loss from discontinued operations, net of tax	$ (461)	$ (397)	$ (1,035)	$ (568)
Loss on disposal, net of tax	(54)		(54)	
Loss from discontinued operations, net of tax	$ (515)	$ (397)	$ (1,089)	$ (568)

Sold assets related to discontinued operations were as follows:

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Prepaid expenses and other assets	$ 14
Property and equipment, net	10
Goodwill	2,078
Intangibles, net	1,327
	$ 3,429

Fees associated with the sale of Cornwall amount to $0.2m.

6. Common and Preferred Stock

Immediately prior to the initial public offering of our common stock on February 9, 2005, we entered into an exchange and recapitalization agreement with all of the holders of common stock, convertible preferred stock and holders of rights to acquire common stock. Pursuant to the agreement, we implemented a reverse stock split of all the outstanding shares of its common stock and stock options and exchanged common stock for all Series A and B Convertible Preferred Stock. The recapitalization was given retroactive treatment in the financial statements and related disclosures.

On September 13, 2007, as a result of the Settlement Agreement (the Paragon Settlement Agreement) among Tri-S, Paragon Systems and Ronald G. Farrell, our Chief Executive Officer, and the former shareholders of Paragon Systems (the Selling Shareholders), we cancelled the shares of the Series C Redeemable Preferred Stock held by the Selling Shareholders. Holders of the Series C Redeemable Preferred Stock had no voting rights, except that a consent of a majority of the holders of the Series C Redeemable Preferred Stock, voting separately as a class, was required to increase or decrease the number of authorized shares of Series C Redeemable Preferred Stock and except as otherwise required by applicable law. The Series C Redeemable Preferred Stock did not have any preemptive, conversion or sinking fund rights nor did it have any rights or preferences in the event of a liquidation, dissolution or winding-up of the Company.

Also, on September 13, 2007, as a result of the Paragon Settlement Agreement, the Company issued to the Selling Shareholders an aggregate of 700,000 shares of common stock and an aggregate of 100 shares of Series D Redeemable Preferred Stock, which (a) have an aggregate redemption value of $1,500,000, payable upon the earlier of September 13, 2012, or the date on which the Company sells 70% or more of its assets in one or more transactions (unless the proceeds from such sale are reinvested in the Company s business, used to restructure debt or used for acquisitions or working capital purposes), and (b) accrue dividends of $750 per share per annum and are payable quarterly.

We are authorized to issue 25 million shares of common stock with a par value of $0.001 per share. The holders of common stock are entitled to one vote per share on all matters. Our common stock does not have cumulative voting rights and has no conversion rights. Each share of common stock has an equal and ratable right to receive dividends to be paid from assets legally available when and if declared by our board of directors. We have never paid any cash dividends on common stock.

During the first quarter of 2008, the Company granted to Mr. Farrell an option to purchase 400,000 shares of common stock at an exercise price of $2.50 per share, which vests with respect to one-half of the underlying shares on the date of grant and the remaining one-half of the underlying shares on the first anniversary of the date of grant. Pursuant to the Paragon Settlement Agreement and concurrently with the grant to Mr. Farrell, the Company granted to the Selling Shareholders options to purchase an aggregate of 40,000 shares of common stock at an exercise price of $2.50 per share, which options vest on the same schedule as the option granted to Mr. Farrell.

7. Debt and Other Obligations

Amended and Restated Credit Agreement

On October 18, 2005, we entered into a Credit Agreement (the Original Credit Agreement) with our Lenders, pursuant to which we borrowed $1,650,000 pursuant to a term loan with a maturity date of October 1, 2007 (Term Loan A) and $3,500,000 pursuant to a term loan with a maturity date of October 1, 2009 (Term Loan B and, together with Term Loan A, the Term Loans). During the second quarter of 2006, the Term Loans were paid in full.

In connection with the Original Credit Agreement, we entered into a Factoring and Security Agreement (the Factoring Agreement) with LSQ, pursuant to which LSQ purchased from us from time to time certain accounts receivable at a discount of 0.7% and provided 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 Agreement had a $6,000,000 initial purchase limit and a four-year term which automatically renewed unless we provided notice of our intent to terminate.

Pursuant to the Original Credit Agreement, we also entered into (i) a Guaranty Agreement pursuant to which we unconditionally and irrevocably guarantee to our Lenders the prompt payment and performance of all of our obligations, indebtedness and liabilities to our Lenders, whether currently existing or subsequently arising (the Obligations); and (ii) a

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Security Agreement, pursuant to which we granted to our Lenders a security interest in substantially all of our assets to secure all of the Obligations. Additionally, we have entered into a Pledge Agreement pursuant to which we pledged to our Lenders the capital stock of Paragon Systems to secure all of our obligations under the Original Credit Agreement and related documents.

On June 27, 2006, Paragon Systems executed a Guaranty of Joint Venture (the JV Guaranty) pursuant to which Paragon Systems unconditionally guarantees to LSQ the prompt payment and performance of all obligations, indebtedness and liabilities, whether currently existing or subsequently arising, of SEP (the JV Obligations). The JV Obligations include the obligations, indebtedness and liabilities of SEP to LSQ under that certain Factoring and Security Agreement between SEP and LSQ dated as of June 27, 2006 (the JV Factoring Agreement), pursuant to which LSQ will purchase from SEP from time to time certain accounts receivable at a discount of 0.7% and provide SEP a professional accounts receivable management service for a funds usage fee equal to the prime rate plus 1.0% on the funds advanced on the outstanding accounts receivable purchased. The JV Factoring Agreement has a $1,000,000 initial purchase limit and a one-year term which will automatically renew unless SEP provides notice of its intent to terminate.

During March 2007, we entered into an Amendment and Forbearance Agreement with our Lenders pursuant to which we amended the Original Credit Agreement and secured an additional $2.5 million term loan (the 2007 Term Loan) with our Lenders to provide additional financing as needed to provide the capital we estimated was necessary to continue to operate the business during 2007. The 2007 Term Loan matures on March 28, 2010. The 2007 Term Loan bears a 0.25% per month fee on the unused portion of the loan.

On December 31, 2007, we entered into an Amended and Restated Credit Agreement (the Amended and Restated Credit Agreement) with our Lenders, which amends and restates the Original Credit Agreement. The Amended and Restated Credit Agreement amends and restates the Original Credit Agreement to provide us with a revolving, asset-based lending facility with up to $25.0 million of borrowing availability, replacing our pre-existing factoring facility with up to $12.0 million of borrowing availability under the Original Credit Agreement. In connection with entering into the Amended and Restated Credit Agreement, we also entered into (i) a Loan and Security Agreement with LSQ, as may be amended from time to time (the Loan and Security Agreement), and (ii) a Supplemental Agreement to Amended and Restated Credit Agreement with our Lenders (the Credit Agreement Supplement and, collectively, with the Amended and Restated Credit Agreement, the Loan and Security Agreement and all other agreements we have with our Lenders, the Loan Documents).

The Amended and Restated Credit Agreement continues to provide for the $2,500,000 2007 Term Loan contemplated by the Original Credit Agreement. Under the Amended and Restated Credit Agreement, interest on the 2007 Term Loan accrues at a rate equal to the prime rate, as published by the Wall Street Journal from time to time (the Prime Rate), plus 4.50% (the Non-Default Rate), but at no time shall the interest rate be less than 11.25% per annum. If an event of default under the Amended and Restated Credit Agreement occurs, then interest accrues on the 2007 Term Loan at a rate equal to the Non-Default Rate plus 5% and certain other default fees specified in the Amended and Restated Credit Agreement would become due and payable. The 2007 Term Loan requires us to pay a Minimum Balance Fee, as described in the Amended and Restated Credit Agreement, if the 2007 Term Loan is repaid prior to maturity.

Pursuant to the Loan and Security Agreement, at our request, LSQ shall make advances (Advances) to us not to exceed $25,000,000 and subject to a borrowing base, which base includes 90% of accounts receivable, including unbilled accounts receivable. Prior to repayment of the 2007 Term Loan, interest accrues on Advances made on the basis of (i) billed accounts receivable at a rate equal to the Prime Rate plus 1% (but not less than 11%) and (ii) unbilled accounts receivable at a rate equal to the Prime Rate plus 4.5% (but not less than 12%). In addition, until the 2007 Term Loan is paid in full, we must pay LSQ a fee of ..7% of the face amount of billed accounts receivable. Following repayment of the 2007 Term Loan, interest accrues on all Advances at a rate equal to the Prime Rate plus 4.5%. Upon the occurrence of an event of default under the Loan and Security Agreement, interest is payable on all Advances at a rate equal to the Prime Rate plus 9.5%. The Loan and Security Agreement includes a subjective acceleration clause and expires on October 31, 2010.

Under the Credit Agreement Supplement, anytime the 2007 Term Loan is outstanding and so long as unbilled accounts receivable are included in the borrowing base for purposes of making Advances, we must pay a monthly fee to our Lenders equal to 2.25% of the highest daily overadvance amount (which is the highest daily amount in any given month calculated as the outstanding 2007 Term Loan plus all outstanding Advances less the borrowing base) less (ii) $60,000 or such lesser amount as will reduce the overadvance fee to zero. In addition, the Credit Agreement Supplement requires that we issue to our Lenders a four-year warrant to purchase 30,000 shares of common stock, at an exercise price of $3.00 per share, for each month in which an overadvance under the Loan and Security Agreement exists. In no event shall such warrants issued to Lenders under the Credit Agreement Supplement be exercisable in the aggregate for greater than 420,000 shares of common stock. As of June 30, 2009, the Company has issued 420,000 warrants to our Lender.

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All of our obligations under the Loan Documents are secured by a first priority security interest in all of our assets and a pledge of all of the equity interests in our subsidiaries.

The outstanding balance under the Loan Documents as of June 30, 2009, is approximately $26.3 million. Additionally, from time to time during 2008 and 2009, we have borrowed more than the maximum amount allowable under the availability formula under the Loan and Security Agreement. Accordingly, on those occasions when the outstanding balance exceeded the availability, we were charged the default interest and fees by our Lenders.

As of December 31, 2007, we were not in compliance with the Loan Documents and the outstanding borrowings exceeded the borrowing base as defined. On March 26, 2008, we entered into an Amendment and Forbearance Agreement, as amended from time to time (the Forbearance Agreement), with our Lenders. Pursuant to the Forbearance Agreement, our Lenders waived certain specified defaults under the Loan Documents and agreed to forebear from exercising all remedies available to them in connection with such existing defaults until the earlier of (i) a potential equity or subordinated debt offering by us or (ii) January 1, 2009. On December 12, 2008, the Forbearance Agreement was amended to extend the end of the forbearance period from January 1, 2009 to January 1, 2010.

If an event of default under the Loan Documents or any agreement we have with our Lenders occurs, then the entire balance outstanding under all such agreements shall become immediately due and payable. We will not be able to repay this balance unless we raise significant capital by selling assets or issuing debt or equity securities, which we may not be able to do on terms acceptable to us, if at all. If the balance outstanding under our agreements with our Lenders becomes immediately due and payable and we are unable to raise significant capital or obtain from our Lenders an additional waiver and an agreement to forbear, then we will not be able to satisfy our obligations to our Lenders, our Lenders may proceed to foreclose on the collateral and our business and financial condition will be materially and adversely affected.

Convertible Notes

During September and October 2005, we issued in a private placement transaction the 10% Notes with an aggregate principal amount of $8,015,000 and warrants to purchase 834,896 shares of common stock for a total purchase price of $8,015,000. The 10% Notes and warrants were issued in four closings between September 2, 2005 and October 14, 2005. The face value of the 10% Notes was $8,015,000 upon issuance. Interest is payable monthly on the face value of the 10% Notes at a rate of 10% per annum. The gross proceeds from the offering of 10% Notes and warrants was allocated to the 10% Notes and warrants in accordance with Emerging Issue Tax Force 98-5, *Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios* (EITF 98-5). In accordance with EITF 98-5, $6,107,000 of the gross proceeds was allocated to the 10% Notes and $1,908,000 was allocated to additional paid in capital related to the warrants and the beneficial conversion feature. The conversion of the 10% Notes was restricted at the issue date because of the need for a shareholder vote to approve the contingently issuable shares as well as certain other restrictions. In February 2006, the shareholders approved the shares issuable upon conversion of the 10% Notes. Accordingly, approximately $1.1 million of the in-the-money beneficial conversion feature was recorded to increase the book value of the 10% Notes. Of the $1.1 million of in-the-money beneficial conversion feature, approximately $700,000 was recorded as interest expense during the second quarter 2006 and approximately $426,000 was recorded as a reduction to additional paid in capital because of additional conversion restrictions associated with a certain portion of the 10% Notes. During the third quarter 2007, the 10% Notes subject to conversion restrictions became convertible. Accordingly, approximately $426,000 was recorded as interest expense and as an increase to paid in capital. The remaining discount on the 10% Notes relative to face value was amortized to interest expense over the remaining life of the 10% Notes.

The 10% Notes are convertible by the holders at an initial conversion price of $4.80 per share subject to certain restrictions. The warrants issued in the private placement expired in September and October of 2008.

The 10% Notes with an outstanding principal balance of approximately $7.6 million matured in September and October 2008. On November 13, 2008, we completed the Exchange Offer in which approximately $6.6 million, or 86%, of the aggregate principal amount of the 10% Notes was tendered for New Notes and warrants.

On December 16, 2008, we issued to each of two accredited investors: (i) a promissory note with a principal amount of $25,000, which is convertible into shares of our common stock at a conversion price of $1.75 per share, accrues interest on the principal amount at a rate of 14% per annum and matures on November 13, 2010; and (ii) a five-year warrant to purchase 2,604 shares of our common stock at an exercise price of $0.75 per share. Each of the investors agreed to accept the promissory note and warrant in full repayment of the 10% convertible promissory note with an outstanding principal amount of $25,000, which matured in September 2008, previously issued by us to such investor.

On January 8, 2009, we issued to each of two accredited investors: (i) a promissory note with a principal amount of $37,500, which is convertible into shares of our common stock at a conversion price of $1.75 per share, accrues interest on

the principal amount at a rate of 14% per annum and matures on November 13, 2010; and (ii) a five-year warrant to purchase 3,906 shares of common stock at an exercise price of $0.95 per share. Each of the investors agreed to accept the promissory note and warrant in full repayment of the 10% convertible promissory note with an outstanding principal amount of $37,500, which matured in October 2008, previously issued by us to such investor.

On February 3, 2009, we issued to an accredited investor: (i) a promissory note with a principal amount of $50,000, which is convertible into shares of our common stock at a conversion price of $1.75 per share, accrues interest on the principal amount at a rate of 14% per annum and matures on November 13, 2010; and (ii) a five-year warrant to purchase 5,208 shares of our common stock at an exercise price of $0.75 per share. The investor agreed to accept the promissory note and warrant in full repayment of the 10% convertible promissory note with an outstanding principal amount of $50,000, which matured in October 2008, previously issued by us to such investor.

8. Income Taxes

We adopted the provisions of FASB Interpretation 48, *Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109* (FIN 48), on January 1, 2007. FIN 48 prescribes a recognition threshold that a tax position is required to meet before being recognized in the financial statements and provides guidance on the de-recognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition issues. The adoption of FIN 48 resulted in the recognition of $32,104 of penalties which was recorded as an adjustment to the January 1, 2007 retained earnings. No adjustments were made in the quarter ended June 30, 2009 to the balance of unrecognized tax benefits and no material change is expected in the next twelve months. In addition, the following information required by FIN 48 is provided:

As noted above, as of January 1, 2007, we have accrued penalties in the amount of $32,104 related to uncertain tax positions. As of June 30, 2009, the total amount of interest and penalties accrued was $187,787. Accrued interest on tax deficiencies and tax penalties are recorded as a component of income tax expense.

The recognition of unrecognized tax benefits will not impact the Company s effective tax rate.

The Company and its subsidiaries file Federal income tax returns, as well as multiple state and local tax returns. The tax years of 2006 to 2008 for all jurisdictions remain open to examination.

At June 30, 2009, the Company had cumulative gross Federal income tax net operating loss (NOL) carryforwards of approximately $19.2 million available to reduce future amounts of taxable income, as a result of taxable losses form operations from 2007 to current and the sale of the Cornwall Group assets and subsequent worthless stock deduction. If not utilized to offset future taxable income the current NOL will expire between 2027 and 2029. Additionally, the Company acquired through its acquisition of Cornwall unused Federal NOLs. Under Internal Revenue Code section 382, there is an annual limitation on the use of the NOLs acquired from Cornwall. If not utilized to offset future taxable income, the cumulative NOL amount will expire from 2020 through 2025. The Company also had approximately $1.3 million of tax effected state NOLs. If not utilized to offset future state taxable income, the state NOLs will expire between 2020 and 2029. For the quarter ended June 30, 2009, management has recorded a total valuation allowance of $3.3 million against its deferred tax assets including the NOL s.

An assessment is made at the end of each reporting period of the likelihood that the recorded net deferred tax asset will be realized. The net deferred tax asset must be reduced by a valuation allowance if, based on the weight of available evidence, it is more likely than not (a likelihood of more than 50%) that some portion or all of the new deferred tax asset will not be realized within a relatively short period, generally no more than three years. As of June 30, 2009, management recorded a total valuation allowance of approximately $8.3 million against its deferred tax assets including the NOL s.

For both of the three months ended June 30, 2009 and 2008, the Company s effective tax rate was 0.0%. For the three months ended June 30, 2009, the principal cause of the difference between the effective rate and the U.S. statutory rate of 34% was the recording of an additional allowance of $3.3 million against the deferred tax asset offsetting its income tax from operations and the additional loss as a result of the worthless stock deduction resulting from the Cornwall Group asset sale.

9. Net Loss per Share

Basic net loss per share is computed by dividing net loss available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted net loss per share gives effect to all potentially dilutive securities. For the three and six months ended June 30, 2009 and 2008, the effect of our warrants and stock options were not included in the computation of diluted earnings per share as their effect was anti-dilutive.

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10. Related Party Transactions

Employment Agreements

Pursuant to the employment agreement, as amended, between us and Mr. Farrell, Mr. Farrell has agreed to serve as our Chief Executive Officer and President until June 30, 2010. 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 earnings before interest, income taxes, depreciation and amortization, as adjusted (EBITDA) for such year, 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; and (iv) continuation of Mr. Farrell s compensation and benefits for the remainder of the term of his employment agreement if his employment is terminated by us without cause or by Mr. Farrell for good reason or upon a change of control of the Company, provided that if a change of control occurs after June 30, 2008 and before July 1, 2010, Mr. Farrell is entitled to receive all monies which he would have been paid under the employment agreement had the term the agreement terminated on the second anniversary of such change of control rather than on June 30, 2010. 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 our Chief Executive Officer. Mr. Farrell is also entitled to participate in any employee benefit plan, stock option plan and other fringe benefit plan at the discretion of the Board.

During 2008, the Company and Mr. Farrell agreed to amend his employment agreement as follows: (i) to reduce his annual salary by (a) 25% during the period from January 1, 2009 through June 30, 2009 and (b) 50% during the period from July 1, 2009 through June 30, 2010; and (ii) to grant to Mr. Farrell (a) 100,000 shares of common stock on the date the amendment to his employment agreement is executed and (b) 81,406 shares of common stock on January 1, 2009. Notwithstanding the foregoing, the reduction in Mr. Farrell s annual salary shall not affect the calculation of bonus, severance or other amounts which Mr. Farrell is entitled to receive, and which are calculated with reference to Mr. Farrell s base salary , under his employment agreement and such bonus, severance and other amounts will be calculated and made as if the reduction in Mr. Farrell s annual salary had not occurred. The stock grants, if made, will be made pursuant and subject to the terms and conditions of the Company s 2004 Stock Incentive Plan, as amended and restated (the Incentive Plan).

The Company and Mr. Farrell further agreed the stock grants will vest in a manner such that an aggregate of 10,000 shares will vest on the last day of each month during the period from January 1, 2009 through May 31, 2010, and the remaining unvested shares underlying the stock grants will vest on June 30, 2010. Notwithstanding the foregoing, if the Company experiences a change in control (as defined in the Incentive Plan), or if Mr. Farrell resigns, is terminated from his position, ceases to be the Company s Chief Executive Officer or otherwise ceases to be employed by the Company, then all shares underlying the stock grants which have not vested by the end of the month in which such change in control occurs, or at the time of such resignation, termination or cessation, will be forfeited.

During 2007, the Company entered into an employment agreement with Nicolas V. Chater, pursuant to which Mr. Chater has agreed to serve as the Company s Chief Financial Officer until June 30, 2010. Pursuant to the employment agreement, the Company has agreed to pay Mr. Chater for his service as the Company s Chief Financial Officer as follows: (i) a base salary at a rate of $250,000 per year, (ii) an annual retention bonus equal to $25,000 per year and (iii) an annual performance bonus equal to 3% of the Company s EBITDA for such year; provided, that (a) the annual performance bonus may not exceed 100% of the base salary for such year and (b) Mr. Chater s 2008 performance bonus shall not be less than $90,000. The employment agreement also provides that, if Mr. Chater s employment is terminated by the Company without cause or by him for good reason, then Mr. Chater shall be entitled to receive a single lump sum in an amount equal to his then-current salary and performance bonus and shall be entitled to participate in the Company s employee benefit, retirement and compensation plans during the twelve-month period following the date of such termination. Notwithstanding the foregoing, if Mr. Chater s employment is terminated by the Company without cause during the 24-month period following a change of control of the Company, then Mr. Chater will be entitled to receive a lump sum payment of his then-current performance bonus and twice his then-current base salary and shall be entitled to participate in the Company s employee benefit, retirement and compensation plans during the 24-month period following the date of such termination.

The Company has also granted to Mr. Chater, pursuant to the Incentive Plan, an option to purchase 100,000 shares of common stock, with one-half of the underlying shares vesting on each of the first anniversary and the second anniversary of the date of grant. The option has an exercise price equal to the fair market value of our common stock on the date of grant. Subject to availability under the Incentive Plan, the Company has also agreed to grant Mr. Chater an option to purchase up to 50,000 shares of our common stock on each anniversary of the execution of the employment agreement, with such options vesting equally over a two-year period. These options will have an exercise price equal to the fair market value of our common stock on the date of grant. In November 2008, the Compensation Committee of the Board of Directors determined to grant 50,000 restricted shares of our common stock in lieu of such options.

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11. Sales to Major Customers

During the six months ended June 30, 2009 and 2008, respectively, 89%, and 69% of the Company s revenue was earned under contracts with various Federal government agencies through its Paragon Systems/SEP subsidiary. At June 30, 2009, three customers individually accounted for at least 10% of total revenue: the Department of Homeland Security Southern California ($15.2 million or 22% of revenue), the Social Security Administration ($11.3 million or 16% of revenue) and Department of Homeland Security Georgia ($7.0 million or 10% of revenue). At June 30, 2009 and 2008, approximately 94% and 79% of accounts receivable were due from various Federal government agencies, respectively.

12. Segment Reporting

The Company s two reportable segments are Cornwall and Paragon Systems/SEP. The accounting policies applicable to these reportable segments are the same as those described in the summary of significant accounting policies. The Cornwall segment focuses on contract guard services to commercial and state and local government customers. The Paragon Systems/SEP segment focuses on contract guard services to various Federal government agencies.

We considered our organization and reporting structure and the information used by our chief operating decision makers to make decisions about resource allocation and performance assessment and determined management evaluates the performance of the segments based primarily on revenues and operating income (loss). Revenues, operating income, and assets for each segment are as follows (in thousands):

	Total	Discontinued operations - Cornwall	Paragon Systems/SEP	Holding Co.
For the six months ended June 30, 2009				
Revenues	$ 63,020	$	$ 63,020	$
Amortization and depreciation	496		265	231
Operating income (loss)	(1,465)		670	(2,135)
Interest expense, net	2,860		724	2,136
Loss from discontinued operations, net of tax	(1,089)	(1,089)		
Current assets	20,787	1,493	19,165	129
Goodwill	7,747		7,747	
Other intangibles	583			583
Total assets	29,689	1,493	27,454	742

	Total	Discontinued operations - Cornwall	Paragon Systems/SEP	Holding Co.
For the six months ended June 30, 2008				
Revenues	$ 44,459	$	$ 44,459	$
Amortization and depreciation	552		269	283
Operating loss	(1,325)		799	(2,124)
Interest expense, net	2,064		458	1,606
Loss from discontinued segment, net of tax	(568)	(568)		
Current assets	29,822	6,345	23,321	156
Goodwill	16,078	8,331	7,747	
Other intangibles	2,802	2,359	201	242
Total assets	49,523	17,131	31,950	442

	Total	Discontinued operations - Cornwall	Paragon Systems/SEP	Holding Co.
For the three months ended June 30, 2009				
Revenues	$ 33,698	$	$ 33,698	$
Amortization and depreciation	265		148	117
Operating income (loss)	(201)		826	(1,027)
Interest expense, net	1,476		374	1,102

Loss from discontinued operations, net of tax	(515)	(515)		
Current assets	20,787	1,493	19,165	129
Goodwill	7,747		7,747	

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	Total	Discontinued operations - Cornwall	Paragon Systems/SEP	Holding Co.
Other intangibles	583			583
Total assets	29,689	1,493	27,454	742

	Total	Discontinued operations - Cornwall	Paragon Systems/SEP	Holding Co.
For the three months ended June 30, 2008				
Revenues	$ 28,168	$	$ 28,168	$
Amortization and depreciation	282		140	142
Operating loss	(174)		712	(886)
Interest expense, net	1,299		336	963
Loss from discontinued segment, net of tax	(397)	(397)		
Current assets	29,822	6,345	23,321	156
Goodwill	16,078	8,331	7,747	
Other intangibles	2,802	2,359	201	242
Total assets	49,523	17,131	31,950	442

Item 6. Exhibits.

The exhibits required to be filed with this Quarterly Report are set forth on the Exhibit Index included herein.

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934 the registrant has duly caused this amendment to be signed on its behalf by the undersigned thereunto duly authorized.

TRI-S SECURITY CORPORATION

Date: September 4, 2009

/s/ Ronald G. Farrell
Ronald G. Farrell
Chairman of the Board and Chief Executive Officer
(duly authorized signatory and Principal Executive Officer)

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Exhibit No.	Description	Method of Filing
2.1	Asset Purchase Agreement, dated May 13, 2009, among the Company, Florida Business I, Inc., formerly known as The Cornwall Group, Inc., and certain of its affiliates, and U.S. Security Associates, Inc. (The Schedules to the Asset Purchase Agreement have been omitted from this Quarterly Report pursuant to Item 601(b)(2) of Regulation S-K, and the Company agrees to furnish copies of such omitted Schedules supplementally to the SEC upon request.)	Incorporated by reference to Exhibit 2.1 to the Company s Quarterly Report on Form 10-Q for the quarter ended March 31, 2009.
3.1	Amended and Restated Articles of Incorporation.	Incorporated by reference to Exhibit 3.1 to the Company s Registration Statement on Form S-1 (No. 333-119737).
3.2	Amended and Restated Bylaws.	Incorporated by reference to Exhibit 3.2 to the Company s Registration Statement on Form S-1 (No. 333-119737).
3.3	Articles of Amendment to Amended and Restated Articles of Incorporation of the Company, dated September 14, 2007.	Incorporated by reference to Exhibit 3.1 to the Company s Current Report on Form 8-K filed on September 19, 2007.
3.4	Articles of Amendment to Amended and Restated Articles of Incorporation, dated August 5, 2009.	Incorporated by reference to Exhibit 3.1 to the Company s Current Report on Form 8-K filed on August 11, 2009.
3.5	Amendment to the Amended and Restated Bylaws of the Company, adopted September 13, 2007.	Incorporated by reference to Exhibit 3.2 to the Company s Current Report on Form 8-K filed on September 19, 2007.
3.6	Amendment to the Amended and Restated Bylaws of the Company, adopted December 13, 2007.	Incorporated by reference to Exhibit 3.1 to the Company s Current Report on Form 8-K filed on December 19, 2007.
4.1	Rights Agreement, dated August 7, 2009, between the Company and Registrar and Transfer Company.	Incorporated by reference to Exhibit 4.1 to the Company s Current Report on Form 8-K filed on August 11, 2009.
10.1	Escrow Agreement, dated May 13, 2009, among The Cornwall Group, Inc. and certain of its affiliates, U.S. Security Associates, Inc. and SunTrust Bank.	Incorporated by reference to Exhibit 10.2 to the Company s Quarterly Report on Form 10-Q for the quarter ended March 31, 2009.
10.2	Non-Compete Agreement, dated May 13, 2009, among the Company, The Cornwall Group, Inc. and certain of its affiliates, and U.S. Security Associates, Inc.	Incorporated by reference to Exhibit 10.3 to the Company s Quarterly Report on Form 10-Q for the quarter ended March 31, 2009.
10.3	Assignment and Assumption Agreement, dated May 13, 2009, among The Cornwall Group, Inc. and certain of its affiliates, and U.S. Security Associates, Inc.	Incorporated by reference to Exhibit 10.4 to the Company s Quarterly Report on Form 10-Q for the quarter ended March 31, 2009.

10.4	Bill of Sale, dated May 13, 2009, among The Cornwall Group, Inc. and certain of its affiliates, and U.S. Security Associates, Inc.	Incorporated by reference to Exhibit 10.5 to the Company s Quarterly Report on Form 10-Q for the quarter ended March 31, 2009.
31.1	Rule 13a-14(a)/15d-14(a) Certification of the Company s Chief Executive Officer.	Filed herewith.
31.2	Rule 13a-14(a)/15d-14(a) Certification of the Company s Chief Financial Officer.	Filed herewith.
32.1	Section 1350 Certification of the Company s Chief Executive Officer.	Filed herewith.
32.2	Section 1350 Certification of the Company s Chief Financial Officer.	Filed herewith.