

TRI-S SECURITY CORP
Form 10-K
March 31, 2005

[QuickLinks](#) -- Click here to rapidly navigate through this document

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

Form 10-K

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2004

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

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
*(State or Other Jurisdiction of
Incorporation or Organization)*

30-0016962
*(I.R.S. Employer
Identification No.)*

**3700 Mansell Road
Suite 220
Alpharetta, GA 30022**
(Address of Principal Executive Offices)

(770) 625-4945

(Registrant's Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: units (each unit consisting of one share of common stock, par value \$0.001 per share, and a warrant to purchase one share of common stock); common stock, par value \$0.001 per share; and warrants to purchase common stock, par value \$0.001 per share

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 No

Edgar Filing: TRI-S SECURITY CORP - Form 10-K

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes No

As of June 30, 2004, there was no public market for the registrant's common equity.

As of March 25, 2005, 3,285,000 shares of common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE: None.

PART I

Note Regarding Forward-Looking Statements

Tri-S Security Corporation, a Georgia corporation (the "Company", "Tri-S" or "we"), has made forward-looking statements in this Annual Report on Form 10-K for the year ended December 31, 2004 (the "Annual Report"), including, without limitation, in the sections herein titled "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 our management. Forward-looking statements include 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 expressions, are intended to identify such forward-looking statements.

Examples of forward-looking statements in this Annual Report include statements regarding: 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; our ability to retain contracts during re-bidding processes; and the other factors that we describe in this Annual Report under the section herein titled "Management's Discussion and Analysis of Financial Condition and Results of Operations 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 statement. You should understand that many important factors, in addition to those discussed in the sections herein titled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Business" and elsewhere in this Annual Report, could cause our results to differ materially from those expressed in forward-looking statements.

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 Annual Report. 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.

Item 1. Business

Introduction and History

Through our wholly-owned subsidiary, Paragon Systems, Inc., an Alabama corporation ("Paragon Systems"), we provide contract guard services to various Federal government agencies. 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.

We were incorporated in Georgia in October 2001 under the name "Diversified Security Corporation." We changed our name to "Tri-S Security Corporation" on August 16, 2004. Our principal executive offices are located at 3700 Mansell Road, Suite 220, Alpharetta, Georgia 30022, and our telephone number at that address is (770) 625-4945.

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. We intend to pursue acquisition opportunities in the contract guard services and system integration services segments of the security industry. We made our first acquisition (the "Acquisition") on February 27, 2004 when we acquired Paragon Systems, a contract guard services and logistics provider. At the closing of the 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 (referred to herein as the "Paragon Notes") to the former shareholders of Paragon Systems; and (ii) agreed to issue to the former shareholders an aggregate of 100 shares of our Series C Redeemable Preferred Stock, par value \$1.00 per share (the "Series C Redeemable Preferred Stock"), with an aggregate redemption value of \$6.0 million.

On February 8, 2005, pursuant to an Exchange and Recapitalization Agreement between the Company and all the holders of our common stock, par value \$0.001 per share, Series A Convertible Preferred Stock, par value \$1.00 per share (the "Series A Convertible Preferred Stock"), and Series B Convertible Preferred Stock, par value \$1.00 per share (the "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. The transactions effected by the Exchange and Recapitalization agreement are referred to in this Annual Report as the "Exchange and Recapitalization."

On February 9, 2005, we commenced an underwritten initial public offering of 1,800,000 units (plus up to an additional 270,000 units subject to the exercise of the underwriters' over-allotment option), with each unit consisting of one share of our common stock and a warrant to purchase one share of our common stock, 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. We filed a Registration Statement on Form S-1 (No. 333-119737) with the Securities and Exchange Commission (the "SEC") registering pursuant to the Securities Act of 1933, as amended (the "Securities Act"), the securities to be sold in the Initial Public Offering (the "Registration Statement"). The SEC declared the Registration Statement effective on February 8, 2005.

Overview of Our Operations

Prior to the Acquisition, we had no operations. Currently, our operations consist only of the operations of 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 for Lockheed Martin 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

Edgar Filing: TRI-S SECURITY CORP - Form 10-K

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 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.

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.

Through Paragon Systems, we employ over 700 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; Stennis Space Center, in Vicksburg, Mississippi; and Gulfport, Mississippi. At our offices in Huntsville, Alabama we maintain a full support staff to support all field operations, including human resources, accounting, payroll, quality control, logistics, computer services, training, and other supporting functions as needed.

In addition to our core business of providing contract guard services, we have two non-core business interests relating to logistics services. First, 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. This contract will expire in September 2005, and we have not determined whether we will pursue any additional logistics contracts. Second, 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. As a minority equity holder, we do not participate in the management of, or have any operational authority with respect to, Army Fleet Support.

We currently have a total of ten customers and thirteen Federal government contracts. We provide contract guard services for eight of our customers and logistics services for the other two customers. Three of our contract guard customers have two contracts with us. The following table sets forth the number of our Federal government contracts during the time periods and in the revenue ranges indicated:

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

3

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. 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 and technology.

Although we currently provide contract guard services only to Federal government agencies, the contract guard services segment of the security industry also includes state government and private sectors, with customer sites including residential and office buildings, wholesale and retail businesses, warehouses, industrial facilities, hospitals and all state-run properties and facilities. The Federal government, state government and private sectors present diverse operating environments and unique challenges for contract guard service providers operating in such sectors. We intend to expand our operations in the Federal government sector and introduce operations in the state government and private sectors.

The Federal government awards substantially all contracts for contract guard services through a competitive bidding process; however, certain agencies permit negotiated contracting through the U.S. General Services Administration ("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 for the Federal government. Contracting with the Federal government, however, poses certain risks including that the Federal

government may terminate the contract at its discretion, that funds to pay awarded contracts may not be appropriated by Congress, and that service providers to the Federal government may not be able to comply with complex procurement laws.

The private sector enterprises, 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 for such contracts. The private sector provides an opportunity for contract guard service providers to grow through acquisitions.

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.

We currently do not operate in the system integration segment of the security industry; however, we intend to expand our business by selectively pursuing acquisition opportunities in this segment. We intend to target for acquisition existing organizations with established reputations for quality customer service. We will seek to identify and acquire organizations offering customized, integrated systems in the high-end commercial and high-end residential electronic security markets.

We believe that offering system integration services will complement, and create synergies with, the contract guard services we currently offer. In the course of providing contract guard services under our current Federal government contracts, for example, our security guards monitor and operate integrated systems sold and installed by providers of integrated systems. If we are able to sell integrated systems to our clients and install such systems for our clients, in addition to monitoring and operating such systems, then we will be able to offer products and services which complement our contract guard 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 and that of the businesses we may acquire in the future, 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; and

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

Federal Government Contracts

The majority 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 providing additional services under our current Federal government contracts and by negotiated contracts. In March 2005, we engaged Proposal Solutions, Inc., a consulting firm located in the Washington, D.C. area, to assist us in preparing contract bids for contract guard services. We believe this consulting firm will provide valuable assistance to us in preparing our bids.

We intend to hire a full-time employee to provide business development and marketing services for the Company. This person's job responsibilities will 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 \$500,000 and \$50 million over a five-year period. 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.

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 system integration market, we seek to identify and acquire organizations offering customized, integrated systems in the high-end commercial and high-end residential electronic security markets.

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 larger 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.

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 host of quality, sizable regional and local providers that are available for acquisition.

Our Contract Guard Services Operations

Through Paragon Systems, we provide contract guard services to various Federal government agencies. Our contract guard 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 Federal agencies we serve, as well as paying all 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.

We strive to provide cost-effective solutions to ensure the safety and security of the assets 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.

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. This contract, including extensions, expires pursuant to its terms in September 2005, and we have not determined whether we will pursue any additional logistics contracts.

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 and Vertex Aerospace LLC collectively own 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. Vertex Aerospace LLC is an aviation and aerospace technical services company, managing and servicing rotary-wing air craft, as well as other equipment, primarily for government customers.

As a minority equity holder, we do not participate in the management of, or have any operational authority with respect to, Army Fleet Support. None of our management personnel or employees

provides any services to Army Fleet Support. In December 2003, Paragon Systems made an initial capital contribution to Army Fleet Support of \$715,000. Since such time through December 31, 2004, Paragon Systems has received approximately \$2.1 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 focus on Federal government agencies. We market our services through the offices of our subsidiary, Paragon Systems, located in Huntsville, Alabama. Currently, the executive officers of Paragon Systems conduct all of our sales and marketing efforts. We currently do not have a separately designated sales and marketing staff but intend to establish a separate sales and marketing department to identify opportunities in the Federal government and private sectors and to negotiate and bid on Federal government contracts. Our key marketing vehicles are our website, Federal government bulletin board sites on the Internet, word of mouth and customer referrals.

Employees

As of December 31, 2004, we employed approximately 760 individuals, consisting of more than 725 security guards, and 38 managerial and administrative employees. Two of the former shareholders of Paragon Systems served as the President and Executive Vice President of Paragon Systems during 2004 and were responsible for managing substantially all of Paragon Systems' operations relating to the provision of contract guard services. These two individuals were employed by Paragon Systems pursuant to employment agreements which expired in February 2005. We are currently conducting an executive search for a President of Paragon Systems.

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 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 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 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 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 60% of our employees and work under collective bargaining agreements with the following unions: the United Union of Security Guards; the Industrial, Technical and Professional Employees Union; 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.

Generally, our Federal government contracts do not require that we obtain a performance bond; however, one of our current contracts does require a performance bond in the amount equal to 20% of the current year's contract price of \$3.0 million or \$600,000. The fee to obtain this bond is 1% of the bond amount. The bond does not cover losses incurred by our failure to perform due to acts of terrorism.

Customers

Since February 27, 2004, when we acquired Paragon Systems, we have provided our contract guard services to eight customers in eight 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 Corps of Engineers; (iv) the U.S. Coast Guard; (v) the Federal Law Enforcement Training Center; (vi) the NASA John C. Stennis Space Center; (vii) the U.S. Food and Drug Administration; and (viii) the U.S. Army Armed Forces Retirement Home.

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 twelve months ended December 31, 2004, five contracts represented more than 80% of our revenues.

For the year ended December 31, 2004, our contracts with the Social Security Administration, the Department of Homeland Security, the Federal Law Enforcement Training Center and the Stennis Space Center each accounted for more than 10% of our revenue.

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.

We provide contract guard services to Federal government agencies located exclusively in the southeastern United States. On any given contract for which we bid, there are generally five to ten other bidders. 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 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 Federal government contracts through the competitive bidding process. Our primary competitive disadvantage results from our centralized management. Although we maintain field offices at certain contract sites, certain primary support functions for all of our contracts are provided out of our office located in Huntsville, Alabama, which is a competitive disadvantage when we are bidding for contracts against firms willing to establish full-blown support offices at the contract site.

Because of the contract guard services industry's low barriers to entry, other competitors are also likely to 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.

Item 2. 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 subsidiary, Paragon Systems, in Huntsville, Alabama. We lease space at both locations. We are obligated to pay rent on the Alpharetta, Georgia facility of \$1,930 per month. This lease may be terminated upon 30 days' notice. We are obligated to pay rent on the Huntsville, Alabama facility of \$3,850 per month, plus a share of operating expenses, through October 2005.

We lease two additional facilities in Huntsville, Alabama. We use one these facilities to support our guard services contract with the State of Alabama and to house our quality control department, and we are obligated to pay rent on this facility of \$1,250 per month through October 2005. We use the other facility to support our logistics services business, and we are obligated to pay rent on this facility of \$2,013 per month through November 2005. Paragon Systems also maintains an off-site facility used for office space located in Baltimore, Maryland on which we are obligated to pay rent of \$2,275 through December 2006.

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. We have leased our office locations at market rates prevailing at the time the leases for such facilities were executed.

Item 3. Legal Proceedings

Based on currently known facts, we believe 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.

Item 4. Submission of Matters to a Vote of Security Holders

On October 13, 2004, the Company's shareholders took the following actions by written consent in lieu of a 2004 annual meeting of the Company's shareholders:

- (i) approved and adopted the Company's amended and restated articles of incorporation in the form filed as Exhibit 3.1 to this Annual Report;
- (ii) approved and adopted the Company's amended and restated bylaws in the form filed as Exhibit 3.2 to this Annual Report;
- (iii) approved and adopted the Company's 2004 Stock Incentive Plan in the form filed as Exhibit 10.42 to this Annual Report; and
- (iv) elected James M. Logsdon to serve as a Class I director of the Company, James A. Verbrugge to serve as a Class II director of the Company, and Ronald G. Farrell and Lee K. Toole to each serve as a Class III director of the Company, with each Class I, Class II and Class III director to serve commencing on the completion of the Initial Public Offering and until the date of the annual meeting of the Company's shareholders held in 2005, 2006 and 2007, respectively, and until such director's successor has been duly elected and qualified or until such director's earlier death, resignation or removal.

The actions of the Company's shareholders taken by written consent on October 13, 2004 were taken by shareholders holding 2,500,000 shares of common stock, which constituted a majority of the outstanding shares of common stock entitled to take such actions.

On January 22, 2005, the Company held its 2005 annual meeting of shareholders (the "Meeting") at which the Company's shareholders took the following actions to adjust the terms of office of the directors of the Company as approved by the Company's shareholders on October 13, 2004:

- (i) elected Mr. Logsdon to serve as a Class I director of the Company, commencing upon the date on which the Registration Statement is declared effective by the SEC and until the date of the Company's 2006 annual meeting of shareholders and until his successor is elected and qualified or until his earlier death, resignation or removal;
- (ii) elected Dr. Verbrugge to serve as a Class II director of the Company, commencing upon the date on which the Registration Statement is declared effective by the SEC and until the date of the Company's 2007 annual meeting of shareholders and until his successor is elected and qualified or until his earlier death, resignation or removal; and
- (iii) elected each of Messrs. Farrell and Toole to serve as a Class III director of the Company, commencing upon the date on which the Registration Statement is declared effective by the SEC and until the date of the Company's 2008 annual meeting of shareholders and until their successors are elected and qualified or until their earlier death, resignation or removal.

The election of each of the directors at the Meeting received the approval of shareholders holding 2,500,000 shares of common stock, which constituted a majority of the outstanding shares of common stock entitled to vote. No votes were withheld or abstained with respect to the

election of directors at the Meeting.

Item 4.5 Executive Officers of the Registrant

Pursuant to General Instruction G (3) of Form 10-K under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), the information regarding the Company's executive officers required by Item 401 of Regulation S-K is hereby included in Part I of this Annual Report.

The following table sets forth the name of each executive officer of the Company, the office held by such officer and the age, as of March 25, 2005, of such officer:

Name	Age	Position
Ronald G. Farrell	61	Chairman of the Board, President and Chief Executive Officer of the Company
E. Wayne Stallings	59	Chief Financial Officer of the Company
Carla Cilyok	38	Chief Financial Officer of Paragon Systems

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

Ronald G. Farrell is the Company's founder and has served as a director and the President and Chief Executive Officer of the Company since the Company was formed in October 2001. 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 served as Chairman of the Board and Chief Executive Officer of Computer Integration Corporation, Sports Leisure, Inc., Automotive Industries, Inc. and Builders Design, Inc.

E. Wayne Stallings has served as the Company's Chief Financial Officer since October 2004. From 1992 to September 2004, Mr. Stallings served in various executive capacities, including Senior Vice President and Chief Financial Officer, with Wellington Leisure Products, Inc., a manufacturer of rope and outdoor products. In February 2003, Wellington Leisure Products, Inc. filed for protection under Chapter 11 of the United States Bankruptcy Code. Mr. Stallings was Chief Financial Officer of Wellington Leisure Products, Inc. from November 1992 to January 2003. Prior to 1992, Mr. Stallings served in various executive capacities for over 10 years in the United States corporate office of Grand Metropolitan, PLC, a United Kingdom public company.

Carla Cilyok has served as the Chief Financial Officer and controller of Paragon Systems since 1997. Prior to 1997, Ms. Cilyok served as the Business Manager for Paragon Systems.

There are no family relationships among any of our executive officers or directors. Except as disclosed in the section of this Annual Report titled "Executive Compensation Employment Agreements", no arrangement or understanding exists between any executive officer and any other person pursuant to which any executive officer was selected to serve as an executive officer. To the best of our knowledge, (i) there are no material proceedings to which any executive officer of the Company is a party, or has a material interest, adverse to the Company; and (ii) there have been no events under any bankruptcy act, no criminal proceedings and no judgments or injunctions that are material to the evaluation of the ability or integrity of any executive officer during the past five years. Our executive officers of the Company are elected or appointed by our board of directors and hold office until their successors are elected and qualified, or until their death, resignation or removal, subject to the terms of applicable employment agreements.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issue Purchases of Equity Securities

Market for Common Equity

Our units commenced trading on The Nasdaq SmallCap Market under the symbol "TRISU" on February 9, 2005. Prior to February 9, 2005, there was no established public trading market or reported quotations of any nature for our units, common stock or warrants.

The units will cease trading on The Nasdaq SmallCap Market at the market's close on April 8, 2005. Commencing on April 11, 2005, our common stock and warrants will trade separately on The Nasdaq SmallCap Market under the symbols "TRIS" and "TRISW", respectively.

As of March 25, 2005, there were approximately 13 holders of record of our common stock.

We have never declared or paid cash dividends on our common stock. We currently intend to retain any earnings for use in our operations and do not anticipate paying cash dividends on our common stock in the foreseeable future.

Sales of Unregistered Securities

During the year ended December 31, 2004, we issued unregistered securities to a limited number of individuals, as described below. None of these transactions involved any underwriters, underwriting discounts or commissions, or any public offering, and we believe that each transaction was exempt from the registration requirements of the Securities Act by virtue of Section 4(2) thereof and Regulation D promulgated thereunder ("Regulation D"). The recipients of securities in each such transaction represented their intention to acquire the securities for investment only and not with a view to or for sale in connection with any distribution thereof. In each instance, the recipients were accredited investors, as that term is defined in Rule 501 of Regulation D. All recipients had adequate access, through their relationships with us, to information about us. Set forth below is a description of the issuances of unregistered securities made by us during the year ended December 31, 2004.

On March 3, 2004, we issued 10,000 shares of Series B Convertible Preferred Stock to Michael Bennett, an accredited investor and a beneficial holder of greater than 5% of our common stock, for a purchase price of \$5.00 per share.

On March 3, 2004, we issued 15,000 shares of common stock to Mr. Bennett in exchange for consulting services rendered by him on our behalf.

On February 27, 2004, we issued an aggregate of 100 shares of our Series C Redeemable Preferred Stock to the former shareholders of Paragon Systems in connection with the Acquisition of Paragon Systems. The shares have an aggregate redemption value of \$6.0 million.

In July 2004, we issued a warrant to purchase 50,000 shares of common stock with an exercise price of \$1.00 per share to BRE LLC in connection with entering into our credit agreement. This warrant was exchanged in the Exchange and Recapitalization for a warrant to purchase 16,181 shares of common stock at an exercise price of \$3.09 per share.

Use of Proceeds of Initial Public Offering

In connection with our Initial Public Offering, on February 8, 2005, the SEC declared effective our Registration Statement (No. 333-119737). Pursuant to the Registration Statement we registered under the Securities Act the sale and issuance of 1,800,000 units, plus an additional 270,000 units underlying the underwriters' over-allotment option. Each unit consists of one share of common stock and one warrant to purchase one share of common stock. The initial public offering price of the units was \$6.00

per unit. The managing underwriters of the offering were Capital Growth Financial, LLC and Bathgate Capital Partners LLC.

Our Initial Public Offering commenced on February 9, 2005. The initial 1,800,000 units were sold to underwriters at a unit price of \$5.52 per unit at the closing of the offering on February 14, 2005. On March 15, 2005, the underwriters exercised their over-allotment option to purchase the additional 270,000 units. The additional 270,000 units were sold to the underwriters at a unit price of \$5.52 per unit at the closing of the over-allotment option on March 17, 2005. All of the units were sold by us. There were no selling shareholders in the offering.

The aggregate gross proceeds from the units sold, including the units sold pursuant to the exercise of the underwriters' over-allotment option, were approximately \$12.4 million. The aggregate net proceeds to us were approximately \$10.3 million after deducting approximately \$2.1 million in underwriting discounts and commissions, offering expenses and consulting fees.

We used approximately \$8.1 million of the net proceeds in repayment of the Paragon Notes, \$300,000 in payment of accrued interest due on our Series C Redeemable Preferred Stock and \$1.1 million for working capital needs.

Item 6. Selected Financial Data

We did not have an operating business before our acquisition of Paragon Systems. The financial statements of Paragon Systems, as an operating entity, provide the more relevant information available for time periods prior to the Acquisition. Consequently, the selected financial data set forth below presents the selected financial data of Paragon Systems prior to the Acquisition and the consolidated selected financial data of the Company for the year ended December 31, 2004, which includes the operations of Paragon Systems after the Acquisition. The historical results are not necessarily indicative of future results.

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.

Paragon Systems was formerly a subchapter S corporation and, 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 selected financial data for the periods presented prior to February 27, 2004. The necessary adjustments include only taxes at a statutory rate of 38% for each period presented. The pro forma income per share calculation of operations prior to February 27, 2004 is based on the weighted average number of common shares outstanding of Tri-S.

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 periods prior to the Acquisition, it is assumed that the Company was incorporated on January 1, 2000.

The operations of Tri-S prior to February 27, 2004 consisted primarily of expenditures relating to the identification and pursuit of acquisition opportunities. For 2003, 2002 and 2001, such expenditures amounted to \$347,000, \$216,000 and \$100,000, respectively. Tri-S recognized deferred income tax benefits on these expenditures of \$130,000, \$80,000 and \$40,000 for 2003, 2002 and 2001, respectively. The loss per share (basic and diluted) for Tri-S for 2003, 2002 and 2001 was \$0.26, \$0.16 and \$0.08, respectively.

The selected financial data should be read in conjunction with our consolidated financial statements, related notes and other financial information set forth in Item 15 hereof, and

Edgar Filing: TRI-S SECURITY CORP - Form 10-K

"Management's Discussion and Analysis of Financial Condition and Results of Operations," set forth in Item 7 hereof.

Selected Financial Data	Paragon Systems, Inc.					
	Tri-S Security Corporation and Subsidiary Consolidated	Jan. 1, 2004 to Feb. 27, 2004	2003	2002	2001	2000
	2004					
(In thousands, except per share data)						
Statement of Operations Data:						
Revenues	\$ 25,425	\$ 4,705	\$ 29,395	\$ 21,364	\$ 16,491	\$ 7,698
Direct labor	13,810	2,481	16,070	11,983	9,092	3,076
% of revenues	54.32%	52.73%	54.67%	56.09%	55.13%	39.96%
Indirect labor and other contract support costs	10,223	2,113	11,151	7,615	6,000	3,417
% of revenues	40.21%	44.91%	37.94%	35.64%	36.38%	44.39%
Amortization of government contracts	298					
% of revenues	1.17%					
Gross profit	1,094	111	2,174	1,766	1,399	1,205
% of revenues	4.30%	2.36%	7.40%	8.27%	8.48%	15.65%
Selling, general and administrative expenses	2,115	230	1,466	1,179	896	652
% of revenues	8.32%	4.89%	4.99%	5.52%	5.43%	8.47%
Amortization expense	462					
Operating income (loss)	(1,021)	(119)	708	587	503	553
% of revenues	-4.02%	-2.53%	2.41%	2.74%	3.05%	7.18%
Depreciation expense	155	28	175	68	88	62
Interest income	3		12	23	28	
Interest expense	(1,380)	(11)	(30)	(7)	(11)	(14)
Interest on redeemable preferred stock	(250)					
Income (loss) before income taxes	(2,648)	(130)	690	603	520	539
Income tax expense (benefit)	(1,008)					
Pro forma income tax expense (benefit)		(49)	262	229	198	205
Net income (loss)	(1,640)					
Pro forma net income (loss)		(81)	428	374	322	334
Basic net income (loss) per common share	(1.98)					
Pro forma basic net income (loss) per common share		(0.10)	0.52	0.46	0.40	0.41
Diluted net income (loss) per common share	(1.98)					
Pro forma diluted net income (loss) per common share		(0.10)	0.39	0.40	0.40	0.41
Balance Sheet Data (at Period End):						
Cash	\$ 313	\$ 275	\$ 846	\$ 877	\$ 647	\$ 239
Current assets	6,636	6,803	5,713	5,911	5,003	3,005
Total assets	22,981	7,230	6,883	6,114	5,147	3,201
Long term obligations	9,822	175	185			
Total liabilities	24,262	3,720	3,243	3,124	2,760	1,207
Cash dividends						

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The results of operations set forth below are presented on a historical basis for the Company. Historical amounts for the years ended December 31, 2004, 2003 and 2002, are derived from audited financial statements for Paragon Systems and Tri-S and represent the mathematical addition of the results of operations for Paragon Systems and Tri-S for such years. The results of operations set forth below include the administrative expenses of Tri-S for all years presented.

Edgar Filing: TRI-S SECURITY CORP - Form 10-K

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 Acquisition. The application of purchase accounting generally results in higher depreciation and amortization expense in periods subsequent to the Acquisition. Accordingly, the results discussed for the year ended December 31, 2004 are not comparable with prior years.

Overview

We operate in a single reportable segment offering contract guard services to various Federal government agencies pursuant to long-term contracts. These guard services include providing uniformed and armed guards for access control, personnel protection, plant security, theft prevention, surveillance, vehicular and foot patrol, 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 Federal government agencies we serve as well as paying all guards and providing them with uniforms, fringe benefits and workers' compensation insurance.

We were incorporated in Georgia in October 2001 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. We currently intend to pursue acquisition opportunities in the contract guard services and systems integration services segments of the security industry. To this end, we acquired Paragon Systems in February 2004. Paragon Systems has been providing contract guard services to Federal government agencies since 1994.

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.

During the year ended December 31, 2004, the Federal government exercised option renewals for eleven of our existing contracts and a six month extension on one of our contracts for providing contract guard and logistics services, which contracts generate aggregate annual revenue of approximately \$30.0 million. Paragon Systems also obtained one new contract for providing contract guard services, which contract generates annual revenue of approximately \$250,000.

During the year ended December 31, 2003, the Federal government exercised option renewals for seven of our existing contracts for providing contract guard and logistics services, which contracts generate aggregate annual revenue of approximately \$9.8 million. Paragon Systems also obtained four new contracts for providing contract guard services, which contracts generate aggregate annual revenue of approximately \$17.7 million. One contract for providing contract guard services which expired on December 31, 2002 was renewed for an additional five-year period and generates aggregate annual revenue of approximately \$1.3 million.

During 2005, all of our existinFONT>

Partner of the Company's accounting auditor or employee of such firm who works on the Company's audit.

- (2) Executive of a Major Lender (*2) of the Company.
- (3) Executive of a Major Business Partner (*3) of the Company (including Partners, etc.).
- (4) A person receiving compensation from the Nomura Group of more than 10 million yen per year, excluding director/officer compensation.
- (5) A person executing the business of an institution receiving more than a Certain Amount of Donation (*4) from the Company.

Edgar Filing: TRI-S SECURITY CORP - Form 10-K

The person's spouse, relatives within the second degree of kinship or anyone who lives with the person shall not correspond to a person listed below (excluding persons in unimportant positions):

(1) Executive of the Nomura Group; or

(2) A person identified in any of subsections (1) ~ (5) in Section 1 above.

(Notes)

- *1: Executive shall mean Executive Directors (*gyoumu shikkou torishimariyaku*), Executive Officers (*shikkouyaku*) and important employees (*jyuuyou na shiyounin*), including Senior Managing Directors (*shikkouyakuin*), etc.
- *2: Major Lender shall mean a lender from whom the Company borrows an amount equal to or greater than 2% of the consolidated total assets of the Company.
- *3: Major Business Partner shall mean a business partner whose transactions with the Company exceed 2% of such business partner's consolidated gross revenues in the last completed fiscal year.
- *4: Certain Amount of Donation shall mean a donation that exceeds 10 million yen per year that is greater than 2% of the donee institution's gross revenues or ordinary income.

<Incentives and Remuneration>

Implementation of Initiatives to offer Incentives to Directors and Executive Officers

Introduction of a performance-linked remuneration system, introduction of stock option plans and others

Table of Contents

Supplementary Explanation

Pursuant to the Compensation Policy (the details explained in Remuneration of Directors and Executive Officers) set by the Compensation Committee, the compensation of Directors and Executive Officers is composed of base salary, annual bonus and long-term incentive plans. Regarding annual bonus, depending on the level of bonus payment, a portion of payment of annual bonus may be deferred.

The Company's deferred compensation plans are as follows:

1. Core deferral plans

Stock Acquisition Right (SAR) Plan B or Notional Stock Unit (NSU) Plan (linked to the Company's stock price. Designed to replicate the key features of the SAR Plan B, and allows equity-linked awards to be made in countries where SARs are less favorably treated from tax or other perspectives)

2. Supplemental deferral plans

Collared Notional Stock Unit Plan (linked to the value of the Company's stock price subject to a cap and a floor) or Notional Indexed Unit Plan (linked to a world stock index quoted by Morgan Stanley Capital International)

Persons Eligible for Stock Options

Inside Directors, Executive Officers, employees, Directors/Executive Officers/ employees of subsidiaries

Supplementary Explanation

The Company has two types of SAR plans to maintain incentives for high levels of performance and to recruit talented staff. The exercise price for SAR Plan A is determined based on the market price when issued, and the exercise price of SAR Plan B is 1 yen per share.

<Remuneration of Directors and Executive Officers>

Disclosure of individual Director Remuneration

Disclosed in part

Disclosure of individual Executive Officer Remuneration

Disclosed in part

Supplementary Explanation

Information concerning compensation for Directors and Executive Officers is disclosed in the *Yukashoken-hokokusho* (Annual Report), Business Report, Form 20-F submitted to the SEC, Explanatory Document on the Status of Operation and Property and other documents all of these documents can be accessed on the Company's website. Individual compensation of certain Directors and Executive Officers is disclosed in the Annual Report in accordance with the Cabinet Office Ordinance on Disclosure of Corporate Affairs, etc.

Whether there are any policies for the calculation of remuneration

Yes

Amount of Remuneration or disclosure of the policy for the calculation of remuneration

<Compensation Policy of Nomura Group >

Edgar Filing: TRI-S SECURITY CORP - Form 10-K

Nomura group is establishing its status firmly as a globally competitive financial services group. To support this, we recognize that our people are our most valuable asset. We have therefore developed our Compensation Policy to ensure we attract, retain, motivate and develop our key talent.

Our Compensation Policy is based around six key themes:

1. Align with Nomura Values and Strategies

Compensation is designed to support delivery against the broader strategic aims of the Group.

Levels and structures of compensation reflect the needs of each business line and allow the Group to effectively compete for key talent in the market.

We develop our staff to support the Nomura values.

2. Reflect Firm, Division and Individual Performance

Pay for Performance is our fundamental principle to motivate and reward our key talent regardless of personal background.

We manage compensation on a firm-wide basis, taking into account the performance of the Group and supporting our ethos of sustainable growth, collaboration and client service. This enables us to manage strategic investments and still operate market-competitive compensation practices.

An individual's compensation is determined by properly reflecting the Group, division and individual performance, ensuring that it is aligned with both the business strategy and market considerations.

Individual compensation award decisions are underpinned by valid and rigorous performance management processes and supporting systems.

Table of Contents

3. Establish Appropriate Performance Measurement with a Focus on Risk

Compensation is not determined by reference solely to revenues. Risk-adjusted profits are being emphasized in Nomura's management information and performance systems and processes.

In addition, qualitative factors such as cross-divisional collaboration, risk management, alignment with organizational values, and compliance are stressed when evaluating performance.

Performance measurement reflects the business needs, taking account of risk associated with each business. Such risk includes market, credit, operational, and liquidity risk among others.

In assessing and measuring risk for compensation, input and advice is received from the risk management and finance divisions.

4. Align Employee and Shareholder Interests

Compensation of group executives and higher paid employees should reflect the achievement of targets which are in line with the creation of shareholder value.

For higher paid executives and employees, a part of their compensation is delivered in equity-linked awards with appropriate vesting periods to ensure that their interests are closely aligned with those of shareholders.

5. Appropriate Compensation Structures

The compensation structure reflects our desire to grow and develop our talent. It is merit based, reflecting performance and is regularly reviewed to ensure its fairness.

For higher paid executives and employees, a significant portion of compensation is deferred, balancing short-term interests with longer-term stewardship of the Group.

Deferred compensation should be subject to forfeiture or clawback in the event of a material restatement of earnings or other significant harm to the business of Nomura.

The percentage of deferral increases as an employee's total compensation increases. A part of deferred compensation is delivered in mid/long-term incentive plans, such as equity linked awards with appropriate vesting periods.

Guarantees of bonus/compensation should be allowed only in limited circumstances such as new hiring or strategic business needs, and multi-year guarantees should not be used as a matter of course.

Edgar Filing: TRI-S SECURITY CORP - Form 10-K

There should be no special or expensive retirement/severance guarantees for senior executives.

Nomura will respect all areas in which it operates and will seek to ensure pay structures reflect the needs of the organization as well as regulatory and government bodies.

6. Ensure Robust Governance and Control Processes

This Policy and any change hereof must be approved by Nomura Holdings Compensation Committee, a majority of which consists of non-executive outside directors.

The Compensation Committee of Nomura Holdings decides individual amounts as well as compensation policy for Directors and Executive Officers of Nomura Holdings, in line with this Policy.

Globally, we institute a review and authorization policy for senior or high-level contracts ensuring consistency with this Policy. This is administered by Human Resources, involves Finance, Risk Management and Regional Compensation Committees and is reviewed by the Executive Managing Board.

Compensation for employees of risk management and compliance functions is determined independently of other business divisions.

The Compensation Committee uses market and specialist advisory groups to advise on appropriate compensation structures and levels as necessary.

< Compensation Policy for Directors and Executive Officers of Nomura Holdings, Inc.>

Compensation of Directors and Executive Officers is composed of base salary, cash bonus and long-term incentive plans.

1) Base Salary

Base salary is determined based on factors such as professional background, career history, responsibilities and compensation standards of related business fields.

A portion of base salary may be paid in equity linked awards with appropriate vesting periods to ensure that medium to long-term interests of Directors and Executive Officers are closely aligned with those of shareholders.

2) Cash Bonus

Cash bonuses of Directors and Executive Officers are determined by taking into account both quantitative and qualitative factors. Quantitative factors include performance of the Group and the division. Qualitative factors include achievement of individual goals and subjective assessment of individual contribution.

Depending on the level of bonus payment, a portion of payment in cash may be deferred. In addition, a portion of deferred bonus may be paid in equity linked awards with appropriate vesting periods in lieu of cash to ensure that medium to long-term interests of Directors and Executive Officers are closely aligned with those of shareholders. Such deferred bonus may be unpaid or forfeited under specific

circumstances.

3) Long-term Incentive Plan

Long-term incentive plans may be awarded to Directors and Executive Officers, depending on their individual responsibilities and performance.

Payments under long-term incentive plans are made when a certain degree of achievements are accomplished. Payments are made in equity linked awards with appropriate vesting periods to ensure that medium to long-term interests of Directors and Executive Officers are closely aligned with those of shareholders.

Table of Contents

< Support System for Outside Directors> [Updated]

The Company has established the Office of Non-Executive Directors and Audit Committee as an organization to support the Audit Committee and Directors' execution of duties. The Office of Non-Executive Directors and Audit Committee serve as a secretariat of the Audit Committee and support Directors to perform their duties, such as by periodic provision of information on the management to Outside Directors.

As a principle process for meetings of the Board of Directors, the necessary explanations on important matters of the Company including business, business plan, financial status, and governance structures such as the internal controls systems, etc., are continuously provided by using occasions such as the briefings prior to meetings of the Board of Directors.

In addition, the Outside Directors may, as necessary, request an explanation or report and/or request materials from Executive Officers and employees, and consult legal, accounting, or other outside experts at the Company's expense.

2. Matters Concerning Respective Decision-Making Functions for the Execution of Business, Audits, Supervision, Nominations, and Remuneration (Current Corporate Governance System) [Updated]

Business Execution Process

As a Company with Three Board Committees, the Board of Directors has, to the extent permitted by laws and regulations, delegated to the Executive Officers decision making authority for business execution functions to ensure that the Executive Officers can execute the Company's business with speed and efficiency. Among the matters delegated to the Executive Officers by resolutions adopted by the Board of Directors, the most important matters of business must be decided upon deliberation by specific management bodies within the Company including the Executive Management Board, the Group Integrated Risk Management Committee, and the Internal Controls Committee. These management bodies are required to report to the Board of Directors on the status of their deliberations at least once every three months. The roles and members of each management body are outlined below.

1. Executive Management Board

This Board is chaired by the Group Chief Executive Officer (Group CEO) and also consists of the Group Chief Operating Officer (Group COO) and other persons designated by the Group CEO. The Executive Management Board deliberates and determines management strategies, business plans, budgets, allocation of management resources, and other important matters related to the management of the Nomura Group.

2. Group Integrated Risk Management Committee

This committee is chaired by the Group CEO and also consists of the Group COO, Divisional Heads (responsible for execution of business in each division) and the Chief Risk Officer (CRO), Chief Financial Officer (CFO), Chief Legal Officer (CLO), Co-CRO and other persons designated by the Group CEO. The Executive Management Board has delegated authority to the Group Integrated Risk Committee to deliberate and determine important matters concerning enterprise risk management of the Nomura Group. The Global Risk Management Committee has been established under the Group Integrated Risk Management Committee to deliberate and decide on individual matters that are highly prioritized from the perspective of position-risk management. As to other efforts concerning risk management, taking into consideration international perspectives, the Company continues to build structures for the furtherance of appropriate management preparedness, such as a board on liquidity risk and a division dedicated to information gathering and analysis on risk management.

3. Internal Controls Committee

This committee is chaired by the Group CEO, any person(s) designated by the Group CEO, an Audit Committee member elected by the Audit Committee, and a Director elected by the Board of Directors. The Internal Controls Committee deliberates and decides upon principal matters related to the maintenance and assessment of internal controls with respect to the Nomura Group's business operation systems, and matters related to the promotion of proper corporate behavior throughout the Nomura Group.

Edgar Filing: TRI-S SECURITY CORP - Form 10-K

In order to further bolster the Company's business execution framework for financial operations that are becoming increasingly sophisticated and specialized, the Company utilizes a system whereby the Executive Officers delegate a part of their authority for business execution decisions to Senior Managing Directors, who focus on individual business and operations.

In addition to the above, an Advisory Board, consisting of external leaders with extensive expertise, has been established as a consultative panel for the Executive Management Board to utilize outside opinions in planning the Company's management strategies.

The Board of Directors and Committees

As an entity adopting the Company with Three Board Committees structure where management oversight and business execution functions are clearly separated, the Board of Directors and the Audit Committee (comprised of a majority of Outside Directors) perform the central role in management oversight functions within the Company. The Chair of the Board of Directors is held by a Director who is not concurrently serving as an Executive Officer, allowing the Board of Directors to better oversee the business conducted by the Executive Officers. The Audit Committee is chaired by an Outside Director, making its independence from the management even clearer. Aiming for transparent management under oversight with an emphasis on external perspective, the Company's Board of Directors is comprised of ten members: Nobuyuki Koga, Koji Nagai, Tetsu Ozaki, Hisato Miyashita, Takao Kusakari, Hiroshi Kimura, Noriaki Shimazaki, Toshinori Kanemoto, Mari Sono and Michael Lim Choo San (including 6 Outside Directors). The Outside Directors, by applying their extensive experience and comprehensive knowledge, and through their activities at the Board of Directors and each of the Nomination, Audit and Compensation Committees, monitor management decisions on significant issues and business execution.

Table of Contents

The Company has established the Nomination Committee, Audit Committee, and Compensation Committee, each comprised of a majority of Outside Directors. The overviews of each Committee are as follows:

1. Nomination Committee

This Committee is a statutory organ which determines the details of any proposals concerning the election and dismissal of Directors to be submitted to general meetings of shareholders. The three members of the committee are elected by the Board of Directors. The Committee's decisions are based on determined standards relating to personality, insight, expertise and experience in corporate management, independence and others. The current members of this Committee are: Nobuyuki Koga, a Director not concurrently serving as an Executive Officer, and Outside Directors Takao Kusakari and Hiroshi Kimura. This Committee is chaired by Nobuyuki Koga.

2. Audit Committee

This Committee is a statutory organ which (i) audits the execution by the Directors and Executive Officers of their duties and the preparation of audit reports and (ii) determines the details of proposals concerning the election, dismissal, and non-reappointment of the accounting auditors to be submitted to general meetings of shareholders. The four members of the Committee are elected by the Board of Directors. The current members of the Committee are: Outside Directors Noriaki Shimazaki, Toshinori Kanemoto, and Mari Sono, and a full-time member of the Audit Committee, Hisato Miyashita. This Committee is chaired by Noriaki Shimazaki. All members satisfy requirements for independent directors as defined in the Sarbanes-Oxley Act of 2002, and Noriaki Shimazaki is a Financial Expert under this Act and has comprehensive knowledge in the areas of finance and accounting.

3. Compensation Committee

This Committee is a statutory organ which determines the Company's policy with respect to the determination of the details of each Director and Executive Officer's compensation. The committee also determines the details of each Director and Executive Officer's actual compensation. The three members of the committee are elected by the Board of Directors. The current members of this committee are: Nobuyuki Koga, a Director not concurrently serving as an Executive Officer, and Outside Directors Takao Kusakari and Hiroshi Kimura. This Committee is chaired by Nobuyuki Koga.

3. Reasons for Adopting the Current Corporate Governance System

The Company with Three Board Committees structure clearly separates management oversight and business execution functions. The Company with Three Board Committees structure expedites the decision-making process by broadly delegating authority for the execution of business functions from the Board of Directors to the Executive Officers. Further, the Company with Three Board Committees structure enhances management oversight and increases transparency by establishing the Nomination, Audit and Compensation Committees, and the majority of the members of each committee are Outside Directors. Among the various organizational structures the Company could have chosen to adopt, the Company believes that the Company with Three Board Committees structure is the most compatible with the corporate governance standards which form a part of the New York Stock Exchange (NYSE) (which the company is listed on) Listed Company Manual. The Company determined that the Company with Three Board Committees structure is the most suitable form of corporate governance at this point in time for the reasons above.

III Implementation of Measures for Shareholders and Other Interested Parties

1. Efforts for Active Meetings of Shareholders and Smooth Exercise of Voting Rights [Updated]

Supplementary Explanation

- a. Early notification for general meetings of shareholders The Company sends a Notice of Convocation at least 3 weeks prior to the day of the general meeting of shareholders in order to allow sufficient time for our shareholders to consider proposed resolutions.

Edgar Filing: TRI-S SECURITY CORP - Form 10-K

Aiming to further enhance convenience, the Company will post the Notice of Convocation on its website approximately one week prior to mailing the Notice of Convocation.

- b. Scheduling general meetings of shareholders to avoid peak days
- The Company believes that for our shareholders to understand our management and our management personnel, the general meeting of shareholders is one of the important ways of communicating between our shareholders and our management. Accordingly, the Company endeavors to schedule general meetings of shareholders so that many of our shareholders will be able to attend and participate in active discussions.
- c. Exercise of voting rights by electronic means
- Shareholders may exercise their voting rights electronically by accessing the website specified by the Company (<http://www.evotep.jp>) using a computer, smartphone or cell-phone.

Table of Contents

d. Participation in electronic voting platform and other efforts to improve environment for exercising voting rights by institutional investors	Custodian trust banks and other shareholders who are nominal owners may use the electronic voting platform for institutional investors operated by ICJ Inc., a joint venture company established by the Tokyo Stock Exchange, Inc. and others.
e. Providing notices of convocation in English	The Company strives to enhance convenience for shareholders, such as by preparing notices of convocation and its business reports in English and by posting such documents on the Company's website simultaneously with the Japanese documents.
f. Others	The Company utilizes video and slides to present our business reports at general meetings of the shareholders so that it may be easily understood visually. Further, for policies about ensuring shareholder rights, please refer to Article 20 Ensuring Shareholder Rights of the Guidelines.

2. Investor Relations (IR) Activities

	Supplementary Explanation	Presentation by the Representative
a. Establishing and announcing disclosure policy	Nomura Group provides investors with fair opportunities to access information about the Nomura Group, based on the Nomura Group's Statement of Global Corporate Policy Regarding Public Disclosure of Information, which was established in accordance with our policies to prohibit disclosing material and nonpublic information in a selective forum, to enhance timely and fair disclosure to third parties, and based on the purpose of Regulation FD in the U.S. Pursuant to the said policy, the Company has established the Disclosure Committee to deliberate and determine material matters related to disclosure of its information, including the operating rules for disclosure of material information regarding the Nomura Group and preparing legal disclosure materials. The said policy is available on our website. Further, for policies regarding information disclosure, please refer to Article 19 Information Disclosures of the Guidelines.	
b. Regular briefings for individual investors	While the Company does not hold regular briefings for individual investors, starting with the closing of our books for the fiscal year ended March 2003, we hold regular briefings on financial results for institutional investors by way of conference calls, and recorded audio files are made available on the Company's website for individual investors. Further, disclosure materials including our business reports, annual reports and presentation materials used at those briefings for institutional investors are also available on our website.	No
c. Regular briefings for analysts and institutional investors	The Company holds regular semi-annual briefings for analysts and institutional investors on our management policy and business strategy in Japan. The Company also holds regular conference calls, after announcing the financial results for each quarter. Further, the management and staff of the Investor Relations Department visit institutional investors individually.	Yes
d. Regular briefings for overseas investors	The Company holds briefings by the management abroad, several times per year. The Company also holds regular conference calls for overseas investors, after announcing the financial results for each quarter. Furthermore, the management and staff of the Investor Relations Department visit institutional investors individually. Materials regarding our management policy and business strategy mentioned in the preceding item are also made available in English on our website.	Yes
e. Disclosing IR materials on the company website	Materials regarding financial information, annual reports, and presentation materials used at various briefings are disclosed on our website (http://www.nomuraholdings.com/investor/)	
f. Department (person responsible) for IR	Department: Investor Relations Department	

g. Others

In order to provide continuous IR services to our investors in Japan and abroad, the Company established the Investor Relations Department in 1998 that is responsible for IR services, and also has assigned IR representatives in New York since 2000.

Further, for policies regarding dialogue with shareholders, please refer to Article 21 Dialogue with Shareholders of the Guidelines.

Table of Contents

3. Measures to Ensure Due Respect for the Stakeholders Standpoint [Updated]

Supplementary Explanation

a. Establishing internal regulations to ensure due respect for the stakeholders standpoint

In March 2004, the Company established the Code of Ethics of Nomura Group applicable to all of the Nomura Group's Officers and employees globally (the Code). The Code is based on the principles of the Company's founder and sets forth matters related to corporate governance and corporate social responsibility that each Officer and employee of the Nomura Group should comply with, and training is conducted to achieve comprehensive awareness. The Company further obtains written oaths from Officers and employees to comply with the Code. The Code is available on our website. In addition, the Company established its Mission Statement in March 2007, which sets forth the importance of our commitment to enriching society and continue to keep the trust of our clients.

Further, for policies related to stakeholders, please refer to Article 22 the Code of Ethics of Nomura Group and Founder's Principles.

b. Environmental conservation initiatives and CSR activities

The Company established a department to be responsible for CSR, which drafts and deploys among the entire Nomura Group initiatives for operational policies that consider the environment and society, and takes initiatives to promote communications with our stakeholders globally. Regarding environmental issues, the Company has set forth its Environmental Statement and Environmental Policy and while aiming to minimize the group's total impact on the environment, through its principal business of finance, the Company is engaging in initiatives which seek to resolve environmental issues.

Further, as for social contribution through the principal business of finance, together with the provision of educational opportunities necessary for all ages regarding finance and economics, activities as a corporate citizen are being developed by having each domestic and foreign location carry out social/community contributions rooted in each respective area.

For details regarding such CSR activities please refer to our homepage: <http://www.nomuraholdings.com/csr/>.

Further, for policies regarding CSR activities, please refer to Article 24 CSR Activities of the Guidelines.

c. Development of policies in relation to information disclosure to stakeholders

The Company endeavors to enhance disclosure contents, including legal disclosure materials, on our website.

d. Others

<Status of the Appointment of Female Directors and Officers>

The Company, beginning with 1 Director and 1 Senior Managing Directors, actively promotes the employment of women.

<Diversity & Inclusion>

Edgar Filing: TRI-S SECURITY CORP - Form 10-K

At the Company, Diversity and Inclusion, which involves mutual respect for employee diversity and cooperation, is promoted. Through the 3 employee networks that are voluntarily managed by employees, activities have been carried out towards bringing about the awareness of employees concerning diversity, personal growth, etc. The diversity and inclusion networks within the Company consist of the following 3 networks: (1) Women in Nomura (WIN) in which women's careers are considered; (2) Life & Families (L&F) in which health/child-rearing/nursing care are considered; and (3) Multi-Culture Value (MCV) in which cross-cultural and cross-generation communication, as well as the diverse values of sexual minorities represented by LGBT and their supporters/persons who understand that are allies, etc., are considered. These networks are managed at each Nomura Group location, and by cooperating globally, activities toward creating an employment environment in which diverse employees can actively participate are promoted. Further, in relation to trainings for employees, by introducing diversity/management training in all management training, change in the thinking of middle management has been promoted and efforts have been made to bring about a corporate culture in which diverse personnel can actively participate.

Table of Contents

The Company actively promotes initiatives to support the success of women. From the program perspective, although the Company has developed the childcare leave program and childcare working hours program that goes beyond the statutory requirements, to further maintain an environment in which it is easy to raise children, and to allow for the simultaneous raising of children and employment, the Company has broadened childbirth leave for spouses and partners so that such leave can be taken for childrearing purposes, and further, the Company endeavors to make available and develop various benefits programs, such as, for the purpose of preventing employees from leaving their jobs due to life events, relocation programs for general career type B employees and spouse relocation leave programs for when a spouse relocates overseas.

For details of each initiative and data regarding the ratio of women in managerial positions and information regarding the actual use of various programs supporting childcare and nursing care, etc., please see the Company's homepage at:

<http://www.nomuraholdings.com/csr/employee/di.html>

<http://www.nomuraholdings.com/csr/data/>

In addition to the above initiatives, in December 2015, the Company established the Group Diversity and Inclusion Department, and the Company's subsidiary, Nomura Securities Co., Ltd. (NSC) established the Diversity and Inclusion Department, as organizations dedicated to promoting active participation by diverse range of employees, including women, seniors and non-Japanese employees. In April 2016, the Company established the Nomura Group Diversity and Inclusion Committee, and NSC established the Diversity and Inclusion Committee. These committees are chaired by the Representative Executive Officer and Group COO of the Company, who concurrently serves as the Deputy President of NSC, and also consists of representatives of each division, etc. Meetings of these committees will be held periodically. These committees will promote more effective initiatives, through deliberating on matters concerning promotion of diversity and inclusion, starting from establishment of an action plan in accordance with the Act Concerning Promotion of Women's Career Activities and details of initiatives, and through close communication within the Nomura Group, such as sharing information on each division's initiatives.

<Health and Productivity Management>

The Nomura Group has adopted and announced the NOMURA Health & Productivity Declaration Statement, and lead by Representative Executive Offer, Deputy President, and Group COO Tetsu Ozaki who acts as Chief Health Officer (CHO), promotes Health and Productivity Management that further proactively addresses health issues through consideration of employees' health care from a management perspective.

As for structuring an organization toward Health and Productivity Management, the Health and Productivity Management Promotion Committee, consisting of the CHO, health professionals such as industrial physicians, as well as representatives from Human

Edgar Filing: TRI-S SECURITY CORP - Form 10-K

Resources and the Nomura Securities Health Insurance Association, is held periodically, and is consistently performing the role of ascertaining employees' health issues, as well as planning and executing measures.

As an example of concrete measures, Nomura Securities prepared the Health White Paper in order to visualize employees' health conditions and understand health issues, and is addressing (1) prevention of the progression of lifestyle-related diseases, (2) thoroughly ensuring the undertaking of medical checkups, and (3) smoking-measures, as priority items. In addition, activities such as the provision of information/education for the purpose of preventing mental illness and improving health literacy are in progress and there will be a promotion of the maintenance of employees' health through such initiatives.

IV Matters Concerning the Internal Controls System

1. Fundamental Policy of Internal Controls System and the Status of its Establishment and Maintenance

The Nomura Group endeavors to ensure proper corporate behavior throughout the group by strengthening and expanding the internal controls system with the objectives of securing transparency and efficiency in management, maintaining compliance with laws and regulations, conducting proper risk management, ensuring reliability of business and financial reporting, and promoting timely and appropriate information disclosure. The Board of Directors has adopted a resolution approving the following Structures for Ensuring Appropriate Operation of Nomura Holdings, Inc. with respect to the Company's internal controls system:

Table of Contents

<Structure for Ensuring Appropriate Business Activities at Nomura Holdings, Inc.>

The Company shall, through the Board of Directors of the Company, establish the following structure (hereinafter referred to as the Internal Controls System) to ensure appropriate business activities at the Company and within the Nomura Group, assess the structure on a regular basis, and revise the structure as necessary. The Board of Directors shall, in addition to ensuring appropriate business through, amongst other measures, the supervision of the execution of duties by Directors and Executive Officers and development of the basic management policy of the Nomura Group, shall also monitor the maintenance by Executive Officers and operational status of the Internal Controls System, and call for improvements when necessary.

Further, the Board of Directors shall establish and thoroughly enforce the Code of Ethics of the Nomura Group, a code of conduct that all Nomura Group officers and employees should comply with, which encompasses an emphasis on customer interests, full awareness of the social mission, compliance with applicable laws and regulations, undertaking of social contribution activities, etc.

I. Matters Concerning the Audit Committee

The Audit Committee shall enforce its powers prescribed by laws and regulations to audit the legality, adequacy and efficiency of the execution by Directors and Executive Officers of their duties through the use of the Independent Auditor, auditing firms and organizations within the Company to ensure the appropriate business activities of Nomura Holdings, Inc.

1. Directors and Employees that will provide Support with respect to the Duties

- (1) The Board of Directors may appoint a Director, not concurrently serving as an Executive Officer, as the Audit Mission Director. The Audit Mission Director shall support audits performed by the Audit Committee, and in order for the Board of Directors to effectively supervise the execution by the Directors and Executive Officers of their duties, the Audit Mission Director shall perform the Audit Mission Director's duties in accordance with the Audit Committee's instructions.
- (2) The Company shall put in place the Office of Non-Executive Directors and Audit Committee to support the duties of the Audit Committee and the Directors. The Audit Committee or a member of the Audit Committee designated by the Audit Committee shall evaluate employees of the Office of Non-Executive Directors and Audit Committee. Regarding the hiring, transfer and discipline of the employees of the Office of Non-Executive Directors and Audit Committee, the consent of the Audit Committee or a member of the Audit Committee designated by the Audit Committee must be obtained.

2. Audit System within the Nomura Group

- (1) The Company shall establish a group audit structure centered around the Company (the holding company) so that the Audit Committee can conduct audits in coordination with the Audit Committees, etc., of subsidiaries.
- (2) The Audit Committee shall audit the legality, adequacy and efficiency of the business of the Nomura Group in coordination, as necessary, with the Audit Committee of its subsidiaries.

3. Structures Ensuring the Effectiveness of the Audit

- (1)

Edgar Filing: TRI-S SECURITY CORP - Form 10-K

Members of the Audit Committee designated by the Audit Committee or the Audit Mission Director may participate in or attend important meetings including meetings of the Executive Management Board.

- (2) The Audit Committee may require an explanation from accounting auditors and accounting firms that conduct audits of financial statements about the audit plan at the beginning of the period, audit status during the period, audit results at the end of the period, and the status of internal controls over financial reporting. Members of the Audit Committee and the Audit Mission Director may exchange opinions with accounting auditors and accounting firms that conduct audits of financial statements as necessary.
- (3) A member of the Audit Committee designated by the Audit Committee may investigate the Company or its subsidiaries through, as necessary, himself/herself, other members of the Audit Committee or the Audit Mission Director.
- (4) The Audit Committee in conducting audits may engage attorneys, certified public accountants, consultants or other outside advisors as deemed to be necessary.

4. Coordination with the Internal Audit Division

- (1) The Company shall obtain the consent of the Audit Committee, or a member of the Audit Committee designated by the Audit Committee, regarding implementation plans and formulation of the budget of the Internal Audit Division, as well as the election and dismissal of the Head of the Internal Audit Division.
- (2) The Audit Committee shall coordinate with the Internal Audit Division by attending meetings of the Internal Controls Committee, hearing reports regarding the status of internal audits, and with regard to internal audits, issuing recommendations, etc., concerning the modification of the implementation plan, additional audits, development of remedial measures, etc.

II. Matters Concerning the Executive Officers

1. Compliance Structure

- (1) Thorough compliance with the Nomura Group Code of Ethics

Executive Officers shall promote lawful management in accordance with laws, regulations and the Articles of Incorporation, and shall swear to comply with the Nomura Group Code of Ethics. At the same time, Executive Officers shall ensure that the Nomura Group Code of Ethics is well known amongst Senior Managing Directors and employees of the Company and shall ensure compliance with the said Code.

Table of Contents

(2) Establishment and Maintenance of the Compliance Structure

Executive Officers shall strive to maintain the Nomura Group's compliance structure through, among other means, the maintenance of compliance-related regulations and the installation of responsible divisions and persons. The Company shall install Compliance Managers, etc., or other persons responsible for compliance, in each company within the Nomura Group to take corrective action against cases regarding any conduct considered questionable in light of social ethics or social justice and to thoroughly ensure that business activities undertaken by employees are based on a law-abiding spirit and social common sense, thereby promoting execution of duties in accordance with laws and regulations.

(3) Compliance Hotline

- (a) Executive Officers shall put into place a Compliance Hotline as a channel through which employees can, with regard to conduct in the Nomura Group that may be questionable based on compliance with laws and regulations, etc., including matters concerning accounting or accounting audits, report such conduct directly to the person appointed by the Board of Directors.
- (b) Executive Officers shall guarantee the confidentiality of anonymous notifications, including the content of such notifications, made through the Compliance Hotline.

(4) Severing Relations with Anti-Social Forces

The Nomura Group shall not engage in any transaction with anti-social forces or groups and Executive Officers shall maintain structures that are necessary for the enforcement of this rule.

2. Risk Management Structure

- (1) Executive Officers shall acknowledge the importance of identification, evaluation, monitoring and management of various risks relating to the execution of the Nomura Group's business centered on risks such as market risk, credit risk, liquidity risk, and operational risk and ensure understanding and management of such risks at each company within the Nomura Group.
- (2) Executive Officers shall strive to maintain a system to ensure the effectiveness of risk management in the Nomura Group through, among other means, the maintenance of regulations concerning risk management and the installation of responsible divisions and persons.
- (3) Executive Officers shall report the status of risk management structures within the Nomura Group to the Group Integrated Risk Management Committee. The Group Integrated Risk Management Committee shall analyze the risk management status of the entire Nomura Group based on the report and take appropriate measures to establish the most suitable risk management structures for the business.
- (4) Executive Officers shall maintain a structure that enables the Nomura Group to prevent or avoid crises, ensure the safety of customers, officers and employees of the Nomura Group, protect operating assets, reduce damage and ensure early recovery from any damage by establishing basic principles of business continuity including precautionary measures against crises, such as natural disasters or system failures, and emergency measures.

Edgar Filing: TRI-S SECURITY CORP - Form 10-K

3. Reporting Structure in Relation to Execution of Duties

- (1) Executive Officers shall report on the status of their own execution of duties not less frequently than once every 3 (three) months. They shall also maintain a reporting structure that governs reporting with respect to Nomura Group directors, executives, and employees.
- (2) Executive Officers shall report the following matters on a regular basis to the Audit Committee directly or through the members of the Audit Committee or the Audit Mission Director:
 - (a) The implementation status of internal audits, internal audit results, and remediation status;
 - (b) The maintenance and operational status of the compliance structure;
 - (c) Risk management status;
 - (d) The outline of quarterly financial results and material matters (including matters concerning the selection and application of significant accounting policies and matters concerning internal controls over financial reporting); and
 - (e) The operational status of the Compliance Hotline and details of the reports received.

- (3) In the event that an Executive Officer, Senior Managing Director, or employee is requested to report on a matter concerning the execution of such person's duties by an Audit Committee Member designated by the Audit Committee or the Audit Mission Director, such person shall promptly report on such matters.

- (4) In the event that a Director, Executive Officer or Senior Managing Director becomes aware of a matter raised below, an immediate report must be made to an audit committee member or audit mission director. Moreover, in the event that the person who becomes aware of such a matter is an executive officer or senior managing director, a report must be made simultaneously to the Executive Management Board. The Executive Management Board will deliberate concerning such matter, and in the event that it is admitted as necessary, based on such results, appropriate measures will be taken.
 - (a) Any material violation of law or regulation or other important matter concerning compliance.

 - (b) Any legal or financial problem that may have a material impact on the business or financial conditions of each Nomura Group company.

Table of Contents

(c) Any order from any regulatory authority or other facts that may potentially cause the Nomura Group to incur a significant loss.

(5) In the event that a Nomura Group director, officer, or employee discovers a matter raised above, the Company must maintain a structure that provides for immediate direct or indirect reporting to an audit committee member or audit mission director.

(6) To ensure that persons making a report prescribed in the preceding paragraph 2 do not receive disadvantageous treatment due to the making of such report, the Company must take appropriate measures.

4. Structure for Ensuring the Effectiveness of the Execution of Duties

(1) Executive Officers shall determine the Nomura Group's management strategy and business execution, and execute business in accordance with the management organization and allocation of business duties determined by the Board of Directors.

(2) Executive Officers shall determine the allocation of business duties between each Senior Managing Director and the scope of authority of each employee, and thereby ensure the effectiveness of the structure for the execution of duties and establish a responsibility structure for the execution of duties.

(3) Of the matters whose business execution decision has been delegated to Executive Officers based on a resolution adopted by the Board of Directors, certain important matters shall be determined through the deliberation and determination by bodies, such as the Executive Management Board, or through documents requesting managerial decisions.

(4) The Executive Management Board shall determine or review the necessary allocation of management resources based on the business plan and budget application of each division and regional area to ensure the effective management of the Nomura Group.

5. Structure for Retention and Maintenance of Information

(1) Executive Officers shall retain the minutes of important meetings, conference minutes, documents regarding requests for managerial decisions, contracts, documents related to finances and other material documents (including their electronic records), together with relevant materials, for at least ten years, and shall maintain access to such documents if necessary.

(2) Executive Officers shall maintain a structure to protect the Nomura Group's non-public information, including its financial information, and promote fair, timely and appropriate disclosure of information to external parties, thereby securing the trust of customers, shareholders, investors, etc.

6. Internal Audit System

(1) Executive Officers shall install a department in charge of internal audit, and by implementing an internal audit program, shall ensure effective and adequate internal controls across the entire business of the Nomura Group.

Edgar Filing: TRI-S SECURITY CORP - Form 10-K

- (2) The Internal Controls Committee shall deliberate or determine basic matters concerning internal controls within the Nomura Group, the annual plan regarding internal audit and the implementation status and results.
- (3) Executive Officers shall report on the status of the internal audit within the Nomura Group and the results thereof to the Internal Controls Committee at least once every three months.

III. The Nomura Group's Internal Controls System

- (1) Executive Officers shall secure the appropriateness of the Nomura Group's business by ensuring that each company within the Nomura Group is fully aware of the Internal Controls System of the Company and by requiring the maintenance of an internal controls system at each company that reflects the actual conditions of each company.
- (2) Executive Officers shall ensure the effectiveness of internal controls concerning financial reporting by the Company by, among other means, maintaining the structures listed in I through III above.

2. Matters Concerning Establishment of the System for Eliminating Anti-social Forces

The Nomura Group has stated in its Code of Ethics, which was adopted for all Officers and employees globally to comply with, that we must reject all transactions with anti-social forces or groups, and our fundamental policy is to eradicate all ties with anti-social forces.

In accordance with this policy, the Company has established a control department to promote an organized response, which strictly monitors, gathers and maintains information concerning anti-social forces. While working with legal counsel or police, etc., we continue to make efforts to eliminate anti-social forces and to take measures to ensure appropriate corporate behavior.

The Company's significant subsidiaries have taken a variety of initiatives such as adopting internal policies for the prevention of giving unlawful benefits, appointing managers responsible for preventing inappropriate demands from outside forces, and establishing internal manuals for employees on how to respond to anti-social forces. In order to eradicate ties with anti-social forces as a group, the Company is also taking initiatives such as conducting employee training and meetings to increase and spread employee awareness on this issue.

Table of Contents

V Others

1. Whether Takeover Defense Strategies Have Been Adopted

No

Supplementary Explanation

With regard to the basic policy to address a shareholder holding a quantity of shares enabling such shareholder to control decisions concerning the Company's management policy, the Company believes that the decision of whether to permit a party to seek ownership of such a volume of shares should ultimately be left to the judgment of the shareholders. Accordingly, the Company has not adopted any so-called takeover defense strategies, such as a prior issue of new stock acquisition rights (a rights plan), etc., at this time.

In the event of an attempt to take over the Company by a party inappropriate for business value and the common benefit of shareholders, a Corporate Value Enhancement Committee established within the Company will examine and evaluate the takeover proposal, etc., and after consultation with a council composed of the Company's outside directors, through sufficient deliberations by the Board of Directors, a conclusion will be rendered in regard to the best strategy for shareholders from the perspective of business value and the common benefit of the shareholders.

2. Other Information regarding the Corporate Governance System

An overview of the Company's timely disclosure regime is provided as follows:

1. Fundamental Policy

Our fundamental policy is to adhere to relevant laws concerning timely disclosure, such as can be found in the Financial Instruments and Exchange Act and the rules of the relevant stock exchanges, in order to safeguard non-public information regarding the Nomura Group as well as to foster appropriate, fair and timely disclosure of such information to persons and entities outside the Nomura Group and keep the trust of the Nomura Group's clients, shareholders, investors and others.

2. Timely Disclosure Regime

Pursuant to the above-mentioned fundamental policy, the Company has adopted the Nomura Group's Statement of Global Corporate Policy Regarding Public Disclosure of Information (the Disclosure Policy) and is taking measures to increase and spread employee awareness of the Disclosure Policy. In accordance with the Disclosure Policy, the Company has also established a Disclosure Committee. The Disclosure Committee, chaired by an officer responsible for Group Corporate Communications, is authorized to establish and maintain a structure for comprehensively and promptly gathering material information that needs to be disclosed, a structure for disclosing such information in a timely manner, and a structure for ensuring the accuracy of the contents of disclosure materials and fairness with regard to the disclosure of materials.

The management of Nomura Group companies and the person in charge of each division and region are responsible for establishing necessary measures to ensure that material information subject to disclosure is properly reported to the Disclosure Committee with respect to each relevant entity, division or region.

Information reported to the Disclosure Committee will be disclosed in a timely manner, based on standards set forth in relevant laws and regulations, and through deliberations with relevant departments on whether such disclosure should be made.

Pursuant to Regulation FD in the U.S., we prohibit disclosing material and non-public information to a selective forum.

3. Monitoring of Timely Disclosure Regime

The internal audit division monitors the effectiveness of internal controls over disclosure of information, and the result is reported to the Audit Committee.

Edgar Filing: TRI-S SECURITY CORP - Form 10-K

Further, as a NYSE-listed corporation, the Company has established internal controls and procedures for financial reporting and documents, and tests and maintains those controls and procedures to ensure their effectiveness pursuant to Section 404 of the Sarbanes-Oxley Act of 2002. The Company will continue to ensure proper corporate behavior throughout the group by strengthening and expanding its corporate governance system.

<Administrative action against the Company's subsidiary, Nomura Securities Co., Ltd. (NSC), and NSC's responses>

In August 2012, Japan's Financial Services Agency issued a business improvement order to our subsidiary, Nomura Securities Co., Ltd., regarding the management of corporate-related information for public stock offerings. With regard to this matter, Nomura Securities Co., Ltd. submitted a business improvement report to Japan's Financial Services Agency on August 8, 2012 and the report was accepted.

On June 29, 2012, prior to the issuance of the above-mentioned business improvement order, Nomura Securities Co., Ltd. announced improvement measures regarding the method of communication for corporate-related information and the information control system. All measures were implemented by the end of December 2012. Efforts have been made to prevent a recurrence and to regain trust by entrenching the improvement measures within the organization and ensuring that the measures function effectively. Going forward, each and every director, officer and employee will have a sense of occupational ethics as a professional involved in the capital markets and steps will be taken to further enhance and reinforce the internal control system.

Table of Contents

Management Organizations

Internal Control System

Table of Contents

21