

SIMPSON MANUFACTURING CO INC /CA/
Form DEF 14A
March 08, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of
the Securities Exchange Act of 1934 (Amendment No.)

Filed by the Registrant X

Filed by a Party other than the Registrant O

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Pursuant to §240.14a-12

Simpson Manufacturing Co., Inc.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

- No fee required.
- Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.
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SIMPSON MANUFACTURING CO., INC.

5956 W. Las Positas Blvd.

Pleasanton, California 94588

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

To the Stockholders of Simpson Manufacturing Co., Inc.:

We will hold the annual meeting of our stockholders at 2:00 p.m., Pacific Daylight Time, on Tuesday, April 23, 2013, at our home office located at 5956 W. Las Positas Blvd., Pleasanton, California. The matters that you will address at this meeting are:

1. A proposal to elect as directors the 3 persons nominated by a committee of independent members of our Board of Directors, each to hold office for a 3-year term and until his or her successor is elected and qualifies or until his or her earlier resignation or removal.
2. A proposal to re-approve our Executive Officer Cash Profit Sharing Plan.
3. A proposal to ratify our Board of Directors selection of PricewaterhouseCoopers LLP as our independent registered public accounting firm for the current fiscal year.
4. An advisory (non-binding) vote to approve Named Executive Officer compensation.
5. Stockholder proposal on majority voting.
6. Stockholder proposal on sustainability reporting.
7. Any other business that properly comes before the meeting.

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Only stockholders of record as of February 28, 2013, are entitled to notice of and will be entitled to vote at this meeting or any adjournment of this meeting.

BY ORDER OF THE BOARD OF DIRECTORS

Brian J. Magstadt
Secretary

Pleasanton, California
March 8, 2013

TO ASSURE THAT YOUR SHARES ARE REPRESENTED AT THE MEETING, WE URGE YOU TO COMPLETE, DATE AND SIGN THE ENCLOSED PROXY AND MAIL IT PROMPTLY IN THE POSTAGE-PAID ENVELOPE PROVIDED, OR VOTE BY TELEPHONE OR THE INTERNET AS INSTRUCTED ON THE PROXY, WHETHER OR NOT YOU PLAN TO ATTEND THE MEETING. YOU CAN REVOKE YOUR PROXY AT ANY TIME BEFORE THE PROXIES YOU APPOINT CAST YOUR VOTES.

SIMPSON MANUFACTURING CO., INC.

5956 W. Las Positas Blvd.

Pleasanton, California 94588

March 8, 2013

PROXY STATEMENT

Solicitation and Voting of Proxies

On behalf of the Board of Directors of Simpson Manufacturing Co., Inc., a Delaware corporation, we are soliciting from you a proxy in the enclosed form for use at our 2013 Annual Meeting of Stockholders. We will hold this meeting at our home office located at 5956 W. Las Positas Blvd., Pleasanton, California, on Tuesday, April 23, 2013, at 2:00 p.m., Pacific Daylight Time. Your proxy will be used at this meeting or at any adjournment of this meeting. Only holders of record of our common stock at the close of business on February 28, 2013, may vote at this meeting. At the close of business on that date, we had 48,543,831 shares of our common stock outstanding and entitled to vote. A majority, or 24,271,916, of these shares, present in person or represented by proxy at this meeting, will constitute a quorum for the transaction of business. We are making this Proxy Statement and our Annual Report to Stockholders for the year ended December 31, 2012, available to each of our stockholders on or about March 8, 2013.

Revocability of Proxy

If you give a proxy, you may revoke it at any time before the proxy holders vote it at the meeting, in any of the 3 following ways:

- deliver a written notice to our Secretary by any means, including facsimile, stating that the proxy is revoked;
- sign a proxy bearing a later date and deliver it to our Secretary; or
- attend the meeting and vote in person, although your attendance at the meeting will not, by itself, revoke your proxy.

If, however, your shares are held of record by a broker, bank or other nominee and you desire to vote at the meeting, you must bring to the meeting a letter from the broker, bank or other nominee confirming your beneficial ownership of the shares you desire to vote.

Expenses of Proxy Solicitation

We are paying the expenses of this solicitation of proxies. After we make this Proxy Statement and other soliciting materials available, we or our agents may also solicit proxies by mail, telephone, electronic mail or facsimile or in person.

Voting Rights

As a holder of our common stock, you are entitled to one vote per share on any matter submitted to a vote of the stockholders. Our Bylaws permit stockholders to cumulate their votes in the election of directors at an annual meeting if, at least 65 days before the meeting, a stockholder notifies our Secretary in writing of the stockholder's intention to cumulate votes. Cumulative voting would entitle each stockholder to give one properly nominated candidate a number of votes equal to the number of directors to be elected multiplied by the number of shares the stockholder holds or to distribute those votes on the same principle among as many properly nominated candidates as the stockholder thinks fit. Our Secretary has not, however, received a cumulative voting notice for this meeting, and as a result cumulative voting will not be available at this meeting.

Our Board of Directors expects all nominees named below to be available for election. If any nominee is not available, the proxy holders may vote for a substitute whom the Governance and Nominating Committee of our Board of Directors may nominate. We are not aware of any specific matter to be brought before the meeting that is not identified in the notice of the meeting and this Proxy Statement. If, however, stockholders present proposals at the meeting that are not included in this Proxy Statement, the proxy holders will have discretion to vote on those proposals as they see fit. The proxies solicited by this Proxy Statement will confer discretionary authority on matters of which we are not aware a reasonable time before the meeting. Accordingly, the proxy holders may use their discretionary authority to vote on any such matter pursuant to the proxies in the enclosed form.

Our stockholders may cast votes personally at the meeting or the proxy holders may cast the votes of stockholders who provide proxies in the enclosed form. Our stockholders will elect directors at the meeting by a plurality of the votes cast at the meeting. In the election of directors, that is, the nominees receiving the highest numbers of affirmative votes of the shares entitled to be voted for them up to the number of directors to be elected by such shares are elected. Votes against a nominee and votes withheld have no legal effect. On each of Proposal Nos. 2, 3, 4, 5 and 6, approval will require the affirmative vote of a majority of the votes cast at the meeting on that Proposal. Proposal No. 4 is an advisory vote only and is not binding on us or our Board of Directors. Abstentions and broker nonvotes count as shares present for determination of a quorum but do not count as affirmative or negative votes on any item to be voted on and do not count in determining the number of shares voted or votes cast on any matter.

**SECURITY OWNERSHIP OF CERTAIN
BENEFICIAL OWNERS AND MANAGEMENT**

The following table provides information, as of February 28, 2013, unless otherwise indicated, about the beneficial ownership of our common stock by

- each stockholder known by us to be the beneficial owner of more than 5 percent of our common stock,
- each director and director nominee,
- each person currently serving as one of our executive officers named in the Summary Compensation Table see Executive Compensation below, and
- all of our current executive officers and directors as a group.

Name and, for Each 5% Beneficial Owner, Address	Amount and Nature of Beneficial Ownership (1)	Percent of Class
Barclay Simpson (2) 5956 W. Las Positas Blvd. Pleasanton, CA 94588	7,863,757	16.2%
Royce & Associates, LLC 745 Fifth Avenue New York, NY 10151	5,300,286	10.9%
BlackRock, Inc. 40 East 52nd Street New York, NY 10022	3,014,010	6.2%
Thomas J Fitzmyers (3)	116,977	*
Karen Colonias (4)	31,996	*
Michael J. Herbert (5)	15,278	*
Phillip Terry Kingsfather (6)	45,173	*
Jeffrey E. Mackenzie (7)	23,422	*
Brian J. Magstadt (8)	8,370	*
James S. Andrasick	356	*
Jennifer A. Chatman (9)	6,068	*
Earl F. Cheit (9)	8,068	*

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Gary M. Cusumano (9)	6,868	*
Peter N. Louras, Jr. (9)	10,751	*
Robin G. MacGillivray (9)	6,068	*
Barry Lawson Williams (9)	8,495	*
All current executive officers and directors as a group (10)	8,151,647	16.7%

* Less than 0.5%

(1) We based the information in this table on information that our officers and directors provided to us and on statements on Schedule 13D or 13G that stockholders filed with the Securities and Exchange Commission and sent to us. Unless otherwise indicated below, the persons named in the table had sole voting and sole investment power with respect to all shares beneficially owned, subject to community property laws where applicable.

(2) Includes 1,000 shares that are subject to options that we granted under our 1994 Stock Option Plan (now part of our 2011 Incentive Plan) and that are exercisable within 60 days.

(3) Includes 9,000 shares that are subject to options that we granted under our 1994 Stock Option Plan (now part of our 2011 Incentive Plan) and that are exercisable within 60 days. Mr. Fitzmyers has a revolving line of credit in the maximum amount of approximately \$2.0 million that is secured by 100,000 shares of our common stock that he owns. There is currently a balance due on this line of credit of approximately \$300,000.

(4) Includes 27,000 shares that are subject to options that we granted under our 1994 Stock Option Plan (now part of our 2011 Incentive Plan) and that are exercisable within 60 days.

(5) Includes 10,000 shares that are subject to options that we granted under our 1994 Stock Option Plan (now part of our 2011 Incentive Plan) and that are exercisable within 60 days.

(6) Includes 28,500 shares that are subject to options that we granted under our 1994 Stock Option Plan (now part of our 2011 Incentive Plan) and that are exercisable within 60 days.

(7) Includes 20,000 shares that are subject to options that we granted under our 1994 Stock Option Plan (now part of our 2011 Incentive Plan) and that are exercisable within 60 days.

(8) Includes 6,500 shares that are subject to options that we granted under our 1994 Stock Option Plan (now part of our 2011 Incentive Plan) and that are exercisable within 60 days.

(9) Includes 5,000 shares that are subject to options that we granted under our 1995 Independent Director Stock Option Plan (now part of our 2011 Incentive Plan) and that are exercisable within 60 days.

(10) Includes 132,000 shares subject to options that are exercisable within 60 days, as described in notes (2) through (9) above.

PROPOSAL NO. 1**ELECTION OF DIRECTORS****Nominees**

We have nominated for re-election at the meeting James S. Andrasick, Gary M. Cusumano and Peter N. Louras, Jr., whose terms as directors expire in 2013. Below are the names of our directors and information about them. The persons authorized to vote the shares represented by proxies in the enclosed form intend to vote for Mr. Andrasick, Mr. Cusumano and Mr. Louras. Under our Bylaws, the stockholders will not be permitted to nominate anyone at the meeting. If stockholders cast any votes at the meeting for any candidates other than those that we have nominated, the persons authorized to vote shares represented by proxies in the enclosed form, except for proxies withholding authority to vote for the election of directors or for any particular nominees, will have full discretion and authority to vote for any or all of the nominees in such order as those persons may determine.

Name	Age	Director Since	Position
Thomas J Fitzmyers (4)	72	1978	Chairman of the Board and Director term expiring in 2014
James S. Andrasick (2) (4)	68	2012	Director term expiring in 2013
Jennifer A. Chatman (1) (2) (3) (5)	53	2004	Director term expiring in 2015
Earl F. Cheit (2) (3) (5)	86	1994	Lead Independent Director term expiring in 2014
Gary M. Cusumano (4) (5)	69	2007	Director term expiring in 2013
Peter N. Louras, Jr. (1) (2) (4) (5)	63	1999	Director term expiring in 2013
Robin G. MacGillivray (2) (3) (4) (5)	58	2004	Director term expiring in 2015
Barclay Simpson (5)	91	1956	Director term expiring in 2015
Barry Lawson Williams (1) (3) (4) (5)	68	1994	Director term expiring in 2014

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- (1) Member of the Compensation and Leadership Development Committee
 - (2) Member of the Audit Committee
 - (3) Member of the Governance and Nominating Committee
 - (4) Member of the Acquisition and Strategy Committee
 - (5) Member of the Growth Committee

Executive Officers

As Chairman of the Board, Thomas J Fitzmyers is an executive officer. Our other executive officers are: Karen Colonias, age 55, our Chief Executive Officer; Brian J. Magstadt, age 45, our Chief Financial Officer, Treasurer and Secretary; and Michael J. Herbert, age 54, and Jeffrey E. Mackenzie, age 51, our Vice Presidents. Phillip Terry Kingsfather, age 66, is a director and the President and Chief Executive Officer of our subsidiary, Simpson Strong-Tie Company Inc. We regard Mr. Kingsfather as one of our executive officers, because he performs management policy-making functions for us. Our executive officers also may serve as directors or officers of our subsidiaries.

Director and Officer Qualifications and Biographical Information

Our directors are individuals of reputation, integrity and accomplishment. They bring to Board issues a range of talents, including a customer-oriented focus, useful education, experience and insights. A majority of our outside directors must be independent. To be independent, an outside director must have no financial, family or close personal ties to us or our executives and must meet the New York Stock Exchange regulatory standard of independence. New directors are oriented to our business and governance through meetings with our officers and directors and visits to our facilities. We also support, and pay for, participation in continuing education programs to assist directors in performing their Board responsibilities.

Thomas J Fitzmyers was appointed Chairman of our Board of Directors in September 2011, effective January 2012. Prior to that, he served as our President and as a director since 1978 and served as our Chief Executive Officer since 1994. He has served as a director of our subsidiary, Simpson Strong-Tie Company Inc., since 1983 and as its Chief Executive Officer from 1983 to February 2009. He also served as a director of our subsidiary, Simpson Dura-Vent Company, Inc., from 1982 until its disposition in August 2010. Mr. Fitzmyers was employed by Union Bank from 1971 to 1978. He was a Regional Vice President when he left Union Bank to join us in 1978. Mr. Fitzmyers' experience as President and Chief Executive Officer of Simpson Manufacturing Co., Inc. gives him unique and invaluable insights into the challenges facing our business and our industry.

James S. Andrasick joined our Board of Directors in June 2012. He brings over 40 years of business experience, most recently as the Chairman of Matson Navigation, until his retirement in 2009, and as its President and Chief Executive Officer from 2002 through 2008. Prior to his promotion to President and Chief Executive Officer of Matson Navigation in 2002, Mr. Andrasick was the Chief Financial Officer of Alexander & Baldwin, Inc., the parent company of Matson Navigation, and was responsible for all business development activity. He currently serves as a Trustee and Chair of the Finance Committee of Mills College and as a Trustee of the U.S. Coast Guard Foundation. He also previously served as a Director and Chairman of the Board of the American Red Cross, Hawaii State Chapter, as well as serving on the boards of the Aloha United Way, Arthritis Foundation and Hawaii Maritime Center and was the Chairman and a Trustee of the University of Hawaii Foundation. Mr. Andrasick holds a Bachelor of Science degree in Engineering from the U.S. Coast Guard Academy and a Masters degree in Management Science from the Massachusetts Institute of Technology. His experience in developing the China market for Matson Navigation and in mergers and acquisitions gives him a unique understanding of the Company's current opportunities, and his strong financial and operational background adds depth to our Board's understanding of our business.

Jennifer A. Chatman is the Paul J. Cortese Distinguished Professor of Management, Haas School of Business, University of California, Berkeley. Before joining the Berkeley faculty in 1993, she was a professor at the Kellogg Graduate School of Management, Northwestern University. She received her Ph.D. from University of California, Berkeley in 1988. She is a Trustee of Prospect Sierra School. In addition to her research and teaching at University of California, Berkeley, she consults with a wide range of organizations and is the faculty director of the Berkeley Executive Leader Program. She teaches in executive development programs at a variety of universities. Ms. Chatman brings to our Board a deep understanding of organizational structure, leadership and compensation that gives us an objective perspective in interpreting and leveraging our unique culture to achieve our strategic objectives.

Earl F. Cheit is Dean and Edgar F. Kaiser Professor Emeritus, Haas School of Business, University of California, Berkeley. Until 2001, he was Chairman of the Board of YCI, a consumer products company, and Senior Advisor, Asia Pacific Economic Affairs, The Asia Foundation. He is a member of the Audit Committee of the Evelyn and Walter Haas, Jr. Fund, an Honorary Trustee of Mills College, a Trustee Emeritus of the University of California, Berkeley, Foundation, and founding Chairman of Cal Performances, the performing arts presenter and commissioner at the University of California, Berkeley. He is a member of the Bay Area Council's Business Hall of Fame selection committee. Mr. Cheit brings a wealth of academic and industry experience to our Board of Directors as well as an understanding of global economies, management and corporate governance.

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Gary M. Cusumano has over 35 years of experience with The Newhall Land and Farming Company, most recently as its Chairman. He retired from Newhall Land and Farming Company in January 2006. He is a director of Granite Construction, Inc., Forest Lawn Memorial Park and the J.G. Boswell Company, was formerly a director of Sunkist Growers, Inc., Watkins-Johnson Company and Zero Corporation and has served on the boards of many not-for-

profit and community service organizations. Mr. Cusumano's service as Chairman of the Newhall Land and Farming Company and his board service with Granite Construction provide our Board of Directors with his perspective and expertise from his service with a publicly traded New York Stock Exchange company and real estate developer.

Peter N. Louras, Jr. is a retired corporate executive. He joined The Clorox Company in 1980 and was Group Vice President from May 1992 until his retirement in July 2000. In this position, he served on The Clorox Company's Executive Committee with overall responsibility for its international business activities and business development function, including acquisitions and divestitures. Before joining The Clorox Company, Mr. Louras, a certified public accountant, worked at Price Waterhouse in its offices in both San Francisco, California, and Philadelphia, Pennsylvania. Mr. Louras is a member of the American Institute of CPAs. He is currently a member of the Board of Directors of Dealer Fusion, a privately owned company. Mr. Louras actively participates in civic projects and serves on the boards of various not-for-profit organizations. Mr. Louras' business background provides the Board of Directors with a global perspective and hands-on experience in business development and strategic acquisitions. Mr. Louras also brings his financial accounting expertise to his role as Chair of the Audit Committee.

Robin G. MacGillivray became Senior Vice President - One AT&T Integration for AT&T in January 2010. In this role, she is overseeing the implementation of several corporate initiatives designed to further integrate merged organizations and operations for optimal customer service and financial performance. Prior to that she was Senior Vice President - Regional and Local Markets, responsible for service and sales to AT&T's small business customers nationwide. She previously served as Senior Vice President - Strategic Process Improvement, where she oversaw that company's call center transformation, DSL improvement, and sales and marketing process standardization efforts. Ms. MacGillivray joined AT&T in 1979, after receiving her bachelor's degree in journalism from the School of Journalism and her master's degree in telecommunications management from the Annenberg School of Communications, both at the University of Southern California. She completed the Stanford Executive Program at Stanford University in 1997. She has worked in numerous AT&T organizations and functions, including Engineering, Operations, Finance, Human Resources, Marketing, Customer Service and Sales. She is the former President of the Board of Directors of the Girl Scouts of Northern California. Ms. MacGillivray brings to our Board of Directors her extensive experience managing complex businesses in highly competitive and rapidly changing environments, cultivated from a variety of functional areas.

Barclay Simpson is Chairman Emeritus of our Board of Directors. Prior to that, he was Chairman of our Board of Directors since 1994. He incorporated our predecessor and went into the structural connector business in 1956. Mr. Simpson is a member of the Boards of Directors of the University Art Museum of the University of California, Berkeley, and the California College of the Arts. He is also active in other charitable and educational institutions. Mr. Simpson's experience in our industry spans more than 50 years, and his ownership stake in Simpson Manufacturing Co., Inc. closely aligns his interests with those of our other stockholders.

Barry Lawson Williams is the retired Managing General Partner of Williams Pacific Ventures Inc., a venture investing and consulting firm. He is a director of PG&E Corporation, SLM Corp., CH2M HILL Companies, Ltd. and Northwestern Mutual Life Insurance Co. Mr. Williams is a director for several not-for-profit organizations, including Sutter Health, Resources Legacy Fund and Management Leadership for Tomorrow. Mr. Williams brings invaluable experience to our Board of Directors in several areas, including financial and acquisition analysis and real estate development, and in his extensive service on several high-profile boards. He also brings legal and environmental experience and a broad understanding of relevant accounting and governance issues that we encounter.

Karen Colonias was appointed as our Chief Executive Officer in September 2011, effective January 2012. From May 2009 to January 2012, she was our Chief Financial Officer, Secretary and Treasurer. Prior to that, she held the position of Vice President of our subsidiary, Simpson Strong-Tie Company Inc., and in that capacity since 2004 served as the Branch Manager of Simpson Strong-Tie's manufacturing facility in Stockton, California. She joined Simpson Strong-Tie in 1984 as an engineer in the research and development department, where she was responsible for the design and testing of new products and code development. In 1998, Simpson Strong-Tie promoted Ms. Colonias to Vice President of Engineering, responsible for Simpson Strong-Tie's research and development efforts. Before joining Simpson Strong-Tie, she worked as a civil engineer for the Bechtel Corporation. Ms. Colonias has a BS in Engineering and an MBA and is also a licensed professional engineer.

Brian J. Magstadt has served as Chief Financial Officer, Treasurer and Secretary since January 2012. He joined Simpson Manufacturing Co., Inc. in 2004 as Financial Reporting Specialist, and, from 2008 until 2012, served as our Financial Reporting Manager, overseeing our external reporting program and managing various other accounting and finance functions. He is a licensed CPA and holds a Bachelor of Science degree in Business Administration from California State University, Chico, and a Masters of Business Administration degree from Santa Clara University.

Michael J. Herbert became Vice President in May 2009, responsible for various international operations outside of North America. From 2000 to May 2009, he served as our and our subsidiaries Chief Financial Officer, Treasurer and Secretary. From 1988 to 2000, he held various financial management positions, with his last position as Director of Finance, with Sun Microsystems, Inc.

Jeffrey E. Mackenzie was appointed Vice President in December 2008. He joined Simpson Manufacturing Co., Inc. in 1994 and from November 2000 to December 2008, served as our Financial Reporting Manager, overseeing our external reporting program and managing various other finance functions, including our equity-based compensation programs. Prior to joining us, he worked for Deloitte & Touche, LLP as a Senior Accountant in San Francisco, California. Mr. Mackenzie is a licensed CPA (currently inactive) and holds a Bachelor of Science degree in Business Administration from California State University, San Diego, and a Masters of Business Administration degree from Santa Clara University.

Phillip Terry Kingsfather has served as the President and Chief Executive Officer of Simpson Strong-Tie Company Inc. since February 2009. From August 2006 to February 2009, he served as President and Chief Operating Officer of Simpson Strong-Tie Company Inc. His career with us started in 1979 as an Outside Sales Representative in the Pacific Northwest for Simpson Strong-Tie Company Inc. In 1985, he became Regional Sales Manager. He joined our Anchor Systems sales team in 1997 and was instrumental in the launch of this product line. In 2003, he was promoted to Vice President of Simpson Strong-Tie Company Inc. in charge of our Anchor Systems product line, where he served until August 2006.

Independence

The New York Stock Exchange corporate governance rules require that the board of directors of a listed company consist of a majority of independent directors. A majority of our directors are independent under those rules.

Our Board of Directors follows the independence standards required by the New York Stock Exchange corporate governance rules to determine director independence. Those standards provide that a director will not be independent of a listed company if:

- the director is, or has been within the last 3 years, an employee of the listed company, or an immediate family member is, or has been within the last 3 years, an executive officer, of the listed company;
- the director has received, or has an immediate family member who has received, during any 12-month period within the last 3 years, more than \$120,000 in direct compensation from the listed company, other than director and committee fees and pension or other forms of deferred compensation for prior service, provided such compensation is not contingent in any way on continued service;

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- (a) the director is a current partner or employee of a firm that is the company's internal or external auditor; (b) the director has an immediate family member who is a current partner of such a firm; (c) the director has an immediate family member who is a current employee of such a firm and personally works on the listed company's audit; or (d) the director or an immediate family member was within the last 3 years a partner or employee of such a firm and personally worked on the listed company's audit within that time;
- the director or an immediate family member is, or has been within the last 3 years, employed as an executive officer of another company where any of the listed company's present executive officers at the same time serves or served on the other company's compensation committee; or
- the director is a current employee, or an immediate family member is a current executive officer, of another company that has made payments to, or received payments from, the listed company for property or services in an amount that, in any of the last 3 fiscal years, exceeded the greater of \$1,000,000 or 2 percent of the other company's consolidated gross revenues.

For purposes of these standards, immediate family member includes a director's spouse, parents, children, siblings, mothers- and fathers-in-law, sons- and daughters-in-law, brothers- and sisters-in-law, and anyone, other than any domestic employee, who shares the director's home.

Applying these independence standards, our Board of Directors has affirmatively determined that Mr. Andrasick, Mr. Cheit, Mr. Louras, Mr. Williams, Ms. Chatman and Ms. MacGillivray are each independent under the New York Stock Exchange corporate governance rules, in that none of them has a material relationship with us, either directly or as a partner, stockholder, officer or employee of an organization that has a relationship with us. Our Board of Directors has determined that our other directors, Mr. Simpson, Mr. Cusumano and Mr. Fitzmyers, are not independent under those rules. In making its determination, our Board of Directors considered all relevant facts and circumstances, including commercial, industrial, banking, consulting, legal, accounting, charitable and familial relationships, and considered the issue not merely from the standpoint of a director, but also from that of persons or organizations with which a director has an affiliation.

Criteria and Diversity

In considering whether to nominate any candidate to serve on our Board of Directors, the Governance and Nominating Committee of our Board of Directors considers the candidate's education, business experience, financial expertise, industry experience, business acumen, interpersonal skills, vision, teamwork, integrity, strategic ability and customer focus. Our Board of Directors does not assign specific weights to particular criteria and no particular criterion is necessarily applicable to all prospective nominees. Our Board of Directors also believes that the backgrounds and qualifications of the directors, considered as a group, should provide a significant composite mix of experience, knowledge and abilities that will allow our Board of Directors to fulfill its responsibilities. We do not discriminate against nominees on the basis of gender, race, religion, national origin, sexual orientation or disability.

Attendance at Meetings

Our Board of Directors held 7 meetings in 2012. Its committees held a total of 25 meetings in 2012, including 6 meetings of the Audit Committee, 7 meetings of the Compensation and Leadership Development Committee, 6 meetings of the Governance and Nominating Committee and 6 meetings of the Acquisition and Strategy Committee. Each director attended at least 75 percent of the meetings of our Board of Directors (except for Barclay Simpson who attended 5 of the 7 meetings) and at least 75 percent of the meetings of the committees on which he or she served in 2012. All of our directors attended the annual meeting of our stockholders in 2012, although we do not have a policy that requires our directors to attend the annual meeting of stockholders. In addition to the 7 meetings that the Board of Directors held in 2012, the independent members of our Board of Directors held 3 meetings in executive session in 2012 on days that the entire Board of Directors did not meet. Each of our independent members attended 100 percent of those executive sessions.

Leadership Structure and the Board of Directors Role in Risk Management

Our Board of Directors and its committees take an active role in overseeing management of our risks. The Board regularly reviews information regarding our operational, financial, legal and strategic risks. Our Compensation and Leadership Development Committee is responsible for overseeing the management of risks relating to our compensation plans; our Audit Committee oversees management of our financial risks; and our Governance and Nominating Committee manages risks associated with the independence of the Board of Directors and potential conflicts of interest. In 2009, our Board of Directors created the Acquisition and Strategy Committee, whose role in risk management includes evaluating and managing our strategic risks. While each committee is responsible for evaluating certain risks and overseeing the management of these risks, our entire Board of Directors is regularly informed about such risks through committee and executive officer reports.

For many years the roles of our Chairman and our Chief Executive Officer have been separated. We believe that this is appropriate under current circumstances, because it allows management to make the operating decisions necessary to manage the business, while helping to keep a measure of independence between the oversight function of our Board of Directors and operating decisions. We feel that this has provided an appropriate balance of operational focus, flexibility and oversight.

Our independent directors meet at regularly scheduled executive sessions without members of management. In 2010, our Board of Directors created the role of Lead Independent Director and appointed Earl F. Cheit to that role. The Lead Independent Director participates in setting the agenda of Board of Directors and Committee meetings, coordinates the distribution and presentation of meeting materials, manages communications between the Board of Directors and management, maintains the focus and punctuality of Board of Directors and Committee meetings and presides over executive session meetings of the independent directors.

Communications with our Board of Directors

We encourage stockholders and interested parties to communicate any concerns or suggestions directly to the independent members of our Board of Directors, by writing to:

Board of Directors

Simpson Manufacturing Co., Inc.

P.O. Box 1394

Alamo, CA 94507-7394

OUR BOARD OF DIRECTORS RECOMMENDS THAT YOU VOTE FOR THE ELECTION OF JAMES S. ANDRASICK, GARY M. CUSUMANO AND PETER N. LOURAS, JR., THE THREE NOMINEES FOR DIRECTOR AT THIS MEETING.

PROPOSAL NO. 2

RE-APPROVAL OF OUR

AMENDED EXECUTIVE OFFICER CASH PROFIT SHARING PLAN

At the annual meeting, we will ask our stockholders to re-approve our amended Executive Officer Cash Profit Sharing Plan. Our Board of Directors adopted our Executive Officer Cash Profit Sharing Plan on January 14, 2003, and our stockholders approved it on March 31, 2003. Our Board of Directors amended it on February 25, 2008, and our stockholders re-approved it on April 23, 2008.

Our Executive Officer Cash Profit Sharing Plan is designed to provide bonuses that qualify as performance-based compensation under section 162(m) of the Internal Revenue Code of 1986 and the regulations and interpretations thereunder. Under Internal Revenue Code section 162(m), we may not deduct from our income for federal income tax purposes compensation in excess of \$1,000,000 that we pay in any one year to any of our employees who is treated as a covered employee pursuant to section 162(m), as amended and as interpreted in Treasury Regulations and notices or other rulings issued by the Internal Revenue Service. This \$1,000,000 limit does not, however, apply to compensation that we pay under a plan approved by our stockholders, if the compensation is performance-based. Our Executive Officer Cash Profit Sharing Plan allows us to deduct performance-based incentive compensation that we pay to each of our covered employees in excess of the \$1,000,000 limit.

We have maintained a Cash Profit Sharing Plan as part of our compensation package for qualified employees for over 30 years. We adopted our Executive Officer Cash Profit Sharing Plan to parallel our Cash Profit Sharing Plan, the only differences being those necessary to conform to the requirements of section 162(m) for the bonuses to be fully deductible. See Executive Compensation Summary Compensation Table. The Executive Officer Cash Profit Sharing Plan will continue to provide for bonuses for our Named Executive Officers on the same terms and will continue to enable us to deduct fully, for federal income tax purposes, bonuses paid to our covered employees under the Executive Officer Cash Profit Sharing Plan. The Executive Officer Cash Profit Sharing Plan does not allow us to pay any awards greater than \$2,500,000 to any covered employee in any year.

Our Board of Directors has delegated the administration of our Executive Officer Cash Profit Sharing Plan to its Compensation and Leadership Development Committee, which comprises Jennifer A. Chatman, Chair, Peter N. Louras, Jr. and Barry Lawson Williams. The members of the Compensation and Leadership Development Committee

are (a) non-employee directors, which means directors who satisfy the requirements established by the Securities and Exchange Commission for non-employee directors under Rule 16b-3, and (b) outside directors, which means directors who satisfy the requirements established under Internal Revenue Code section 162(m). Our Board of Directors appoints the members of the Compensation and Leadership Development Committee for indefinite terms and may remove any of them from the Compensation and Leadership Development Committee at any time. Subject to the oversight of our Board of Directors, the Compensation and Leadership Development Committee has the sole discretion and authority to administer and interpret the Executive Officer Cash Profit Sharing Plan in accordance with Internal Revenue Code section 162(m).

The Compensation and Leadership Development Committee determines the amount of the award that each of our Named Executive Officers is eligible to receive under the Executive Officer Cash Profit Sharing Plan each fiscal quarter. The Compensation and Leadership Development Committee bases each determination of the awards on a percentage of the amount by which net profits, as defined by the Compensation and Leadership Development Committee, of the company for a fiscal quarter exceed a qualifying level of net profits for the company for that fiscal quarter. The Compensation and Leadership Development Committee bases qualifying levels on the value of net operating assets of the company multiplied by a rate of return on those assets. The Compensation and Leadership Development Committee bases individual percentages on job function. See Executive Compensation Compensation Discussion and Analysis. The Compensation Committee has discretion to reduce or eliminate any award under the Executive Officer Cash Profit Sharing Plan.

The Compensation and Leadership Development Committee may at any time amend the Executive Officer Cash Profit Sharing Plan, subject in some cases to the approval of our stockholders, or terminate the Executive Officer Cash Profit Sharing Plan.

Under present federal income tax law, participants realize ordinary income equal to the amount of the award received in the year of receipt. We are entitled to deduct from our taxable income the amount constituting ordinary income to the participant, as long as the Executive Officer Cash Profit Sharing Plan satisfies the requirements of Internal Revenue Code section 162(m). As described above, Internal Revenue Code section 162(m) limits the deductibility of compensation not based on performance that is paid to certain corporate executives. We intend to administer the Executive Officer Cash Profit Sharing Plan in a manner that, under Internal Revenue Code section 162(m), maximizes the deductibility of compensation that we pay.

A copy of the Executive Officer Cash Profit Sharing Plan, as amended, is attached to this Proxy Statement as Exhibit A and is incorporated herein by this reference. The foregoing description of the Executive Officer Cash Profit Sharing Plan is qualified in its entirety by reference to Exhibit A attached hereto.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR APPROVAL OF THE SIMPSON MANUFACTURING CO., INC. EXECUTIVE OFFICER CASH PROFIT SHARING PLAN, AS AMENDED AND ATTACHED AS EXHIBIT A.

PROPOSAL NO. 3

RATIFICATION OF SELECTION OF INDEPENDENT

REGISTERED PUBLIC ACCOUNTING FIRM

Our Board of Directors has selected PricewaterhouseCoopers LLP as the principal independent registered public accounting firm to audit our internal controls over financial reporting and our financial statements for 2013. You will be asked to ratify that selection.

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PricewaterhouseCoopers LLP has audited our financial statements since before our initial public offering in 1994. A PricewaterhouseCoopers LLP representative will be present at the meeting, will be given an opportunity to make a statement at the meeting if he or she desires to do so, and will be available to respond to appropriate questions.

OUR BOARD OF DIRECTORS RECOMMENDS THAT YOU VOTE FOR RATIFICATION OF THE SELECTION OF PRICEWATERHOUSECOOPERS LLP.

PROPOSAL NO. 4

ADVISORY VOTE TO APPROVE NAMED EXECUTIVE OFFICER COMPENSATION

At each annual meeting, we provide our stockholders with the opportunity to vote to approve, on a non-binding, advisory basis, the compensation of our Named Executive Officers as disclosed in this proxy statement in accordance with the compensation disclosure rules of the Securities and Exchange Commission. At this meeting, the stockholders will vote on the following resolution:

RESOLVED that the compensation paid to this corporation's Named Executive Officers, as disclosed pursuant to Item 402 of Regulation S-K, including the Compensation Discussion and Analysis, compensation tables and narrative discussion, is hereby approved.

As described below under Executive Compensation Compensation Discussion and Analysis, we seek to closely align the interests of our Principal Executive Officer, our Principal Financial Officer and our 3 other most highly compensated executive officers (our Named Executive Officers) with the interests of our stockholders. Our compensation programs are designed to reward our Named Executive Officers for the achievement of short-term and long-term strategic and operational goals and the achievement of increased total stockholder value, while at the same time avoiding the encouragement of unnecessary or excessive risk-taking.

The vote on this resolution is not intended to address any specific element of compensation; rather, the vote relates to the overall compensation of our Named Executive Officers, as described in this proxy statement in accordance with the compensation disclosure rules of the Securities and Exchange Commission. This vote is advisory, which means that it is not binding on us, our Board of Directors or the Compensation and Leadership Development Committee of our Board of Directors. The Compensation and Leadership Development Committee and our Board or Directors value the views of our stockholders and will take into account the outcome of the vote when considering future compensation decisions for our Named Executive Officers.

OUR BOARD OF DIRECTORS RECOMMENDS THAT YOU VOTE FOR THE ABOVE RESOLUTION TO APPROVE NAMED EXECUTIVE OFFICER COMPENSATION.

PROPOSAL NO. 5

STOCKHOLDER PROPOSAL TO ADOPT A MAJORITY

VOTING STANDARD IN DIRECTOR ELECTIONS

The California State Teachers Retirement System (CalSTRS) Investments, 100 Waterfront Place, MS-04, West Sacramento, California 95605-2807, has represented that it beneficially owns shares of our common stock having a market value in excess of \$2,000, and has informed us that it intends to submit the following proposed resolution at the Annual Meeting:

BE IT RESOLVED:

That the shareholders of Simpson Manufacturing Co., Inc. hereby request that the Board of Directors initiate the appropriate process to amend the Company's articles of incorporation and/or bylaws to provide that director nominees shall be elected by the affirmative vote of the majority of votes cast at an annual meeting of shareholders, with a plurality vote standard retained for contested director elections, that is, when the number of director nominees exceeds the number of board seats.

CalSTRS provided the following supporting statement:

SUPPORTING STATEMENT:

In order to provide shareholders a meaningful role in director elections, the Company's current director election standard should be changed from a plurality vote standard to a majority vote standard. The majority vote standard is the most appropriate voting standard for director elections where only board nominated candidates are on the ballot, and it will establish a challenging vote

standard for board nominees to improve the performance of individual directors and entire boards. Under the Company's current voting system, a nominee for the board can be elected with as little as a single affirmative vote, because withheld votes have no legal effect. A majority vote standard would require that a nominee receive a majority of the votes cast in order to be re-elected and continue to serve as a representative for the shareholders.

In response to strong shareholder support a substantial number of the nation's leading companies have adopted a majority vote standard in company bylaws or articles of incorporation. In fact, more than 80% of the companies in the S&P 500 have adopted majority voting for uncontested elections. We believe the Company needs to join the growing list of companies that have already adopted this standard.

CalSTRS is a long-term shareholder of the Company and we believe that accountability is of utmost importance. We believe the plurality vote standard currently in place at the Company completely disenfranchises shareholders and makes the shareholder's role in director elections meaningless. Majority voting in director elections will empower shareholders with the ability to remove poorly performing directors and increase the directors' accountability to the owners of the Company, its shareholders. In addition, those directors who receive the majority support from shareholders will know they have the backing of the very shareholders they represent. We therefore ask you to join us in requesting that the Board of directors promptly adopt the majority vote standard for director elections.

Please vote FOR this proposal.

STATEMENT OF THE BOARD IN OPPOSITION TO THE STOCKHOLDER PROPOSAL

Our Board of Directors is committed to sound corporate governance policies and practices and welcomes a dialog with our stockholders on corporate governance topics. After careful consideration, our Board and its Governance and Nominating Committee, consisting entirely of independent directors, believe that the above stockholder proposal to change the voting standard for our directors is unnecessary and not in the interests of the Company and its stockholders. Our directors are currently elected by plurality vote. In a plurality vote, the nominees receiving the highest number of affirmative votes of the shares entitled to be voted for them are elected. For the reasons outlined below, plurality voting should be retained for electing our directors, and we recommend that you vote **AGAINST** this proposal.

Plurality voting for directors has a long history in the U.S. and has effectively ensured decisive director elections. We are governed by Delaware corporation law, and plurality voting in director elections is the Delaware standard (unless the charter specifies otherwise). The rules governing plurality voting are well-established over many decades of experience and precedent, and we believe plurality voting is familiar to, and well understood by, stockholders. The stockholder proposal would upset this longstanding and common director election voting procedure.

We believe that changing to majority voting would shift disproportionate weight to the one-size-fits-all views of proxy advisory services and, if adopted, would not achieve its desired intent. Many institutional investors rely on proxy advisory firms for voting recommendations. Those firms often base their recommendations on single issues and apply inflexible policies. Our Board of Directors is concerned that these recommendations are made without consideration of the performance and unique circumstances of our company or the contributions of the particular director to our company. Accordingly, we believe that adoption of majority voting would be detrimental to the majority of our stockholders.

The legal community, stockholder advocates, corporate governance experts, public companies and other groups continue to evaluate and debate the benefits, disadvantages and consequences of majority voting. In 2010, for example, the U.S. Congress rejected a majority voting mandate, which had appeared in preliminary drafts of the Dodd-Frank Wall Street Reform and Consumer Protection Act but was deleted from the final legislation. We proactively monitor the ongoing debate and developments on this topic. We believe that adopting majority voting would subject the Company to the problems and ambiguities that are topics of this debate.

If this proposal were to be adopted, a director nominee who receives less than a majority of the votes cast would not be elected. Under Delaware law, however, a director serves until his or her successor is elected. As a result, an incumbent director who does not receive a majority vote for re-election would nevertheless continue to serve as a director. Thus, unlike plurality voting, majority voting can result in failed elections – an election in which a nominee does not receive a majority of the votes and therefore either continues as a hold-over director or resigns and leaves a vacancy on the Board of Directors. A failed election would inevitably be disruptive and result in additional and potentially expensive procedures to resolve the anomaly of an unelected director or for the Board of Directors to fill the vacancy. Any Board vacancy could impair our Board of Directors’ oversight functions and risk non-compliance with SEC and NYSE regulations requiring that a minimum number of our directors be independent. We do not believe such a result would further stockholder democracy. In contrast, the plurality voting standard promotes stability in our governance processes by ensuring that a full slate of directors is elected at each annual meeting and that we can remain in compliance with applicable NYSE listing standards and federal securities laws.

A change in the vote standard is unnecessary, because the current board nominee evaluation and election process has produced a highly qualified and independent Board of Directors having extensive and diverse experience, qualifications, attributes and skills. The independent Governance and Nominating Committee of our Board of Directors has consistently nominated strong, highly qualified directors. We believe our stockholders are satisfied with the composition of our Board of Directors and the Company’s financial and operational performance under the strategic direction of the Board of Directors, as each of the Committee’s nominees has consistently been elected by a large majority of the outstanding shares.

Additionally, under our policy (described below under “Governance and Nominating Committee of our Board of Directors”), a stockholder can at any time recommend to the Board a candidate for election to our Board of Directors. The Governance and Nominating Committee evaluates each candidate recommended by a stockholder with the same careful and comprehensive process it uses to evaluate candidates recommended by our officers or other directors. Stockholders are also invited to communicate concerns to our directors, and our Board of Directors has established a process for stockholders to communicate anonymously their feedback and concerns with the Board of Directors (as described below under “Communication with our Board of Directors”).

We publicly report the results of voting for directors after each annual meeting of stockholders. This report gives the public prompt notice of the numbers of votes cast for each nominee and withheld from voting for each nominee. The Board also reviews the voting results of each annual meeting.

OUR BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT YOU VOTE AGAINST THE PROPOSAL TO ADOPT A MAJORITY VOTING STANDARD IN DIRECTOR ELECTIONS.

PROPOSAL NO. 6

STOCKHOLDER PROPOSAL TO REQUIRE A SUSTAINABILITY REPORT

Walden Asset Management (Walden), a division of Boston Trust & Investment Management Company, One Beacon Street, Boston, Massachusetts 02108, has represented that it beneficially owns shares of our common stock having a market value in excess of \$2,000, and has informed us that it intends to submit the following proposed resolution at the Annual Meeting:

RESOLVED

Shareholders request that Simpson Manufacturing issue a sustainability report describing the company's environmental, social and governance (ESG) risks and opportunities including greenhouse gas (GHG) emissions reduction targets and goals. The report should be available by November 1, 2013, prepared at reasonable cost, omitting proprietary information.

Walden provided the following supporting statement:

SUPPORTING STATEMENT

We believe tracking and reporting on ESG business practices makes a company more responsive to a transforming global business environment characterized by finite natural resources, changing legislation, and heightened public expectations for corporate accountability. Reporting also helps companies better integrate and gain strategic value from existing sustainability efforts, identify gaps and opportunities in products and processes, develop company-wide communications, publicize innovative practices, and receive feedback.

The Principles for Responsible Investment (PRI) is a United Nations initiative whose members seek the integration of ESG factors in investment decision making. Members collectively hold over \$33 trillion of assets under management and request information on ESG factors to analyze fully the risks and opportunities associated with existing and potential investments.

Carbon Disclosure Project (CDP), representing over 655 institutional investors globally with more than \$78 trillion in assets, has for years called for disclosure from companies on their climate change management programs. Over two thirds of the S&P 500 now report to CDP.

Sustainability reporting is on the rise globally. In 2011, there was a 46% increase in the number of organizations worldwide using the Global Reporting Initiative's (GRI) Guidelines for their ESG reporting according to G&A Institute. Smaller companies are proactively adopting sustainability reporting to report on progress as they grow and anticipate sustainability reporting from investors and customers.

Companies such as 3M, Apple, Intel and Microsoft, among many others, increasingly require their suppliers to track and report on key environmental and social factors. A key Simpson Manufacturing customer, Home Depot, encourages sustainability improvement reporting from suppliers through its Supplier Sustainability Program. Competitors such as Masco Corporation and United Technologies Group publish comprehensive sustainability reports.

In contrast, Simpson Manufacturing does not report on its sustainability efforts nor disclose GHG data. Climate change is one of the most financially significant environmental issues currently facing investors. Occupational safety and health, vendor and labor standards, waste and water reduction targets and product related environmental impacts are particularly important ESG considerations in Simpson Manufacturing's sector and may have the potential to pose significant regulatory, legal, reputational and financial risks.

The company recognizes on its website that the extraction and harvesting of some raw materials can have a significant social and economic impact both positive and negative and that it endeavors to identify and limit the materials in [our] supply chain that pose negative implications. However, shareholders currently have no access to substantial information on how the company is managing these business factors.

We recommend the report include a company-wide review of policies, practices and metrics related to ESG performance using the GRI index and checklist as a reference.

STATEMENT OF THE BOARD IN OPPOSITION TO THE STOCKHOLDER PROPOSAL

We are committed to ethical business practices and compliance with the law in all areas of our operations. We strive to be a good corporate citizen in the communities where we operate. We and our Board of Directors take environmental, social and governance issues very seriously, but believe that a special review of our practices and an additional report to stockholders on sustainability would be expensive, time-consuming and largely unhelpful. We are committed to monitoring and evaluating the most appropriate ways to manage our business, including relations with our employees, customers, suppliers, investors and regulators, as well as our impact on the environment and in the communities in which we operate. The evaluation also includes determining how best to communicate our efforts.

Our Board of Directors believes that this proposal is contrary to the interests of the Company and our stockholders. Preparing a sustainability report would involve extraordinary expense and would not be a prudent use of our resources. While we recognize the importance of environmental, social and governance considerations and always strive to conduct our business in a socially responsible manner, we do not believe that a sustainability report would provide any meaningful benefit to management or sufficiently useful information to our stockholders.

The proposal ignores the burden on human resources and the considerable expense involved in preparing a report, including the necessity to engage consultants with specialized expertise. The proposed report would require major expansion of the types and amount of information we gather, analyze and disclose, significantly exceeding any business need and existing or anticipated reporting requirements. We prefer, in the exercise of our business judgment, to prudently allocate our resources to the continued development of products that are necessary to build safer and more economical structures, to enhance our business operations and to continue to support various social initiatives, including those described below. In addition, the proponents would have us use the GRI Guidelines in preparing the report. The GRI Guidelines dictate a reporting framework that is voluminous, complex and vague and that would require an extraordinary investment of time and money. We feel that our resources are better devoted to improving our company and our role in our communities, than to reporting on such improvements.

We are already committed to conducting our business with conscientious regard for environmental and social issues. For more than 50 years, Simpson Manufacturing Co., Inc. and its subsidiaries have earned a reputation for quality, integrity, service and innovation in every area of our business, including commitments to the building materials industry, the communities in which we operate and our employees. Our mission is to help people build safer structures economically. We do this by designing, engineering and manufacturing No Equal products that meet or exceed our customers' needs and expectations. We strengthen the wellness of our community by improving the quality of life for people around the world. For example:

- We cultivate a culture of integrity and accountability we expect our employees to treat all members of their communities with respect and fairness.
- Our workforce spans a variety of cultures, and does not discriminate on any basis, including race, color, religion, sex, national origin, age, disability or sexual orientation.
- We develop engineered solutions to make connections stronger while using less material. An example of this is our line of connectors for use with engineered wood products that are sustainably harvested and engineered for consistent performance.
- We encourage our employees to participate in charitable causes through employee gift matching programs and company-sponsored programs, such as providing money and materials to Habitat for Humanity projects and disaster relief efforts.
- We have environmental, health and safety programs to monitor our compliance with applicable requirements.
- We use recyclable packaging wherever possible and encourage recycling of waste products.

We regularly monitor and review our policies to ensure their appropriate implementation and to address new and evolving standards and issues in the global marketplace.

We believe that our existing practices, including programs and activities to ensure compliance with applicable legal and regulatory requirements, our social responsibility programs, our dedication to improving the communities in which we operate, and our environmental efforts fully address the apparent purpose of the proposal. Therefore, conducting a special review and preparing a sustainability report is an unnecessary and ineffective use of company resources. The time and expense would divert personnel and resources from our business and operations and would be detrimental to the interests of our stockholders.

OUR BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT YOU VOTE AGAINST THE PROPOSAL TO REQUIRE A SUSTAINABILITY REPORT.

EXECUTIVE COMPENSATION

Compensation Discussion and Analysis

Summary

Our philosophy on compensation is to closely align the interests of our Named Executive Officers with those of our stockholders. Our compensation is also structured to give our employees, not just our Named Executive Officers, an opportunity to earn above-market compensation for outstanding performance, measured by our success. Our Named Executive Officers include our Principal Executive Officer, our Principal Financial Officer and our 3 other most highly compensated executive officers. We believe that we do this by providing a high degree of incentive to achieve both short-term and long-term goals, goals that when met, also increase our stockholders' return. Because payments to our employees depend on our first reaching financial goals, our stockholders participate in our returns before our employees. To avoid unnecessary or excessive risk-taking in our compensation programs, our goals are focused on branch or company performance, not on individual performance. Our Named Executive Officers' total compensation comprises a mix of base salary and retirement plan contributions, a quarterly cash incentive program and long-term equity incentives.

Historically, our programs have rewarded our employees with above-market compensation during highly prosperous periods and have kept a cohesive team of our most valued employees during more challenging economic times, such as we have experienced recently. Since we use a measure based on operating profit as the basis for both our non-equity incentive plan and our equity incentive plans, we believe that this is the most relevant measure to evaluate our financial performance for the purpose of making compensation decisions. The following table illustrates the correlation of the compensation of our Named Executive Officers with our financial performance.

Performance Measure (000s)	2012		2011		2010	
	Amount	Change	Amount	Change	Amount	Change
Income from Continuing Operations	\$ 61,709	(16.7)%	\$ 74,057	(5.6)%	\$ 78,424	149.0%
CEO Cash Profit Sharing	1,199	(23.3)%	1,563	27.7%	1,224	240.4%

In 2012, the amount of CEO cash profit sharing declined, consistent with the decline in our income from continuing operations in 2012. In 2011, CEO cash profit sharing increased, while our income from continuing operations decreased, as a result of:

- a gain in 2010 of \$5.2 million on our sale of real estate located in Brea, California;
- an increase in 2011 from 2010 of \$11.2 million in equity-based and non-equity-based compensation charges; and
- a gain in equity method investment in 2011 of \$4.4 million as compared to a loss in 2010 of \$0.5 million.

The first 2 items are included in income from continuing operations but excluded from the computation of the cash profit sharing payment. The third item was included in the computation of the cash profit sharing but excluded from income from continuing operations.

The other part of our incentive compensation is equity-based compensation. Before 2012, equity-based compensation consisted of grants of non-qualified stock options. Beginning in 2012 equity-based compensation consists primarily of awards of restricted stock units. Equity compensation is also awarded to participating employees, including our Named Executive Officers, based on performance-based results. Generally, equity-based compensation awards are based on achieving the same operating profit goals as our cash profit sharing plans. Once awarded, however, the value of these awards depends on our stock price performance over time. Stock options granted to our Named Executive Officers vest over 4 years at a rate of 25 percent per year. The restrictions on restricted stock units lapse 25 percent on each of the date of the award and the first, second and third anniversaries of the date of the award, except for those awarded to Karen Colonias, Phillip Terry Kingsfather and Brian J. Magstadt beginning in 2013, which will lapse 75 percent on the third anniversary of the date of the award and 25 percent on the fourth anniversary of the date of the award. For our employees to fully realize the value of the equity-based compensation, we must continually improve our operating results.

The Compensation and Leadership Development Committee made some changes to our Named Executive Officers' base salaries for 2013. Salaries for our Chairman and one of our Vice Presidents, Michael J. Herbert, were reduced by 33% and 7%, respectively, and the salary for our Chief Financial Officer was increased by 3%. Our Chief Executive Officer and the President and Chief Executive Officer of Simpson Strong-Tie Company Inc. received no increase over their 2012 salaries. In 2012, the rate of contribution to our Named Executive Officers' profit sharing trust accounts remained unchanged from 2011 at 7 percent of base salary plus the 3 percent safe-harbor contribution. See *Salary and Profit Sharing Trust Contributions* below.

We encourage you to read this Compensation Discussion and Analysis in its entirety, as well as the information in the Summary Compensation Table and other related tables and disclosures, for an understanding of our compensation programs.

Analysis

The overall philosophy of our compensation program is to provide a high degree of incentive to employees by creating programs that reward achievement of specific profit goals. We have followed the same philosophy for many years and that experience has continuously reinforced our belief that it successfully drives our financial performance. We believe that our incentive programs, based on profit targets, align the interests of employees and stockholders, allow us to attract high-performing employees and help us retain the services of employees whose contributions are instrumental in achieving our goals. Historically, as a means of creating a sense of unity and cooperation among our employees, we have not had any special compensation plans exclusively for executive officers. Our Named Executive Officers are at-will employees. We do not have a written employment agreement with any of them, and we generally do not offer any severance benefits. We or the officer can terminate the employment relationship at any time, for any reason, with or without cause.

The primary objective of our overall compensation program is to motivate our Named Executive Officers and other officers and employees to increase stockholder value, and we aim to compensate them fairly relative to our achievement of that objective. To retain their services, some portion of their compensation, in the form of salary and profit sharing trust contributions, should compensate them for their own investment of time, regardless of the performance of our businesses. Each element of the compensation of our Named Executive Officers and other officers and employees possesses characteristics intended to motivate them in different ways. We believe that coordinating the compensation elements helps us to retain the services of our Named Executive Officers, other officers and other key employees and to motivate them to achieve results that increase the value of our common stock. The following is an analysis of the basic elements of our compensation program.

The Compensation and Leadership Development Committee of our Board of Directors believes that, to maintain a sense of unity and fairness, the forms of compensation for our Named Executive Officers generally should match those of all of our salaried employees. Our compensation program comprises 4 basic elements:

- salary,
- payments to our defined contribution profit sharing plan,
- cash profit sharing, and
- equity-based compensation.

Role of Compensation Consultant

The Compensation and Leadership Development Committee may engage independent advisers to assist in carrying out its responsibilities. In April 2010, the Compensation and Leadership Development Committee engaged Venture Pay Group as its compensation consultant, and in June 2010, Venture Pay Group issued its report. The report included 3 major elements:

- a benchmark analysis of total direct compensation for our Named Executive Officers compared to industry peers,
- recommendations for potential changes to compensation programs, at several levels, to align our programs with our strategic objectives, and
- a review of current trends and issues in executive compensation.

The Compensation and Leadership Development Committee met with Venture Pay Group, reviewed its report with our officers and considered its recommendations. Although Venture Pay Group provided advice to the Compensation and Leadership Development Committee, the decisions made by the Compensation and Leadership Development Committee reflect factors and considerations in addition to the information and recommendations provided by Venture Pay Group. As a result of the benchmarking information, the Compensation and Leadership Development Committee increased the base salary component of our Named Executive Officers' Compensation in 2011. See *Salary and Profit Sharing Trust Contributions* below. As recommended by Venture Pay Group, the Compensation and Leadership Development Committee approved the Simpson Manufacturing Co., Inc. 2011 Incentive Plan, which was approved by our stockholders at our annual meeting in April 2011. We awarded restricted stock units in 2012 and 2013 under the 2011 Incentive Plan. In 2012, the Compensation and Leadership Development Committee also implemented a long-term incentive program to give selected employees, including some of our Named Executive Officers, additional incentives if they help us achieve our strategic objectives. For 2013, as in 2012, this program includes potential additional awards of restricted stock units to Karen Colonias, Brian J. Magstadt, Phillip Terry Kingsfather and Michael J. Herbert; see *Equity-Based Compensation Awards* below.

In 2011, the Compensation and Leadership Development Committee engaged Towers Watson as its compensation consultant. The lead consultant, who changed employers from Venture Pay Group to Towers Watson in 2011, remained the same. The consulting services were requested and approved by the Compensation and Leadership Development Committee and not recommended or provided by our officers. Towers Watson was engaged for 2 primary purposes:

- to update a benchmarking analysis of total direct compensation for our Chief Executive Officer compared to the peer groups developed by Venture Pay Group in 2010; and
- to recommend potential changes to our long-term compensation program for our Chief Executive Officer, our Chief Financial Officer and Simpson Strong-Tie Company Inc.'s President and Chief Executive Officer, to align our programs with strategic objectives.

Towers Watson recommended to the Compensation and Leadership Development Committee modifying various terms of future equity-based compensation awards consistent with the operating profit goals, adding goals based on strategic objectives and adding a component reflecting total stockholder return. The Compensation and Leadership Development Committee incorporated these features into the potential equity-based compensation awards for 2012 and has continued using them for 2013. See *Equity-Based Compensation Awards* below.

Comparative Market Information

Venture Pay Group compared our Named Executive Officer compensation to 2 peer groups, including an Industry Match peer group compiled by Venture Pay Group and the peer group selected by ISS/Risk Metrics. Venture Pay Group also used a set of proprietary proxy compensation survey databases to complete the benchmarking analysis. Venture Pay Group performed benchmarking on total direct compensation from our 2009 fiscal year and on a 3-year average. The 2 peer groups were:

Industry Match Peer Group

Ameron International Corp.{1}	Astec Industries Inc.	Blount International Inc.
Ceradyne Inc.{2}	Chart Industries Inc.	Circor International Inc.

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Colfax Corp.

Eagle Materials Corp.

Esco Technologies Inc.

Graftech International Ltd.

Kaydon Corp.

Materion Corp.

Minerals Technologies Inc.

OM Group Inc.

Quanex building Products Corp.

Robbins Myers Inc.

RTI International Metal Inc.

Titanium Metals Corp.{3}

Tredegar Corp.

ISS/Risk Metrics Peer Group

Aircastle Ltd.	American Woodmark Corp.	Ameron International Corp.{1}
Blount International Inc.	Colfax Corp.	Columbus McKinnon Corp.
Graco Inc.	Great Lakes Dredge & Dock Corp.	GT Advanced Technologies Inc.{4}
Quanex building Products Corp.	Standex International Corp.	Tennent Co.

{1} Acquired by National Oilwell Varco, Inc. in 2011.

{2} Acquired by 3M Company in 2012.

{3} Acquired by Precision Castparts Corp. in 2012.

{4} Formerly known as GT Solar International, Inc.

Venture Pay Group selected the Industry Match peer group based on a broad range of publicly traded companies in related industries and with characteristics similar to ours, including industry specialization, revenues, market capitalization, net income and total assets. Data gathered on the peer groups included base salary, bonus, total cash compensation, long-term incentives and total direct compensation. The peer group study has not been updated since it was compiled in 2010.

Salary and Profit Sharing Trust Contributions

Base salary is a guaranteed minimum amount for performing the functions of the job, but salary alone provides no additional performance opportunity or motivation to increase value over the long term. The Compensation and Leadership Development Committee determines the salaries for all of our Named Executive Officers using historical salary levels for their positions and adjustments for changes in cost of living and responsibilities. Past benchmarking studies performed by compensation consultants, most recently in 2010, confirmed that the salaries for our Chief Executive Officer and the other Named Executive Officers were substantially below the 25th percentile except in one case where the officer's salary was slightly above the 25th percentile. As a result, the Compensation and Leadership Development Committee believes that our Chief Executive Officer's and the other Named Executive Officers' salaries are fair relative to salaries of their peers, given the other elements of our compensation program, even though these salaries are generally lower than those paid by comparable companies. We consider our salary levels sufficient to motivate our Named Executive Officers to perform the basic functions of their jobs. Although our base salaries have historically been set at levels that the Compensation and Leadership Development Committee believes are below the market, a greater proportion of total compensation is based on a system that provides employees with incentives to attain our profitability goals.

We and our U.S. subsidiaries maintain defined contribution profit sharing plans for U.S.-based salaried employees, including our Named Executive Officers, and for U.S.-based non-union hourly employees. An employee is eligible for participation in a given calendar year if he or she is an employee on the first and last days of that year and completes the minimum service requirement during that year. The minimum service requirement for a salaried employee is at least 1,000 hours of service and for an hourly employee is at least 750 hours of service. As of December 31, 2012, 803 employees participated in the salaried plan and 544 employees participated in the hourly plan. Under both of these plans, our Board of Directors has exclusive discretion to authorize contributions to the plan trusts. These plans limit contributions to the plan trusts to amounts deductible for federal income tax purposes under Internal Revenue Code section 404(a). Karen Colonias, Brian J. Magstadt

and Michael J. Herbert, who are Named Executive Officers, are trustees of the plan trusts and also participate in the plan for salaried employees. Some of our foreign subsidiaries maintain similar plans for their employees.

For all years through 2008, we made contributions to the profit sharing trust for our Named Executive Officers in amounts equal to 15 percent of their base salaries, up to the amounts that we were allowed to deduct from income under Internal Revenue Code section 404(a). In addition, all employees are entitled to a proportionate share of forfeited contributions from employees who terminate their employment before fully vesting in the profit sharing plan. In February 2009, in response to reduced profitability resulting from difficult economic conditions, the Compensation and Leadership Development Committee established a contribution amount equal to 10 percent of base salaries to the profit sharing trust beginning with the contribution that was made in 2010, up to the amounts that we are allowed to deduct from income under Internal Revenue Code section 404(a) for all of our and our subsidiaries' U.S. based salaried employees. This reduced rate was also used for the contribution that was earned in

2010 and paid in 2011. During 2011, we amended the profit sharing trust plan to include a 401(k) feature that allows employees to contribute their own pre-tax earnings in addition to the amount that we contribute to their accounts. As part of this change, we changed the amount of the discretionary contribution to 7 percent, and the remaining 3 percent contribution, now made quarterly, is made to comply with the safe-harbor rules that govern the plan. The safe-harbor contribution is not forfeitable and is fully vested when the contribution is made. We expect the current contribution rate to continue indefinitely, although the Compensation and Leadership Development Committee has discretion to consider changes to this contribution at any time. The Compensation and Leadership Development Committee views compensation through contribution to employees' profit sharing plan accounts as serving a similar objective as salaries.

Compensation and the Achievement of Operating and Strategic Goals

The Compensation and Leadership Development Committee does not delegate its duties of determining executive officer compensation. Our officers do, however, participate in our annual budgeting process, which forms the basis for the Compensation and Leadership Development Committee's determination of operating profit goals used for determining qualifying income for our cash profit sharing plans and whether we award equity-based compensation. Our Board of Directors reviews and approves the annual budget.

Before the beginning of each year, our managers and employees propose budgets for the coming year for their respective profit centers. Our senior managers, including our Named Executive Officers, review the proposed budgets, adjust these budgets as they consider appropriate, and present the budgets to our Board of Directors. Our Board of Directors then considers and approves a budget that it considers appropriate for each profit center. Based on the approved budgets, the Compensation and Leadership Development Committee determines:

- the return on asset goals for the coming year, on which the Compensation and Leadership Development Committee bases the qualifying income levels for both our Executive Officer Cash Profit Sharing Plan and our Cash Profit Sharing Plan;
- the profitability goals for the coming year, on which the Compensation and Leadership Development Committee bases equity awards under our 2011 Incentive Plan; and
- the basis for strategic goals for the coming year, which the Compensation and Leadership Development Committee uses in determining additional equity awards under our 2011 Incentive Plan for participating employees who can help us achieve our strategic initiatives, including Named Executive Officers.

Our Named Executive Officers are subject to the same standards as our other officers and employees for purposes of equity-based compensation awards under our 2011 Incentive Plan and payments under our Executive Officer Cash Profit Sharing Plan. With the few exceptions noted below in the Summary Compensation Table, we generally do not have special programs for our Named Executive Officers. Our Board of Directors and its Compensation and Leadership Development Committee aim to design the goals to be achievable, but only with considerable effort, effort the Compensation and Leadership Development Committee believes will promote the growth and profitability of our business. Although the goals are based on the approved budgets, both the budgeting process and the setting of the goals involve subjective judgments of our Board of Directors and its Compensation and Leadership Development Committee. The Compensation and Leadership Development Committee, according to its guidelines, has discretion to increase or decrease equity-based compensation awards based on factors that it deems relevant. For example, the Compensation and Leadership Development Committee may award additional equity-based compensation to an employee who is promoted during the year, if the employee's profitability goal for that year is achieved. The Compensation and Leadership Development Committee also has discretion to award equity-based compensation when the relevant goal is not achieved, but has never done so with respect to a Named Executive Officer. Our Board of Directors also bases equity-based compensation awards for the independent members of our Board of Directors under our 2011 Incentive Plan on the Company-wide profitability goals.

Executive Officer Cash Profit Sharing Plan

To achieve the goal of long-term stock price appreciation, the Compensation and Leadership Development Committee believes that compensation that is based on profitability needs to incorporate both short-term and long-term elements. It also believes that consistent achievement of short-term profitability goals is likely to result in long-term growth and, with it, stock price appreciation. The short-term element is our non-equity incentive plan that provides compensation through two cash profit sharing plans, including our Executive Officer Cash Profit Sharing Plan for our Named Executive Officers and our Cash Profit Sharing Plan for other qualified employees. Under our

Executive Officer Cash Profit Sharing Plan, we pay quarterly incentive compensation out of the portion of our profits that exceeds a specified return on qualified assets. The amounts are shown in the Summary Compensation Table under the heading, Non-Equity Incentive Plan Compensation. At the beginning of each year, the Compensation and Leadership Development Committee reviews and approves the quarterly operating profit goals for the year, the rate of return on qualified assets, and the percentage participation of each of our Named Executive Officers. Again, this process involves subjective judgment and is not amenable to numerical or statistical analysis. The Compensation and Leadership Development Committee generally defines the quarterly operating profit goal as:

Income from operations for Simpson Strong-Tie Company Inc.

Plus: Stock compensation charges
 Certain incentive compensation and commissions
 Salaried pension contributions
 Self-insured workers compensation costs

Equals: Operating profit

The adjustments to income from operations are excluded because they are not specifically within our officers control. This formula includes items that affect profitability that our officers can influence, such as staffing levels, direct and indirect manufacturing costs, and operating expenses, and the Compensation and Leadership Development Committee believes this is likely to promote prudent allocation of resources.

The Compensation and Leadership Development Committee bases qualifying levels on the value of the net operating assets of Simpson Strong-Tie Company Inc., multiplied by a rate of return on those assets. We set the qualifying level based on average assets, net of specified liabilities, at quarterly intervals. We project the qualifying level for the coming year in the budgeting process at the beginning of the year and use it to estimate Executive Officer Cash Profit Sharing in the operating budget. We generally determine the return on assets as follows:

Average assets, net of specified liabilities, for the 3 months ended on the last day of the second month of the quarter

Less: Cash
 Real estate
 Acquired assets (excluding cash, real estate, goodwill and indefinite lived intangible assets) based on tiered phase-in schedule*
 Goodwill and indefinite lived intangible assets
 Self-insured workers compensation reserves

Multiplied by: Specified return on asset percentage for Simpson Strong-Tie Company Inc.

Equals: Qualifying level

*The phase-in period for the acquired assets into the average asset base is as follows:

Year 1	0%
Year 2	33%
Year 3	66%
Year 4	100%

We believe this formula includes items that are likely to affect the return on assets that our officers can influence, such as staffing levels, direct and indirect manufacturing costs, and operating expenses, and promotes prudent allocation of resources.

The operating profit goal is a targeted value, and the qualifying level is a threshold return on assets at which the Executive Officer Cash Profit Sharing Plan compensation levels are determined. If the operating profit of Simpson Strong-Tie Company Inc. exceeds the qualifying level, compensation is paid to the officer out of that excess. If the operating profit realized falls short of the qualifying level, no compensation is paid.

The Compensation and Leadership Development Committee bases individual percentages of participation on job function for our Named Executive Officers. Management sets the individual percentages for participants in our Cash Profit Sharing Plan. The Compensation and Leadership Development Committee generally may give higher participation percentages to those with more responsibility. For example, our Chief Executive Officer receives a higher percentage of the available pool than our other officers. The Compensation and Leadership Development Committee has discretion to increase, reduce or eliminate any award under our Executive Officer Cash Profit Sharing Plan, but the percentage of the qualifying level that each officer receives generally does not change during the year, except for minor changes when other participants enter or leave the pool during the year. We do not guarantee any minimum payments to our Named Executive Officers under our Executive Officer Cash Profit Sharing Plan. We believe that our Executive Officer Cash Profit Sharing Plan motivates our Named Executive Officers to maximize our short-term profits and rewards them when those profits are realized. With occasional adjustments that the Compensation and Leadership Development Committee felt were warranted, we have implemented this program for many years, and we believe it has contributed substantially to our success.

In 2012, the Compensation and Leadership Development Committee did not specifically target, or benchmark, the amount of short-term incentive compensation to be paid to our Named Executive Officers to any particular percentile or level within the prior benchmarking studies.

Based on our operating profit goal for each of the 4 quarters of 2013, our officers may receive a payout after our quarterly earnings are announced to the public. If the operating profit is lower or higher than the targeted operating profit, the payout will be correspondingly lower or higher, but we generally do not make any payment when the operating profit for the quarter is less than the qualifying level for the quarter.

For the full year 2013, the annual operating profit goals, qualifying levels and targeted payouts for each of the following executive officers are as follows:

	Operating Profit Goal	Qualifying Level	Targeted Payout{1}
Karen Colonias	\$ 95,779,000	\$ 59,880,000	\$ 895,000
Thomas J Fitzmyers	95,779,000	59,880,000	246,000
Phillip Terry Kingsfather	95,779,000	59,880,000	722,000
Michael J. Herbert	95,779,000	59,880,000	268,000
Brian J. Magstadt	95,779,000	59,880,000	245,000
Jeffrey E. Mackenzie	95,779,000	59,880,000	163,000

{1} Amounts expected to be paid for the full year of 2013 if operating profit goals established at the beginning of the year are met and qualifying levels are as projected at the beginning of the year.

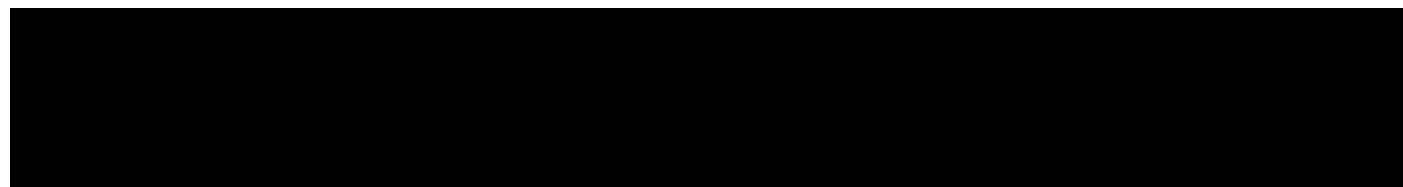
We use these parameters only to provide incentive to our officers and employees who participate in our Executive Officer Cash Profit Sharing Plan and our Cash Profit Sharing Plan. You should not draw any inference whatsoever from these parameters about our future financial performance. You should not take these parameters as projections or guidance of any kind.

For 2012, the operating profit goals, the qualifying level and the targeted payout that we presented in our reports on Form 8-K, filed with the Securities and Exchange Commission on February 2, 2012, and June 8, 2012, are reprinted below, along with the amounts that we paid to our Named Executive Officers for the four calendar quarters of 2012.

	Operating Profit Goal	Year Ended December 31, 2012 Qualifying Level	Targeted Payout{1}	Actual Payout
Karen Colonias	\$ 86,753,000	\$ 57,671,000	\$ 950,000	\$ 1,208,049
Thomas J Fitzmyers	86,753,000	57,671,000	575,000	658,129
Phillip Terry Kingsfather	86,753,000	57,671,000	800,000	955,759
Michael J. Herbert	86,753,000	57,671,000	389,000	474,790
Brian J. Magstadt	86,753,000	57,671,000	225,000	289,280

{1} Amounts were expected to be paid for the full year of 2012 if operating profit goals established at the beginning of the year were met and qualifying levels were as projected at the beginning of the year.

The actual payout in the table above was the sum of the payouts for each of the quarters during the year in which payments under the Executive Officer Cash Profit Sharing Plan were made to the Named Executive Officers. The quarterly payout, if any, for each of the Named Executive Officers in 2012 was computed as follows:



First	\$ 23,145,000	\$ 13,994,000	\$ 9,151,000	\$ 722,000	\$ 217,093	\$ 146,252	\$ 176,982	\$ 88,859	\$ 51,421
Second	38,571,000	14,804,000	23,767,000	1,738,000	542,710	327,773	425,690	209,852	130,520
Third	33,272,000	14,467,000	18,805,000	1,309,000	431,700	179,517	346,514	169,580	103,377
Fourth	7,026,000	13,365,000	(6,339,000)	41,000	16,546	4,587	6,573	6,499	3,962
					\$ 1,208,049	\$ 658,129	\$ 955,759	\$ 474,790	\$ 289,280

{1} Included is a portion of branch level profit sharing pool shared with home office employees, including the Named Executive Officers.

We compute the Qualifying Income, if any, as the difference between the Actual Operating Profit and the Actual Qualifying Level. Qualifying Income is the basis for the computation of amounts available to be distributed under both our Cash Profit Sharing Plan and our Executive Officer Cash Profit Sharing Plan. As the result of the transition of some of our Named Executive Officers into new roles in 2012, we computed the profit sharing pool for the Named Executive Officers as 6.47 percent of the Qualifying Income for the first quarter, 6.53 percent of the Qualifying Income for the second quarter and 6.12 percent of the Qualifying Income for the third and fourth quarter of 2012.

Based on historical information about the profitability of each of the operating units, the Compensation and Leadership Development Committee of our Board of Directors approves these percentages so that they correspond to the effort put forth and the results achieved by the participants. The Compensation and Leadership Development Committee may adjust the percentages from time to time so that the program will continue to create equitable results for all participants, including our Named Executive Officers. A portion of the profit sharing pool from the branch level operating units is shared with home office employees, including the Named Executive Officers, in consideration for their contributions to the success of the branch level operating units. We add this amount to the computed Named Executive Officer profit sharing pool to determine the amount available to be paid to our Named Executive Officers. We then allocate the Named Executive Officer profit sharing pool among the Named Executive Officers that participate in percentages approved by the Compensation and Leadership Development Committee at the beginning of the year. The participation by each Named Executive Officer is based on the officer's level of responsibility and contribution to the success of the operating unit. Unless the composition or responsibilities of the Named Executive Officers change, as they did in 2012, these participation rates generally do not change substantially from year to year, although the Compensation and Leadership Development Committee has discretion to make changes that it considers appropriate.

Our Executive Officer Cash Profit Sharing Plan is intended to comply with Internal Revenue Code section 162(m) and the related regulations and interpretations. For these officers, our Executive Officer Cash Profit Sharing Plan replaced our Cash Profit Sharing Plan described below, in which all officers had participated for over 30 years. The total awards to any participating officer under the Executive Officer Cash Profit Sharing Plan earned during the 4 quarters of a calendar year may not exceed \$2,500,000. In other respects, our Executive Officer Cash Profit Sharing Plan provides incentive compensation to the participating officers on the same terms as apply to other employees under our Cash Profit Sharing Plan. Our Executive Officer Cash Profit Sharing Plan enables us to deduct fully, for federal income tax purposes, amounts we pay to participating officers under our Executive Officer Cash Profit Sharing Plan. In 2012, only the payments to our Chief Executive Officer exceeded \$1,000,000 under our Executive Officer Cash Profit Sharing Plan.

Our Board of Directors has delegated the oversight of our Executive Officer Cash Profit Sharing Plan to its Compensation and Leadership Development Committee. The Compensation and Leadership Development Committee has sole discretion and authority to administer and interpret our Executive Officer Cash Profit Sharing Plan in accordance with Internal Revenue Code section 162(m). The Compensation and Leadership Development Committee may at any time amend our Executive Officer Cash Profit Sharing Plan, subject in some cases to the approval of our stockholders, or may terminate it at any time.

The Compensation and Leadership Development Committee determines the amount of the award that each of the participating officers will be eligible to receive under the Executive Officer Cash Profit Sharing Plan each fiscal quarter. The Compensation and Leadership Development Committee bases awards on a percentage of the amount by which the operating profit, as defined by the Compensation and Leadership Development Committee, exceeds the qualifying level for the fiscal quarter.

We maintain our Cash Profit Sharing Plan for the benefit of our employees and our subsidiaries' employees, other than the officers who participate in our Executive Officer Cash Profit Sharing Plan discussed above. Because it excludes our most highly compensated employees, the Cash Profit Sharing Plan is not covered by Internal Revenue Code section 162(m), and we believe that compensation paid under it is tax deductible. We may change, amend or terminate our Cash Profit Sharing Plan at any time. Under our Cash Profit Sharing Plan, as currently in effect, the Compensation and Leadership Development Committee reviews and approves a qualifying level for the coming fiscal year for Simpson Strong-Tie

Company Inc. and its qualifying branches. The qualifying level equals the value of the net operating assets, as defined by the Compensation and Leadership Development Committee, of Simpson Strong-Tie Company Inc. or its respective branches, multiplied by a rate of return on those assets, as determined by the Compensation and Leadership Development Committee. If profits exceed the qualifying level in any fiscal quarter, we pay a portion of the excess to the eligible employees as cash compensation. Our executive officers determine, and the Compensation and Leadership Development Committee reviews and approves, the percentage of the excess that we will distribute and the rates we use to calculate the amounts that we distribute to participants. Whether or not we pay amounts in any quarter under our Cash Profit Sharing Plan does not affect an employee's ability to earn amounts in any other quarter under our Cash Profit Sharing Plan. Under our Cash Profit Sharing Plan, we paid amounts totaling \$17.3 million in 2012, \$22.0 million in 2011 and \$15.0 million in 2010.

Equity-Based Compensation Awards

The Simpson Manufacturing Co., Inc. 2011 Incentive Plan affords our Named Executive Officers and other selected employees, directors and consultants the opportunity to own shares of our common stock, by which we intend:

- to enhance our ability to attract and retain qualified individuals as officers, employees, directors and consultants, and
- to provide such individuals with incentives to continue service with us, devote their best efforts to Simpson Manufacturing Co., Inc. and improve our economic performance, thus enhancing the value of Simpson Manufacturing Co., Inc. for the benefit of its stockholders.

While the purpose of our Executive Officer Cash Profit Sharing Plan is to motivate our officers to achieve short-term profit goals, we believe that compensation through equity-based awards motivates our key employees to pursue long-term stock price appreciation. We believe this because our program requires achieving an annual profitability goal to receive an equity-based compensation award and, for participants to realize substantial value, sustained effort as the restrictions on restricted stock unit awards lapse and as stock options vest and mature. In addition, rather than making a single large award, our program generally awards equity-based compensation in smaller annual increments, only for years when we meet our profitability goals.

We established the principal terms of the equity-based compensation awards when we adopted the 2011 Incentive Plan (and its predecessor plan, the 1994 Stock Option Plan), and we have generally applied them consistently since then. We believe that they generally are below the range of comparable compensation plans identified in the Venture Pay Group Industry Match peer group. Under our 1994 Stock Option Plan, we granted non-qualified stock options, until February 2011, that have 7-year terms, except for those we granted to Barclay Simpson, which have 5-year terms. Each stock option has an exercise price equal to the market price at the time it was granted, except for options we granted to Barclay Simpson, which have exercise prices that are 110 percent of the market price at the times they were granted. Stock options granted to Named Executive Officers vest annually over the first 4 years at a rate of 25 percent per year. Under our 2011 Incentive Plan, we awarded restricted stock units, beginning in January 2012. Each restricted stock unit award is valued at the closing price on the New York Stock Exchange on the day before the Compensation and Leadership Development Committee approves the award. Restrictions on restricted stock unit awards, including those made to Named Executive Officers, generally lapse 25 percent on each of the date of the award and the first, second and third anniversaries of the date of the award. The 2011 Incentive Plan is qualified under Internal Revenue Code section 162(m).

Stock option grants for every participating employee, including a Named Executive Officer, vest fully if the employee ceases to be employed by us after reaching age 60 or in the event of a change in control. Similarly, the restrictions on restricted stock unit awards for every participating employee, including a Named Executive Officer, lapse if the employee ceases to be employed by us after reaching age 60 or in the event of a change in control. We believe that this allows employees, who have made substantial contributions during their careers, to retire without having to give up any of the value that they have earned on their stock options and restricted stock unit awards. We also believe that it is appropriate,

on a change in control, to accelerate the vesting of outstanding stock options and the lapse of restrictions on restricted stock units, because we do not afford other significant termination benefits to our employees.

We believe that equity-based compensation aligns the interests of our Named Executive Officers with the interests of our stockholders, because the Named Executive Officers realize additional value on the same basis as our stockholders. We make an annual award of equity-based compensation to a Named Executive Officer only when we meet our profitability goal for Simpson Strong-Tie Company Inc. for the preceding year, or in certain cases, when the Named Executive Officer achieves a goal based on one of our strategic initiatives as discussed below. If we achieve our operating profit goals for 2013, computed as income from operations plus stock compensation charges, certain incentive compensation and commissions, salaried pension contributions and self-insured workers' compensation costs, we anticipate awarding restricted stock units to the following executive officers for the following numbers of shares of our common stock:

	Operating Profit Goal	Restricted Stock Unit Award
Karen Colonias	\$ 95,779,000	18,300 shares
Phillip Terry Kingsfather	95,779,000	9,150 shares
Brian J. Magstadt	95,779,000	7,578 shares
Thomas J Fitzmyers	95,779,000	3,865 shares
Michael J. Herbert	95,779,000	1,720 shares
Jeffrey E. Mackenzie	95,779,000	1,720 shares

We use these parameters only for the purposes stated above. You should not draw any inference whatsoever from these parameters about our future financial performance. You should not take these parameters as projections or guidance of any kind.

We believe our formula for computing the operating profit goals includes items that are likely to affect profitability and that our officers can influence, such as staffing levels, direct and indirect manufacturing costs, and operating expenses, and promotes prudent allocation of resources.

In addition, for 2013, the Compensation and Leadership Development Committee approved additional restricted stock unit awards and goals for Karen Colonias, Phillip Terry Kingsfather and Brian J. Magstadt. These awards will be based on performance against estimated sales of the products from our recent strategic acquisitions of S&P Clever Reinforcement Company AG, S&P Clever Reinforcement International AG, Fox Industries, Inc., Automatic Stamping, LLC and Automatic Stamping Auxiliary Services, LLC (collectively, the Recently Acquired Businesses). The number of restricted stock units may be increased or decreased based on the percentage above or below estimated sales, but at least 75 percent of the sales goal must be reached for an award to be earned. The number of potential restricted stock units earned and the goals for these individuals are (subject to adjustment as further described below) as follows:

Recently Acquired Businesses	Potential Restricted Stock Unit Award		
	Karen Colonias	Phillip Terry Kingsfather	Brian J. Magstadt
75% of sales goal \$31,789,000	6,100 shares	3,050 shares	2,526 shares
100% of sales goal \$42,385,000	12,200 shares	6,100 shares	5,052 shares
150% of sales goal \$63,578,000	24,400 shares	12,200 shares	10,104 shares

We use these parameters only for the purposes stated above. You should not draw any inference whatsoever from these parameters about our future financial performance. You should not take these parameters as projections or guidance of any kind.

The total number of restricted stock units that may be earned by achieving both the operating profit goal and the sales goal of the Recently Acquired Businesses may be modified up or down by 10 percent based on a peer group comparison of total stockholder return, including stock price appreciation and dividends paid. The peer group consists of the following companies:

Illinois Tool Works	Fastenal Company
Gibraltar Industries	Eagle Materials Inc.
Masco Corporation	Trex Co. Inc.
USG Corporation	Stanley Black & Decker, Inc.

If our total stockholder return is below the peer group average, we will award 90 percent of the restricted stock units; if it is at the peer group average, we will award 100 percent of the restricted stock units; and if it is above the peer group average, we will award 110 percent of the restricted stock units. Therefore, the maximum potential restricted stock units awards will be 46,970 shares for Karen Colonias, 23,485 shares for Phillip Terry Kingsfather and 19,450 shares for Brian J. Magstadt. Restrictions on all of the restricted stock unit awards earned by Karen Colonias, Phillip Terry Kingsfather and Brian J. Magstadt will lapse 75 percent on the third anniversary of the date of the award and 25 percent on the fourth anniversary of the date of the award (subject to provisions discussed above relating to retirement after age 60 or a change in control).

The Compensation and Leadership Development Committee of our Board of Directors also approved the additional grant of at least 1,250 restricted stock units to Michael J. Herbert if we exceed our 2013 budgeted goal for sales in the Asia/Pacific segment by 10 percent, to increase to a maximum of 2,500 restricted stock units if we exceed our 2013 budgeted goal for sales in the Asia/Pacific segment by 15 percent, as follows:

Asia/Pacific	Potential Restricted Stock Unit Award
110% of sales goal \$17,898,000	1,250 shares
115% of sales goal \$18,712,000	2,500 shares

We use these parameters only for the purposes stated above. You should not draw any inference whatsoever from these parameters about our future financial performance. You should not take these parameters as projections or guidance of any kind.

In 2011, our Board of Directors adopted our 2011 Incentive Plan and our stockholders approved it at their 2011 annual meeting. We may not sell more than 16.32 million shares of common stock (including shares already sold) pursuant to all awards granted under our 2011 Incentive Plan or its predecessor plans, the 1994 Stock Option Plan and the 1995 Independent Director Stock Option Plan. Common stock sold on conversion of restricted stock units or on the exercise of stock options granted under the 2011 Incentive Plan, or its predecessor plans, may be previously unissued shares or reacquired shares, bought on the market or otherwise.

The Compensation and Leadership Development Committee targets equity-based compensation awards to all employees, including our Named Executive Officers, to total less than 1.0 percent of the outstanding shares of our outstanding common stock each year. This range is a general guideline that the Compensation and Leadership Development Committee believes should avoid undue dilution of our stockholders' investment. In 2013, we awarded 349,396 restricted stock units, excluding 9,975 restricted stock units awarded to our independent directors, out of a possible 448,044 restricted stock units that the Compensation and Leadership Development Committee had approved for operating profit performance and strategic goals during 2012. This represents about 0.7 percent of our outstanding shares of common stock. Our Chief Executive Officer and the other Named Executive Officers all met their operating profit goals for 2012, and we therefore granted to them 54,390 restricted stock units in 2013. Michael J. Herbert did not achieve the minimum goal for international sales in 2012 but did complete the introduction of products from the Recently Acquired Businesses into Asia or the Middle East and identified a potential acquisition target in the Asia/Middle East region; he was awarded a total of 2,500 additional restricted stock units. Karen Colonias, Phillip Terry Kingsfather and Brian J. Magstadt achieved 75 percent of the sales goal for the Recently Acquired Businesses and were awarded 4,575, 2,287 and 1,145 restricted stock units, respectively. The total stockholder return was below the peer group average, so the restricted stock units awards for Karen Colonias, Phillip Terry Kingsfather and Brian J. Magstadt were reduced by 2,592, 1,296 and 648 restricted stock units, respectively. For 2013, the Compensation and Leadership Development Committee approved a number of shares equal to approximately 0.9 percent of the outstanding shares of our common stock for possible restricted stock unit awards in 2014. If we meet all of our operating profit and strategic goals and total stockholder return is above average for 2013, we anticipate awarding 436,450 restricted stock units under our 2011 Incentive Plan, 99,710 of which would be granted to Named Executive Officers.

The Compensation and Leadership Development Committee determines the number of restricted stock units that we may award to each of our officers based on several factors, including position, length of service, prior equity-based compensation awards and shares of our stock owned. The Compensation and Leadership Development Committee uses these and other factors that it considers relevant in particular cases, in an effort to make each employee's award commensurate with the employee's contribution. These judgments are largely subjective, and the factors are not weighted in any particular way. See *Wealth Accumulation* below. For example, when an employee becomes an officer, the Compensation and Leadership Development Committee may approve an equity-based compensation award to the officer that the Compensation and Leadership Development Committee believes will afford the officer enough of an investment in our common stock to align the officer's interests with the interests of our stockholders. After the officer achieves that level of investment, the Compensation and Leadership Development Committee generally reduces the equity-based awards to the officer. The intent of the 2011 Incentive Plan is to reward performance achievements with future value. The Compensation and Leadership Development Committee believes that our long-term incentives are lower than competitive practice, based on the 2010 report from Venture Pay Group.

Timing of Stock Option Grants and Restricted Stock Unit Awards

The Compensation and Leadership Development Committee approves the number of shares to be awarded under our 2011 Incentive Plan and the general terms of the awards on achieving the profitability and strategic goals set at the beginning of the year. The only variable that remains after the end of the year is the determination whether we have achieved our goals. The Compensation and Leadership Development Committee cannot make this determination until the financial statements are prepared and the financial statement audit by our independent registered public accounting firm is substantially complete. The Compensation and Leadership Development Committee ordinarily meets to finalize the equity incentive awards within a few days of announcing our financial results for the year. The Compensation and Leadership Development Committee values such awards according to the closing price of our common stock reported by the New York Stock Exchange at the close of trading on the day before the meeting, which may or may not be the day of the announcement. In 2013, the Compensation and Leadership Development Committee awarded a total of 359,371 restricted stock units, including 9,975 restricted stock units awarded to our independent directors, and established the value of these awards according to the closing price on February 5, 2013, which was 2 business days before the announcement of our fourth

quarter 2012 earnings on February 7, 2013. We have followed this practice for all equity-based compensation awards under our 2011 Incentive Plan (or its predecessor plan, the 1994 Stock Option Plan), not just for awards made to our officers. We generally award equity-based compensation only once each year and do not ordinarily make awards at other times, such as when employees are newly hired or promoted, although the Compensation and Leadership Development Committee has the discretion to do so.

Wealth Accumulation

Our compensation programs for our Named Executive Officers, as well as other high-performing employees, are predominately based on quarterly and annual operating results. We believe that we should award above-average compensation for above-average performance and that we should closely tie the reward to that performance. As a result, we believe our compensation structure allows high-performing employees the opportunity to accumulate wealth for themselves, while creating value for our stockholders. A feature of our 2011 Incentive Plan, however, allows us to limit excess equity-based compensation awards to certain individuals. When an employee is promoted into a key role, such as an officer of Simpson Manufacturing Co., Inc. or a senior officer of Simpson Strong-Tie Company Inc. or one of its subsidiaries, we may give the employee an opportunity to earn an equity-based compensation award for a substantial number of shares if the employee meets his or her operating goals. The Compensation and Leadership Development Committee sets limits for these employees that, when reached, are removed from their annual award targets. The Compensation and Leadership Development Committee believes that this approach balances appropriate incentive for selected key employees to continue to perform at a high level, against avoiding excessive accumulation of equity-based compensation awards by reducing the number of shares available for awards after the employee reaches an amount that the Compensation and Leadership Development Committee judges to be appropriate.

Employee Stock Bonus Plan

Under our 1994 Employee Stock Bonus Plan, we award shares of our common stock, based on years of service, to employees who do not participate in our 2011 Incentive Plan. The Compensation and Leadership Development Committee reviews and approves the number of shares we award, as well as the period of service. The Compensation and Leadership Development Committee has tried to balance the amount of the stock bonus awards over the years as the stock price has fluctuated, by increasing or reducing the number of shares that we award in a given year. We also award cash bonuses to these employees to compensate for their income taxes payable as a result of these bonuses. We have generally issued the shares to an employee in the year following the year in which the employee reached a tenth anniversary. The Compensation and Leadership Development Committee must approve the awards each year and may terminate the plan at any time. None of our Named Executive Officers participates in our 1994 Employee Stock Bonus Plan.

2012 Results of Advisory Vote to Approve Named Executive Officer Compensation

At the annual meeting in April 2012, a substantial majority of our stockholders, more than 97 percent of the votes cast, approved the compensation of our named executives officers. After consideration of this high level of support, the Compensation and Leadership Development Committee decided that we did not need to make substantial changes to our compensation programs. Nevertheless, the Compensation and Leadership Development Committee continually monitors and evaluates our compensation policies and considers changes that could more closely align the interests of our employees and stockholders.

Our Board of Directors has determined that an annual advisory vote on the compensation of our Named Executive Officers allows our stockholders to provide timely, direct input on our compensation philosophy, policies and practices as disclosed in our proxy statement each year. Our Board of Directors continues to believe that an annual vote is therefore consistent with our efforts to engage in an ongoing dialogue

with our stockholders on the compensation of our Named Executive Officers and other corporate governance matters.

Material Risk Considerations of Compensation Policies

We face various types of risk daily, including market risk, credit risk and currency risk, as well as general business risk. Our compensation programs look at longer time frames from one quarter to one year and beyond one year. Therefore, we do not feel that they expose us to undue risk-taking. To compete in and expand our markets, however, some risk is unavoidable and in some cases desirable and appropriate.

While our compensation programs reward our employees for time spent at work and for the achievement of specific performance objectives, we also consider how and to what extent these programs encourage risk-taking. We believe that our cash profit sharing and equity-based incentive plans promote a measured approach to areas of risk that we face as an organization. While the objectives of the plans are to achieve and increase our profitability, we believe they also encourage sound financial management and the safeguarding of our assets. In addition, we believe our compensation programs promote a sense of unity and cooperation among all of our employees, not just our executive officers, affording less opportunity and incentive for an individual employee to take undue risk in an attempt to increase his or her own compensation at the expense of the long-term health of Simpson Manufacturing Co., Inc.

Through our cash profit sharing incentive plans, employees are encouraged to maximize quarterly profits by increasing revenues and reducing costs. Compensation under these plans is paid on a quarterly basis, regardless of our performance in a later quarter. While the quarterly time horizon could potentially create opportunities for employees to maximize income in one quarter at the expense of a future quarter, we feel that this risk is balanced in the longer-term aspects of the cash profit sharing plan, as it is an ongoing program and income shifted from one quarter to another would not likely increase total bonus payments over time. It is also mitigated in the use of the qualifying level component of the program which rewards prudent stewardship of assets and sound allocation of resources. This effect is further balanced by our equity-based incentive plan, which requires profitability goals to be met for a full year before we award equity-based compensation, and then the stock options or restricted stock units generally vest over a period of years thereafter. The value of an equity-based compensation award also is affected by appreciation of the market price of our common stock over time. Any attempt to maximize short-term profits at the expense of long-term financial health would work against our employees' incentive to maximize their compensation.

Summary Compensation Table

The table below provides information on compensation for the year ended December 31, 2012, for our Named Executive Officers our Principal Executive Officer, our Principal Financial Officer and our 3 other most highly compensated executive officers. Thomas J Fitzmyers was our Principal Executive Officer and Karen Colonias was our Principal Financial Officer until December 2011. The amounts shown include all compensation for services to us and our subsidiaries in all capacities.

Name and Principal Position	Year	Salary(\$)	Restricted Stock Unit Awards (\$){1}	Option Awards (\$){2}	Non-Equity Incentive Plan Compensation (\$){3}	All Other Compensation (\$){4}	Total(\$)
Karen Colonias, Our President and Chief Executive Officer	2012	350,000	209,183		1,199,491	26,272	1,784,946
	2011	283,089		516,500	642,193	32,148	1,473,930
	2010	262,119			474,023	24,969	761,111
Brian J. Magstadt, Our Chief Financial Officer and Secretary	2012	225,000	114,311		286,474	15,630{5}	641,415
Thomas J Fitzmyers, Our Chairman	2012	222,814	171,135		672,988	43,044{6}	1,109,981
	2011	346,118		185,940	1,563,311	62,831{6}	2,158,200
	2010	336,036			1,224,419	56,015{6}	1,616,470
Phillip T. Kingsfather, President and Chief Executive Officer of Simpson Strong-Tie Company Inc.	2012	305,910	531,846		957,676	101,275{7}	1,896,707
	2011	297,000		1,094,980	682,703	163,469{7}	2,238,152
	2010	275,000			529,055	156,667{7}	960,722
Michael J. Herbert, Our Vice President	2012	291,582	114,145		476,278	26,734{8}	908,739
	2011	283,089		413,200	642,233	33,148{8}	1,371,670
	2010	262,119			474,023	26,667{8}	762,809

{1} We determined the value of restricted stock unit awards by multiplying the number of restricted stock units by the fair value per share as of the award date. The restricted stock was valued using the market price of the shares on the award date in accordance with Accounting Standards Codification Topic 718 Compensation Stock Compensation. The restricted stock units were awarded on January 30, 2012, and were valued at \$33.23, the closing stock price on January 27, 2012.

Vesting of all unvested restricted stock units is accelerated in the event of a change in control. See Grants of Plan-Based Awards below.

{2} We determined the value of stock option awards by multiplying the number of shares subject to the stock option by the fair value per share as of the grant date. We applied the Black-Scholes stock option pricing model to determine fair value in accordance Accounting Standards Codification Topic 718 Compensation Stock Compensation, using the following assumptions:

Grant Date	Risk Free Interest Rate	Dividend Yield	Expected Life	Volatility	Exercise Price	Weighted Average Fair Value
02/03/11	2.62%	1.75%	6.2 years	39.0%	\$ 29.66	\$ 10.33

In January 2005, our Board of Directors resolved to accelerate the vesting of all unvested stock options in the event of a change in control. See Grants of Plan-Based Awards below.

{3} Awards earned under our Executive Officer Cash Profit Sharing Plan are earned in 1 quarter and paid in the following quarter. The amount in this column represents all cash paid during the specified years under our Executive Officer Cash Profit Sharing Plan. No amounts are deferred or payable by their terms at a later date. See Executive Compensation Compensation Discussion and Analysis *Executive Officer Cash Profit Sharing Plan* above.

{4} For 2012, each amount includes a contribution to the officer's profit sharing trust account of an amount equal to 7 percent of the officer's salary earned in the preceding year, up to the annual qualified contribution limits of \$17,150, per account, plus a share of funds forfeited by other employees who terminated from the profit sharing trust with an unvested balance. Each amount also includes a contribution equal to 3 percent of the officer's salary made quarterly in 2012 after the close of the quarter in which it is earned. This contribution is made to comply with the safe-harbor rules that govern the plan. The contribution earned in the last quarter of 2011 and the first 3 quarters in 2012 is included in each amount shown. For 2011 and 2010, each amount includes a contribution of an amount equal to 10 percent of the officer's salary, earned in the preceding year, for each of the specified years to the officer's profit sharing trust account, up to the annual qualified contribution limit of \$24,500 per account, plus a share of funds forfeited by other employees who terminated from the profit sharing trust with an unvested balance. Another 3 percent contribution, made quarterly in 2011 after the close of the quarter in which it is earned, was made to comply with the safe-harbor rules that govern the plan. The contribution earned in the first 3 quarters of 2011 is included in the amount shown for 2011.

{5} Includes:

2012

Profit sharing trust contribution and forfeitures	\$	15,130
Charitable gift matching contributions		500

{6} Includes:

	2012	2011	2010
Profit sharing trust contribution and forfeitures	\$ 23,139	\$ 33,129	\$ 25,667
Hire of aircraft	17,986	19,031	19,385
Reimbursement of personal income taxes related to hire of aircraft	1,919	10,671	10,963

The amount related to Mr. Fitzmyers' use of an aircraft included travel between his home and our offices and travel on business. The total cost to us for chartering aircraft, including Mr. Fitzmyers' compensation, approximated \$462,000 in 2012, \$508,000 in 2011 and \$532,000 in 2010. In computing the compensation cost of airplane use, we applied the Standard Industrial Fare Level tables prescribed by applicable Internal Revenue Service regulations. The independent members of our Board of Directors unanimously approved this arrangement.

{7} Includes:

	2012		2011		2010
Profit sharing trust contribution and forfeitures	\$ 25,342	\$	32,461	\$	25,667
Housing allowance	75,833		130,000		130,000
Personal electronics purchase			854		
Reimbursement of personal income taxes related to personal electronics purchase			154		
Charitable gift matching contributions	100				1,000

The amount related to Mr. Kingsfather's housing allowance included incremental financing and transaction costs. The arrangement terminated in July 2012.

{8} Includes:

	2012		2011		2010
Profit sharing trust contribution and forfeitures	\$ 25,332	\$	32,148	\$	25,667
Personal electronics purchase	402				
Charitable gift matching contributions	1,000		1,000		1,000

Compensation and Leadership Development Committee Interlocks and Insider Participation

The Compensation and Leadership Development Committee of our Board of Directors currently comprises Jennifer A. Chatman, Chair, Peter N. Louras, Jr. and Barry Lawson Williams, all of whom are independent directors. Ms. Chatman, Mr. Louras and Mr. Williams have no relationships with us or any of our subsidiaries, other than as members of our Board of Directors and its committees.

Transactions with Related Persons, Promoters and Certain Control Persons

In 2003, Thomas J Fitzmyers, then our Chief Executive Officer and a member of our Board of Directors, leased an airplane that a third-party charter company managed. He sold this airplane in 2009. We paid the charter company standard hourly rates when Mr. Fitzmyers used this airplane to travel between his home and our offices or to travel on business. Mr. Fitzmyers was responsible for maintaining the airplane, and he received a portion of the payments that were made to the charter company for its use, whether by us or others. Since the sale of this airplane, we continued to pay a charter service for Mr. Fitzmyers' travel between his home and our offices and to travel on business under a similar arrangement. This arrangement ended at the end of 2012. In 2012, we paid approximately \$462,000 for Mr. Fitzmyers use of this and other airplanes, including \$19,905 that we paid to Mr. Fitzmyers as compensation (see Summary Compensation Table above). The members of our Board of Directors who are not employees or officers unanimously approved this arrangement. Beginning in 2013, we will no longer hire an airplane for Mr. Fitzmyers, but will reimburse him for the cost of his travel based on commercial flight rates to and from our offices or when he travels on Company business.

Grants of Plan-Based Awards

The following table summarizes the awards under our 2011 Incentive Plan of restricted stock units to our Named Executive Officers during 2012. The Compensation and Leadership Development Committee awarded these restricted stock units because we achieved our 2011 operating goals that the Compensation and Leadership Development Committee had approved at the beginning of 2011.

Name	Grant Date	All Other Stock Awards: Number of Shares of Stock or Units (#)	Grant Date Fair Value of Stock and Option Awards (\$/Share)
Karen Colonias	01/30/12	6,295	33.23
Brian J. Magstadt	01/30/12	3,440	33.23
Thomas J Fitzmyers	01/30/12	5,150	33.23
Phillip Terry Kingsfather	01/30/12	16,005	33.23
Michael J. Herbert	01/30/12	3,435	33.23

The restrictions on the restricted stock units lapse (vest) as follows:

Name	Vesting Term{1}	Vesting Increments
Karen Colonias	3 years	annually
Brian J. Magstadt	3 years	annually
Thomas J Fitzmyers	3 years	annually
Phillip Terry Kingsfather	3 years	annually
Michael J. Herbert	3 years	annually

{1} Restricted stock units vest one fourth on each of the award date and the first, second and third anniversaries of the award date. As discussed below, vesting of restricted stock units will accelerate on a change in control or on the participant ceasing to be employed by us after reaching age 60.

We generally award restricted stock units or grant stock options under our 2011 Incentive Plan once each year, in January or February, on the day that the Compensation and Leadership Development Committee meets to approve the awards and grants that employees earned by meeting our goals for the preceding fiscal year. In 2012, we awarded 352,511 restricted stock units, excluding 8,550 restricted stock units awarded to our independent directors, under our 2011 Incentive Plan. In 2011, we granted stock options under our 1994 Stock Option Plan to purchase 1,362,000 shares of our common stock pursuant to commitments related to the preceding fiscal years. The exercise price per share of the options equaled or exceeded the closing market price per share of our common stock as reported by the New York Stock Exchange for the day preceding the date of the Compensation and Leadership Development Committee meeting granting the options.

Generally, restrictions on restricted stock units that the Compensation and Leadership Development Committee has awarded under our 2011 Incentive Plan lapse (vest) in increments over 3 years and stock options that were granted under our 1994 Stock Option Plan (now part of our

2011 Incentive Plan) vest (become exercisable) in increments over 4 years. Our Board of Directors has, however, resolved to accelerate the vesting of restricted stock units and stock options in two situations. First, when an employee ceases employment with us after reaching age 60, all of the employee's unvested restricted stock units and stock options vest fully. Second, all outstanding restricted stock units vest and all stock options will fully vest, and must be exercised, on a change in control of Simpson Manufacturing Co., Inc., which we define as any of the following transactions, in which the holders of our common stock

immediately before the transaction do not continue to have substantially the same proportionate ownership in an entity that owns all or substantially all of the assets of Simpson Manufacturing Co., Inc. immediately thereafter:

- a consolidation or merger of Simpson Manufacturing Co., Inc. in which it is not the surviving corporation;
- a reverse merger in which Simpson Manufacturing Co., Inc. is the surviving corporation but the shares of our common stock outstanding immediately before the reverse merger are converted by virtue of the reverse merger into other property; or
- the approval by our stockholders of a plan or proposal for the dissolution and liquidation of Simpson Manufacturing Co., Inc.

These acceleration provisions apply to all participants in our 2011 Incentive Plan (including our 1994 Stock Option Plan, now part of our 2011 Incentive Plan), including our Named Executive Officers.

In 2013, we awarded restricted stock units under our 2011 Incentive Plan for 359,371 shares, including those awarded to our independent directors, of our common stock pursuant to commitments related to the preceding fiscal year. These restricted stock units are valued according to the closing market price per share of our common stock as reported by the New York Stock Exchange for the day preceding the date of the Compensation and Leadership Development Committee meeting awarding these restricted stock units. Restrictions on these restricted stock units generally lapse 25 percent on each of the date of the award and the first, second and third anniversaries of the date of the award except for those awarded to Karen Colonias, Phillip Terry Kingsfather and Brian J. Magstadt, which will lapse 75 percent on the third anniversary of the date of the award and 25 percent on the fourth anniversary of the date of the award. Restrictions on the restricted stock units also lapse when an employee ceases employment with us after reaching age 60 or on a change in control of Simpson Manufacturing Co., Inc.

Outstanding Equity Awards at Fiscal Year End

As of December 31, 2012, our Named Executive Officers held the following stock options that had been granted under our 1994 Stock Option Plan (now part of our 2011 Incentive Plan) and restricted stock units that had been awarded under our 2011 Incentive Plan:

Name	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable {1}	Option Exercise Price(\$)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested (\$){1}
Karen Colonias	3,000		40.72	01/25/13		
	2,000		33.62	02/01/14	4,722{4}	154,834
	12,500	37,500{2}	29.66	02/02/18		
Brian J. Magstadt	5,500	6,500{3}	29.66	02/02/18	2,580{4}	84,598
Thomas J Fitzmyers	9,000		40.72	01/25/13		
	4,500	13,500{2}	29.66	02/02/18	3,863{4}	126,668
Phillip Terry Kingsfather	33,000		40.72	01/25/13		
	2,000		33.62	02/01/14	12,004{4}	393,611
		79,500{2}	29.66	02/02/18		
Michael J. Herbert	4,000		40.72	01/25/13		
		30,000{2}	29.66	02/02/18	2,577{4}	84,500

{1} As discussed above see Grants of Plan-Based Awards vesting of stock options and restricted stock units will accelerate on a change in control or on the employee ceasing employment with us after reaching age 60.

{2} Unless vesting accelerates as discussed above, options vest at the rate of 25 percent per year on the anniversary of the date of grant.

{3} Unless vesting accelerates as discussed above, options vest at the rate of 1/48th per month each month beginning with the first month after the month of grant.

{4} Restricted stock units vest 25 percent on the award date and 25 percent on each of the 1st, 2nd and 3rd anniversary of the award date.

Stock Option Exercises and Stock Vested

The following table provides information for the year ended December 31, 2012, on the exercise of stock options granted to our Named Executive Officers under our 1994 Stock Option Plan (now part of our 2011 Incentive Plan) and on the vesting of restricted stock unit awards:

Name	Stock Option Awards		Stock Awards	
	Number of Shares Acquired on Exercise (#)	Value Realized on Exercise (\$)	Number of Shares Acquired on Vesting (#)	Value Realized on Vesting (\$)
Karen Colonias			1,573	52,271
Brian J. Magstadt			860	28,578
Thomas J Fitzmyers			1,287	42,767
Phillip Terry Kingsfather	26,500	81,827	4,001	132,953
Michael J. Herbert	10,000	31,336	858	28,511

Potential Payments on Termination or Change in Control

We do not currently have or plan to adopt any deferred compensation programs or, except for a small number of employees in our recently acquired Swiss subsidiary, any defined benefit pension plans and generally do not pay benefits after termination of employment. We may, however, compensate a former employee after terminating employment with us, by way of the acceleration of vesting of stock options and restricted stock units on voluntary termination after reaching the age of 60 or on a change in control. These circumstances, in addition to those applicable to salaried employees generally, and the potential payments for our Named Executive Officers are as follows as of December 31, 2012:

Benefits and Payments on Termination	Voluntary Termination(1)	Change in Control{1}
Accelerated vesting of stock options and restricted stock units:		
Karen Colonias	\$	\$ 272,209
Brian J. Magstadt		104,943
Thomas J Fitzmyers	168,923	168,923
Phillip Terry Kingsfather	642,446	642,446
Michael J. Herbert		178,400

{1} As discussed above under Grants of Plan-Based Awards, vesting of stock options and the lapsing of restrictions on restricted stock units will accelerate on the employee ceasing employment with us after reaching age 60 or on a change in control.

Assumes a market value of \$32.79 per share of our common stock, the closing stock price on December 31, 2012, at voluntary termination or change in control. No material conditions or obligations apply to the receipt of payment on voluntary termination.

Director Compensation

The following table provides information on compensation for the year ended December 31, 2012, that we paid to our directors who are not also our employees or officers. The amounts shown include all compensation for services to us.

Name	Fees Earned or Paid in Cash(\$)	Stock Awards (\$){1}	All Other Compensation (\$){2}	Total (\$)
James S. Andrasick	73,000			73,000
Jennifer A. Chatman	94,500	47,353		141,853
Earl F. Cheit	101,000	47,353	1,000	149,353
Gary M. Cusumano	94,000	47,353		141,353
Peter N. Louras, Jr.	107,000	47,353		154,353
Robin G. MacGillivray	98,000	47,353	1,000	146,353
Barry Lawson Williams	94,500	47,353	1,000	142,853

{1} We determined the value of restricted stock unit awards by multiplying the number of restricted stock units by the fair value per share as of the award date. The restricted stock was valued using the market price of the shares on the award date in accordance Accounting Standards Codification Topic 718 Compensation Stock Compensation. The restricted stock units were awarded on January 30, 2012, and were valued at \$33.23, the closing stock price on January 27, 2012. Vesting of all unvested restricted stock units is accelerated on a change in control; see Grants of Plan-Based Awards above.

The outstanding stock option and restricted stock awards as of December 31, 2012, for these directors were as follows:

Name	Stock Options	Restricted Stock Units
Jennifer A. Chatman	6,000	1,425
Earl F. Cheit	6,000	1,425
Gary M. Cusumano	5,000	1,425
Peter N. Louras, Jr.	6,000	1,425
Robin G. MacGillivray	6,000	1,425
Barry Lawson Williams	6,000	1,425

{2} Represents matching contributions made by us for charitable gifts made by the director.

We pay each of our directors whom we do not compensate as an officer or employee

- an annual retainer of \$40,000,

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- a fee of \$2,000 for attending in person each meeting of our Board of Directors or attending by telephone a meeting that is scheduled to be held by telephone conference,
- a fee of \$2,000 for attending in person each committee meeting held on a day when our Board of Directors does not meet, whether or not he or she is a member of the committee,
- a fee of \$1,000 for each committee meeting he or she attends in person on the same day as a meeting of our Board of Directors or another committee, whether or not he or she is a member of the committee, and
- a fee of half the normal fee for each Board of Directors or committee meeting he or she attends by telephone, unless it is scheduled to be held by telephone conference.

We pay the Lead Independent Director an additional annual fee of \$10,000. We pay the Chair of the Audit Committee an additional annual fee of \$8,000. We pay the Chair of each of the Compensation and Leadership Development Committee, the Acquisition and Strategy Committee and the Governance and Nominating Committee an additional annual fee of \$4,000. The annual retainer and the additional annual fees for the Lead Independent Director and the Committee Chairs are not prorated in the year that a director is appointed to the Board of Directors. We reimburse outside directors for expenses that they incur in attending Board of Directors and committee meetings and educational programs. We pay each outside director \$3,000 per day and reimburse his or her expenses when he or she visits our facilities to observe operations.

Equity-Based Compensation Awards for Independent Directors

Each of our independent directors, whether newly appointed or continuing his or her service, is eligible to receive 1,425 restricted stock units under our 2011 Incentive Plan for each year that we meet our annual operating profit goal. A newly appointed director is eligible to receive the entire restricted stock unit award as long as he or she served on the Board of Directors during the year and the operating profit goal for that year was achieved. The operating profit goal for awards for our independent directors is the same as the operating profit goal for awards to our Named Executive Officers. In 2013, because Simpson Strong-Tie Company Inc. achieved its 2012 operating profit goals, we awarded 1,425 restricted stock units under our 2011 Incentive Plan to each of our independent directors. If we meet the Simpson Strong-Tie Company Inc. operating profit goal for 2013, we anticipate awarding in 2014 to each of our independent directors 1,425 restricted stock units under our 2011 Incentive Plan.

No stock options granted to our directors under our 1995 Independent Director Stock Option Plan (now part of our 2011 Incentive Plan) were exercised during 2012.

Potential Payments on Resignation or Change in Control for Independent Directors

We do not currently have or plan to adopt any deferred compensation programs or defined benefit pension plans and generally do not pay benefits after resignation from the Board of Directors. We may, however, compensate a former director who resigns from the Board of Directors by accelerating the lapse of restrictions on the directors' restricted stock units if the director is over age 60 or a change in control occurs, as follows as of December 31, 2012:

Benefits and Payments on Termination	Resignation{1}	Change in Control{1}
Accelerated lapse of restrictions on restricted stock units:		
Jennifer A. Chatman	\$	\$ 35,053
Earl F. Cheit	35,053	35,053
Gary M. Cusumano	35,053	35,053
Peter N. Louras, Jr.	35,053	35,053
Robin G. MacGillivray		35,053
Barry Lawson Williams	35,053	35,053

{1} Assumes a market value of \$32.79 per share of our common stock, the closing stock price on December 31, 2012, on resignation or change in control. No material conditions or obligations apply to the receipt of payment on resignation.

Compensation Consultants

In 2011, the Compensation and Leadership Development Committee engaged Towers Watson as its compensation consultant. The Lead Consultant, who changed employers from Venture Pay Group to Towers Watson in 2011, remained the same. Towers Watson's services were requested and approved by the Compensation and Leadership Development Committee and not recommended or provided by our officers. Towers Watson was engaged for 2 primary purposes:

- to update a benchmarking analysis of total direct compensation for our Chief Executive Officer compared to the peer groups developed by Venture Pay Group in 2010, although this did not include a full year over year analysis of our other Named Executive Officers compensation; and
- to recommend potential changes to our long-term compensation program for our Chief Executive Officer, our Chief Financial Officer and Simpson Strong-Tie Company Inc.'s President and Chief Executive Officer, to align our programs with strategic objectives.

Towers Watson made recommendations to the Compensation and Leadership Development Committee to modify the terms of future equity-based compensation awards to keep the operating profit goals, to add strategic goals and to add a total stockholder return component. The Compensation and Leadership Development Committee incorporated these features into the potential equity-based compensation awards beginning in 2012. See *Equity-Based Compensation Awards* above. We paid Towers Watson total fees of \$45,300 for these services in 2011. In 2012, we paid an additional \$13,403 to finalize the billing on this engagement.

Compensation and Leadership Development Committee

The Compensation and Leadership Development Committee of our Board of Directors is responsible for the development and review of our compensation policy for all of our salaried employees, including equity-based compensation, and is responsible for reviewing and approving the compensation discussion and analysis for inclusion in our Annual Report on Form 10-K and our proxy statement. The Compensation and Leadership Development Committee comprises 3 independent directors, as defined by the New York Stock Exchange rules; see Proposal No. 1 Election of Directors Independence above. In addition, the members of the Compensation and Leadership Development Committee are both:

- non-employee directors directors who satisfy the requirements established by the Securities and Exchange Commission for non-employee directors under Rule 16b-3 under the Securities Exchange Act of 1934; and
- outside directors directors who satisfy the requirements established under Internal Revenue Code section 162(m).

Our Board of Directors appoints the members of the Compensation and Leadership Development Committee for indefinite terms and may remove any member at any time. The Compensation and Leadership Development Committee operates under a written charter that our Board of Directors adopted, which is also available on our website at <http://www.simpsonmfg.com/financials/compensation.html>. We will provide a printed copy of the charter to any stockholder on request.

Compensation and Leadership Development Committee Report

The Compensation and Leadership Development Committee of our Board of Directors reviewed the above Compensation Discussion and Analysis, discussed it with our officers and recommended its inclusion in our Annual Report on Form 10-K for the year ended December 31, 2012, and in this Proxy Statement.

Compensation and Leadership Development Committee

Jennifer A. Chatman, Chair
Peter N. Louras, Jr.
Barry Lawson Williams

Report of the Audit Committee of our Board of Directors

The Audit Committee of our Board of Directors is responsible for financial and accounting oversight. Its policies and practices are described below.

Composition

The Audit Committee comprises 5 independent directors, as defined by the New York Stock Exchange rules. It operates under a written charter that our Board of Directors adopted, which is available on our website at <http://www.simpsonmfg.com/financials/audit.html>. We will provide a printed copy of the charter to any stockholder on request. The members of the Audit Committee are Peter N. Louras, Jr., Chair, James S. Andrasick, Jennifer A. Chatman, Earl F. Cheit and Robin G. MacGillivray. Our Board has determined that each of them meets the definitions and standards for independence and is financially literate, and that 1 of the Audit Committee members, Peter N. Louras, Jr., has financial management expertise as required by New York Stock Exchange rules and meets the Securities and Exchange Commission definition of an audit committee financial expert.

Responsibilities

The Audit Committee is directly responsible for the appointment, compensation, retention and oversight of the accounting firm that we engage as our independent registered public accounting firm. Our officers are responsible for our internal controls and financial reporting process. Subject to the Audit Committee's oversight, our independent registered public accounting firm is responsible for performing an independent audit of our internal controls over financial reporting, for performing an independent audit of our consolidated financial statements in accordance with generally accepted auditing standards, and for reporting on those audits.

Review with Officers and the Independent Registered Public Accounting Firm

The Audit Committee met 6 times in 2012 and has held discussions with our officers and the independent registered public accounting firm. Our officers represented to the Audit Committee that our consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States. The Audit Committee has reviewed and discussed the consolidated financial statements with our officers and PricewaterhouseCoopers LLP, our independent registered public accounting firm. The Audit Committee has discussed with PricewaterhouseCoopers LLP the matters that they were required to discuss under Statement on Auditing Standards No. 114, *The Auditor's Communications With Those Charged With Governance*, which amends Statement on Auditing Standards No. 61, *Communication with Audit Committees*.

The Audit Committee has received the written disclosures and the letter from PricewaterhouseCoopers LLP, a registered public accounting firm, required by applicable requirements of the Public Company Accounting Oversight Board affirming the registered public accounting firm's

independence in compliance with Rule 3526. The Audit Committee discussed with PricewaterhouseCoopers LLP that firm's independence. On that basis, the Audit Committee believes that PricewaterhouseCoopers LLP is independent.

Summary

Based on the Audit Committee's discussions with our officers and PricewaterhouseCoopers LLP, the Audit Committee's review of the representations of our officers, and the report of PricewaterhouseCoopers LLP to the Audit Committee, the Audit Committee recommended that our Board of Directors include the audited consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2012, as filed with the Securities and Exchange Commission. The Audit Committee believes that it has satisfied its responsibilities under its charter.

Audit Committee

Peter N. Louras, Jr., Chair
James S. Andrasick
Jennifer A. Chatman
Earl F. Cheit
Robin G. MacGillivray

Audit and Related Fees

Audit Fees

For professional services for the audit of our annual consolidated financial statements included in our annual report on Form 10-K, the audit of our internal control over financial reporting, and review of the condensed consolidated financial statements included in our quarterly reports on Form 10-Q, we paid PricewaterhouseCoopers LLP an aggregate of approximately \$2,444,000 for 2012 and \$2,204,000 for 2011, approximately 76 percent and 74 percent, respectively, of the total fees that we paid to PricewaterhouseCoopers LLP for those years.

Audit-Related Fees

For professional services for audit-related services, we paid PricewaterhouseCoopers LLP an aggregate of approximately \$26,000 for 2012, approximately 1 percent of the total fees that we paid to PricewaterhouseCoopers LLP for that year. We did not pay any audit-related fees to PricewaterhouseCoopers LLP for 2011.

Tax Fees

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For professional services for tax compliance associated with our annual tax returns, and for tax advisory and planning services, we paid PricewaterhouseCoopers LLP an aggregate of approximately \$725,000 for 2012 and \$756,000 for 2011, approximately 23 percent and 25 percent, respectively, of the total fees that we paid to PricewaterhouseCoopers LLP for those years.

All Other Fees

For all other services, we paid PricewaterhouseCoopers LLP an aggregate of approximately \$6,000 for 2012 and \$34,000 for 2011, less than 1 percent and approximately 1 percent, respectively, of the total fees that we paid to PricewaterhouseCoopers LLP for each of those years. In 2012, these other services were primarily for the preparation of a report to a subsidiary's Board of Directors on the merger of the acquired businesses in Switzerland and for consultation related to the importation of products into the European Community. In 2011, these other services were primarily for a valuation report for one of our German subsidiaries, assistance in preparing an application for a customs code related to the importation of one of our products to Denmark and for a subscription to an online accounting research tool.

The Audit Committee must pre-approve fees to be paid to PricewaterhouseCoopers LLP before PricewaterhouseCoopers LLP begins work. The Audit Committee pre-approved all fees and services for PricewaterhouseCoopers LLP's work in 2012 and 2011. The Audit Committee has determined that the fees for services rendered were compatible with maintaining PricewaterhouseCoopers LLP's independence.

Governance and Nominating Committee of our Board of Directors

Our Board of Directors has a standing Governance and Nominating Committee, which is primarily responsible for nominating candidates to our Board of Directors. Its charter and our corporate governance guidelines are available on our website at <http://www.simpsonmfg.com/financials/governance.html>. We will provide a printed copy of each to any stockholder on request. The 4 members of the Governance and Nominating Committee, Robin G. MacGillivray, Chair, Jennifer A. Chatman, Earl F. Cheit and Barry Lawson Williams, are independent and meet all applicable independence requirements.

The Governance and Nominating Committee considers all candidates identified as potential directors, including those submitted by stockholders for its consideration. Any of our stockholders can recommend a director candidate to the Governance and Nominating Committee by writing a letter to:

Simpson Manufacturing Co., Inc.

Board of Directors Governance and Nominating Committee

5956 W. Las Positas Blvd.

Pleasanton, CA 94588

For the Governance and Nominating Committee to consider a candidate for the 2014 annual meeting, we must receive the letter not later than November 9, 2013. The letter should include a description of the attributes that the stockholder believes the candidate would bring to our Board of Directors and the candidate's biography and contact information.

When evaluating a director candidate, whether or not recommended by a stockholder, the Governance and Nominating Committee uses for guidance our Governance Guidelines on Director Qualification and Key Director Responsibilities and considers the candidate's education, business experience, financial expertise, industry experience, business acumen, interpersonal skills, vision, teamwork, integrity, strategic ability and customer focus. The Governance and Nominating Committee will review and discuss potential candidates who come to its attention, whether from internal or external sources. From the review and discussion, the Governance and Nominating Committee may narrow the list of potential candidates and interview the remaining candidates. The Governance and Nominating Committee will recommend for consideration by the full Board of Directors any candidate that the Governance and Nominating Committee considers to be suitable.

Our Bylaws also permit our stockholders directly to nominate directors. To do so, a stockholder must notify our Secretary at least 75 days, but not more than 90 days, before an annual meeting, unless we do not publicly disclose the date of the meeting at least 85 days before the date that the meeting is scheduled to be held, in which case our Secretary must receive the stockholder's notice within 10 days after we publicly disclose the meeting date. A stockholder's notice nominating 1 or more director candidates must state as to each such candidate

- the candidate's name, age, business address and residence address,
- the candidate's principal occupation or employment,
- the number of shares of our common stock that the candidate beneficially owns and other information, if any, required by our Bylaws, and
- any other information relating to the candidate that is required to be disclosed in solicitations of proxies for election of directors, or is otherwise required, pursuant to Regulation 14A under the Securities Exchange Act of 1934 (including without limitation the candidate's written consent to being named in the proxy statement as a nominee and to serving as a director if elected).

The stockholder's notice must also state the stockholder's name and address, as they appear on our books, and the number of shares of our common stock that the stockholder beneficially owns and other information, if any, required by our Bylaws. We will disregard a purported nomination that does not comply in all respects with our Bylaws. We did not receive such a notice from any stockholder for our 2013 annual meeting of stockholders.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires our directors and officers and persons who own more than 10 percent of our common stock to file initial reports of ownership and reports of changes in ownership of our common stock with the Securities and Exchange Commission. Securities and Exchange Commission regulations require such persons to furnish us with copies of all section 16(a) reports that they file. Based solely on our review of the copies of such reports that we received and written representations from the executive officers and directors, we believe that in 2012 our directors and officers and 10 percent stockholders met all of the section 16(a) filing requirements regarding our common stock.

Code of Ethics

We have adopted a code of business conduct and ethics that applies to our Chief Executive Officer and our Chief Financial Officer, as well as all other of our and our subsidiaries' employees. This code is posted on our website at <http://www.simpsonmfg.com/about/ethics.html>. We will provide a printed copy of the code, free of charge, to any stockholder on request.

OTHER BUSINESS

Our Board of Directors does not presently intend to bring any other business before the meeting. Insofar as our Board of Directors is aware, no matters will be brought before the meeting except as specified in the notice of the meeting. The persons that you will appoint as your proxies in the enclosed form intend to vote according to their judgment on any other business that properly comes before the meeting.

**DISCLAIMER REGARDING INCORPORATION BY REFERENCE OF THE REPORTS OF
THE AUDIT AND COMPENSATION AND LEADERSHIP DEVELOPMENT COMMITTEES**

THE INFORMATION SHOWN IN THE SECTIONS ENTITLED REPORT OF THE AUDIT COMMITTEE OF OUR BOARD OF DIRECTORS AND COMPENSATION AND LEADERSHIP DEVELOPMENT COMMITTEE REPORT SHALL NOT BE DEEMED TO BE INCORPORATED BY REFERENCE BY ANY GENERAL STATEMENT INCORPORATING BY REFERENCE THIS PROXY STATEMENT INTO ANY FILING BY SIMPSON MANUFACTURING CO., INC. WITH THE SECURITIES AND EXCHANGE COMMISSION UNDER THE SECURITIES ACT OF 1933, AS AMENDED, OR THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED, EXCEPT TO THE EXTENT THAT SIMPSON MANUFACTURING CO., INC. INCORPORATES THIS INFORMATION BY SPECIFIC REFERENCE, AND SUCH INFORMATION SHALL NOT OTHERWISE BE DEEMED FILED UNDER SUCH ACTS.

STOCKHOLDER PROPOSALS

We must receive stockholder proposals for inclusion in our proxy statement and form of proxy relating to our 2014 Annual Meeting of Stockholders a reasonable time before we begin our solicitation, and in any event not later than November 9, 2013.

BY ORDER OF THE BOARD

Brian J. Magstadt
Secretary

TO ASSURE THAT YOUR SHARES ARE REPRESENTED AT THE MEETING, WE URGE YOU TO COMPLETE, DATE AND SIGN THE ENCLOSED PROXY AND MAIL IT PROMPTLY IN THE POSTAGE-PAID ENVELOPE PROVIDED, OR VOTE BY TELEPHONE OR THE INTERNET AS INSTRUCTED ON THE PROXY OR THE NOTICE REGARDING THE AVAILABILITY OF PROXY MATERIALS, WHETHER OR NOT YOU PLAN TO ATTEND THE MEETING. YOU CAN REVOKE YOUR PROXY AT ANY TIME BEFORE IT IS VOTED.

EXHIBIT A

**SIMPSON MANUFACTURING CO., INC.
EXECUTIVE OFFICER CASH PROFIT SHARING PLAN**

Adopted January 14, 2003

and Amended through February 25, 2008

Purpose

The purpose of this Plan is to recognize outstanding effort and achievement by executive officers of Simpson Manufacturing Co., Inc. and its subsidiaries (together, the Company). The Plan is intended to provide qualified performance-based compensation in accordance with section 162(m) of the Internal Revenue Code of 1986, as amended, and the regulations and interpretations thereunder (the Code).

Committee

The Plan shall be administered by a Compensation Committee (the Committee) of the Board of Directors of the Company. The Committee shall consist of at least two outside directors of the Company who satisfy the requirements of Code section 162(m). The Committee shall have the sole discretion and authority to administer and interpret the Plan in accordance with Code section 162(m).

Covered Employees

Any employee of the Company treated as a covered employee pursuant to section 162(m) of the Code, as amended and as interpreted in Treasury Regulations and notices or other rulings issued by the Internal Revenue Service, and any other employee of the Company designated by the Committee.

Amount of Award

The Committee will determine the amount of the award that each covered employee will be eligible to receive under the Plan each fiscal quarter. Awards will be based on a percentage of the amount by which net profits of the Company or a branch or subsidiary of the Company for a fiscal quarter exceed a qualifying level of net profits for the Company or such branch or subsidiary, respectively, for that fiscal quarter. The results for each fiscal quarter will be determined independently of the results for any other fiscal quarter; profits or losses in one fiscal quarter will not be used to calculate net profits in any subsequent fiscal quarter.

The Committee shall set the standards for determining net profits, the qualifying levels and the percentages of excess profits that covered employees are eligible to receive with respect to a fiscal quarter, no later than the latest time permitted by the Code for that fiscal quarter. Qualifying levels will be based on the value of net operating assets of the Company, the branch or the subsidiary, multiplied by a rate of return on those assets. Individual percentages will be based on job function.

No award in excess of \$2,500,000 will be paid to any covered employee under this Plan with respect to any fiscal year. The Committee, in its sole discretion, may reduce or eliminate the award to any covered employee in any year. The reduction in the amount of an award to any covered employee shall not, however, affect the amount of the award to any other covered employee.

A-1

Payment of Awards

Awards will be paid quarterly, within five weeks of the last day of the fiscal quarter. No bonus shall be paid unless and until the Committee certifies in writing that the performance goals of the Plan are satisfied.

No covered employee is eligible to receive an award under the Plan until he or she works an entire fiscal quarter for the Company. Anyone who is terminated by the Company without cause, as determined by the Committee in its sole discretion, dies, is on disability or voluntarily quits the Company before the last day of a fiscal quarter, will be paid on a pro-rata basis for the days actually worked in that fiscal quarter.

Scope of the Plan

Nothing in this Plan shall be construed as precluding or prohibiting the Company from establishing or maintaining other bonus or compensation arrangements, which may be applicable to all employees and officers or applicable only to selected employees or officers; provided, however, that an individual who receives an award under this Plan with respect to a fiscal quarter shall not be permitted to participate in any other bonus arrangement or plan of the Company for that fiscal quarter that provides bonuses similarly calculated as a percentage of profits in excess of a qualifying level.

Amendment and Termination

The Company reserves the right to amend or terminate this Plan at any time with respect to future services of covered employees. Plan amendments will require stockholder approval only to the extent required by applicable law.

General

The establishment of the Plan shall not confer any legal right on any covered employee or other person to continued employment, nor shall it interfere with the right of the Company to discharge any covered employee and treat him or her without regard to the effect that such treatment might have on him or her as a participant in the Plan. The laws of the State of California will govern any legal dispute involving the Plan.

No Funding

The Company shall not be required to fund or otherwise segregate any cash or any other assets that may at any time be paid to participants under the Plan. The Plan shall constitute an unfunded plan of the Company. Neither the Company nor the Committee shall, by any provision of the Plan, be deemed to be a trustee of any property, and any obligations of the Company to any participant under the Plan shall be those of a debtor and any rights of any participant or former participant shall be limited to those of a general unsecured creditor.

Non-Transferability of Benefits and Interests

Except as expressly provided by the Committee, no benefit payable under the Plan shall be subject in any manner to anticipation, alienation, sale, transfer, assignment, pledge, encumbrance or charge, and any such attempted action shall be void. No benefit payable under the Plan shall be in any manner liable for or subject to debts, contracts, liabilities, engagements or torts of any participant or former participant. This section shall not apply to an assignment of a contingency or payment due after the death of the covered employee to the deceased covered employee's legal representative or beneficiary.

A-2

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United Technologies Corp. acquisition of Red Hawk Industries	1.0x
	NA
NICE Systems Ltd. acquisition of FAST Video Security AG	2.1x
	NA
Confidential Representative Private Company Acquisition	5.0x
	28.5x
Axsys Technologies, Inc. acquisition of Diversified Optical Products, Inc.	2.5x
	13.9x
United Technologies Corp. acquisition of Lenel Systems International Inc.	13.3x
	20.0x
United Technologies Corp. acquisition of Kidde plc	2.0x
	15.9x
Honeywell International, Inc. acquisition of Novar Plc	1.0x
	8.7x
General Electric Co. acquisition of Edwards System Technology, Inc.	3.1x
	14.7x
Siemens AG acquisition of Photo-Scan plc	
	107

	1.7x
	9.5x
Schneider Electric S.A. acquisition of Andover Controls Corp.	
	2.4x
	14.4x
Securitas AB acquisition of Bell Group plc	
	1.5x
	16.6x
The Stanley Works acquisition of Frisco Bay Industries, Ltd.	
	1.3x
	11.3x
The Stanley Works acquisition of Blick Plc	
	1.6x
	11.3x
Honeywell International, Inc. acquisition of Silent Witness Enterprises Ltd.	
	1.5x
	11.2x
Mean	
	2.9x
	14.7x
Median	
	1.9x
	14.1x

The preceding comparable transaction analysis resulted in an implied valuation of ISI of between approximately \$68.7 million and \$76.2 million.

Based on this analysis, Giuliani Capital Advisors determined that the merger consideration was within or below the range of enterprise values implied by the multiples of the selected comparable transactions.

Discounted Cash Flow Analysis

Discounted cash flow analysis is a method of valuing an asset as the present value of the sum of (i) its unlevered free cash flows over a forecast period and (ii) its theoretical terminal value at the end of the forecast period. Giuliani Capital Advisors calculated the future cash flows of ISI according to the financial projections for the fiscal years 2007 through 2009 as provided by ISI or assumed in accordance with Argyle management's views. The terminal values of ISI were calculated based on projected adjusted EBITDA for 2009, using exit multiples ranging from 7.5x to 11.5x. The range of EBITDA exit multiples Giuliani Capital Advisors applied to its discounted cash flow analysis of ISI was set at a minimum multiple of 7.5x to encompass the lowest comparable companies' Enterprise Value/adjusted EBITDA multiple, as shown in the comparable company analysis table. The range was then increased by intervals of 1.0 in order to include the broader range of comparable companies' Enterprise Value/adjusted EBITDA multiples. Giuliani Capital Advisors applied discount rates ranging from 12.5% to 22.5%. Giuliani Capital Advisors used such discount rates based on its judgment of the estimated weighted average cost of capital of comparable publicly traded companies, as well as adjustments relating to factors deemed specific to ISI, a privately held company. Based on this analysis, the implied enterprise value of ISI indicated a range of valuations for ISI between \$66.2 million and \$123.4 million. The implied results were trimmed to discard the highest and lowest ranges in order to avoid the potential anomalous effects of outliers and arrive at a more precise implied valuation range. The discounted cash flow analysis resulted in a minimum implied enterprise value of \$75.4 million.

Based on this analysis, Giuliani Capital Advisors determined that the merger consideration was within or below the range of enterprise values implied by the multiples of the selected comparable companies, the multiples of the selected comparable transactions and the ISI discounted cash flow analysis. Giuliani Capital Advisors' valuation was based upon the operating metrics of revenues and adjusted EBITDA. The recordation of \$20.0 million of goodwill would affect the balance sheet, but not operating performance. Accordingly, the recordation of goodwill would be expected to have no effect on a valuation of ISI based upon comparable companies, comparable transactions or discounted cash flow analyses.

Analysis of the Historical Trading Activity of Argyle's Common Stock

Giuliani Capital Advisors analyzed the historical prices and trading activity of Argyle's common stock on the OTC Bulletin Board. Since the date when Argyle's common stock commenced trading on the OTC Bulletin Board, such date being March 2, 2006, until December 6, 2006, the price of Argyle's common stock ranged from \$7.15 to \$7.55, with an average daily volume of approximately 12,159 shares. For the 90 trading days ended December 6, 2006, the price of Argyle's common stock ranged from \$7.15 to \$7.39, with an average daily trading volume of approximately 9,173 shares. For the ten trading days ended December 6, 2006, the price of Argyle's common stock ranged from \$7.27 to \$7.38, with an average daily trading volume of approximately 35,848 shares.

The closing price of \$7.38 of Argyle's common stock on December 6, 2006 was, in Giuliani Capital Advisors' analysis, determined to be a representative price for Argyle's common stock, as it relates to Argyle's status as a special purpose acquisition company prior to the announcement of its merger with ISI. Giuliani Capital Advisors used this price for indicative purposes only, since share price may fluctuate, to calculate the value of the merger consideration, which will be partially paid in Argyle's shares of common stock.

General Matters Regarding Fairness Opinion

The preparation of a fairness opinion involves various determinations as to the most appropriate and relevant methods of financial analysis and the application of those methods to particular circumstances and, therefore, such an opinion is not susceptible to summary description. Furthermore, Giuliani Capital Advisors did not attribute any particular weight to any analysis or factor considered by it, but rather made qualitative judgments as to the significance and relevance of each analysis and factor. Accordingly, Giuliani Capital Advisors' analyses must be considered as a whole. Considering any portion of such analyses and of the factors considered without considering all analyses and factors, could create a misleading or incomplete view of the process underlying the conclusions expressed in the opinion.

In its analysis, Giuliani Capital Advisors made a number of assumptions with respect to industry performance, general business and economic conditions and other matters, many of which are beyond the control of ISI, Argyle and Giuliani Capital Advisors. Any estimates contained in these analyses are not necessarily indicative of actual values or predictive of future results or values, which may be significantly more or less favorable than those set forth in the analysis. In addition, analyses relating to the value of ISI do not purport to be appraisals or to reflect the prices at which securities of Argyle may be sold after the merger is approved.

Giuliani Capital Advisors' opinion does not constitute a recommendation to the Board of Directors or to any holder of Argyle's securities as to how such a person should vote or act with respect to any of the proposals set forth in this proxy statement/prospectus. The opinion does not address the merits of the decision of the Board of Directors to enter into the merger transaction as compared to any alternative business transactions that might be available to Argyle nor does it address the underlying business decision to engage in the merger transaction.

Giuliani Capital Advisors is a nationally recognized investment banking firm that is continually engaged in providing fairness opinions and advising in connection with mergers and acquisitions, leveraged buyouts, recapitalizations and private placement transactions. The Board of Directors retained Giuliani Capital Advisors based on such qualifications, as well as recommendations from other companies that had engaged members of Giuliani Capital Advisors' engagement team for similar purposes and Giuliani Capital Advisors' ability to perform research and render a fairness opinion within the required timeframe.

Conclusion of Argyle's Board of Directors. After careful consideration of all relevant factors, Argyle's Board of Directors determined that the acquisition is fair to and in the best interests of Argyle and its stockholders. The Board of Directors has approved and declared the proposal advisable and recommends that you vote or give instructions to vote "FOR" the approval of the acquisition.

The foregoing discussion of the information and factors considered by the Argyle Board is not meant to be exhaustive, but includes the material information and factors considered by it.

44

Certain U.S. Federal Income Tax Consequences of the Merger

The following discussion is a general summary of the material U.S. federal income tax consequences of the merger to Argyle and to current holders of its common stock, as well as to the holders of the stock of ISI, who are “United States persons,” as defined in the Internal Revenue Code of 1986, as amended (referred to in this proxy statement/prospectus as the Code) and who hold such stock as a “capital asset,” as defined in the Code. The discussion does not purport to be a complete analysis of all of the potential tax effects of the merger. The discussion does not address the tax considerations applicable to particular stockholders based on their individual circumstances, or to particular categories of stockholders subject to special treatment under certain U.S. federal income tax laws (such as dealers in securities, banks, insurance companies, tax-exempt entities, mutual funds, and foreign persons). In addition, the discussion does not consider the tax treatment of partnerships or other pass-through entities or persons who hold stock through such entities. The discussion also does not describe tax consequences arising under the laws of any other federal tax or any state, local or foreign tax.

The discussion is based upon the Code, U.S. Treasury Department regulations, rulings of the Internal Revenue Service (“IRS”), and judicial decisions now in effect, all of which are subject to change or to varying interpretation at any time. Any such changes or varying interpretations may also be applied retroactively.

Argyle has not obtained a ruling from the IRS nor an opinion of counsel as to the U.S. federal income tax consequences of the merger. There can be no assurance that the IRS will not take a different position, or that position will not be sustained.

Because of the complexity of the tax laws and because the tax consequences to Argyle or any particular stockholder of Argyle or ISI may be affected by matters not discussed herein, stockholders are urged to consult their own tax advisors as to the specific tax consequences of the merger, including tax reporting requirements, the applicability and effect of federal, state, local, foreign and other applicable tax laws and the effect of any proposed changes in the tax laws.

Tax Consequences to Argyle and its Current Stockholders

Neither Argyle nor the current holders of its common stock will recognize gain or loss as a result of the merger for U.S. federal income tax purposes.

Tax Consequences to Stockholders of ISI

Gain or Loss on Merger. Amounts received by stockholders of ISI pursuant to the merger generally will be treated as full payment in exchange for their shares of stock in ISI. As a result, a stockholder of ISI generally will recognize gain or loss for U.S. federal income tax purposes equal to the difference between (1) the amount of cash and the fair market value of stock received by such stockholder pursuant to the merger and (2) such stockholder’s tax basis in its stock in ISI.

A stockholder’s gain or loss generally will be computed on a “per share” basis, so that gain or loss is calculated separately for blocks of stock acquired at different dates or for different prices. The amounts received by a stockholder of ISI pursuant to the merger will be allocated proportionately to each share of stock owned by such stockholder. The gain or loss recognized by such stockholder in connection with the merger generally will be a capital gain or loss, and will be a long-term capital gain or loss if the share has been held for more than one year, and a short-term capital gain or loss if the share has not been held for more than one year. Long-term capital gain of non-corporate taxpayers may be subject to more favorable tax rates than ordinary income or short-term capital gain. The deductibility of capital losses is subject to various limitations.

Back-Up Withholding. Unless a stockholder of ISI complies with certain reporting and/or Form W-9 certification procedures or is an exempt recipient under applicable provisions of the Code and Treasury Regulations, such stockholder may be subject to back-up withholding tax with respect to payments received pursuant to the merger. The back-up withholding tax is currently imposed at a rate of 28%. Back-up withholding generally will not apply to payments made to some exempt recipients (such as a corporation) or to a stockholder who furnishes a correct taxpayer identification number and certain other required information. If back-up withholding applies, the amount withheld is not an additional tax, but generally is allowed as a credit against the stockholder's U.S. federal income tax liability provided the requisite procedures are followed.

Anticipated Accounting Treatment

Argyle will account for the acquisition of ISI as a purchase. The purchase price will be allocated to the various tangible and intangible assets and assumed liabilities based upon an appraisal.

Regulatory Matters

The acquisition is not subject to the Hart-Scott-Rodino Act or any federal or state regulatory requirement or approval, except for filings necessary to effectuate related transactions with the state of Delaware.

**PROPOSAL TO APPROVE THE
2007 OMNIBUS SECURITIES AND INCENTIVE PLAN**

Background

Argyle's 2007 Omnibus Securities and Incentive Plan (referred to below as the 2007 Incentive Plan) has been approved by Argyle's Board of Directors and will take effect upon consummation of the merger, provided that the merger and the 2007 Incentive Plan are approved by the stockholders at the special meeting.

Under the terms of the 2007 Incentive Plan, 1,000,000 shares of Argyle common stock are reserved for issuance in accordance with its terms. Argyle currently anticipates that, shortly after the merger, it will grant awards to acquire up to approximately _____ shares pursuant to the 2007 Incentive Plan to members of the ISI management team, current officers, directors and consultants of Argyle and to new employees of Argyle to be hired after the merger. However, at this time, Argyle's Board of Directors has not approved the issuance of any such awards and is not under any contractual obligation to do so - the merger agreement only requires the availability of a plan, not what awards will be made pursuant to the plan. Assuming that the anticipated grants are made, there would be at least approximately _____ shares remaining for issuance in accordance with the 2007 Incentive Plan's terms. The purpose of the 2007 Incentive Plan is to assist Argyle in attracting, retaining and providing incentives to its employees, officers, directors and consultants, or the employees, officers, directors and consultants of its affiliates, whose past, present and/or potential future contributions to Argyle have been, are or will be important to the success of Argyle and to align the interests of such persons with Argyle's stockholders. It is also designed to motivate employees and to significantly contribute toward growth and profitability, to provide incentives to Argyle's officers, directors, employees and consultants who, by their position, ability and diligence are able to make important contributions to Argyle's growth and profitability. The various types of incentive awards that may be issued under the 2007 Incentive Plan will enable Argyle to respond to changes in compensation practices, tax laws, accounting regulations and the size and diversity of its business.

All officers, directors, employees and consultants of ISI and Argyle will be eligible to be granted awards under the 2007 Incentive Plan. All awards will be subject to the approval of Argyle's Board of Directors or its Compensation Committee.

Description of the 2007 Incentive Plan

A summary of the principal features of the 2007 Incentive Plan is provided below, but is qualified in its entirety by reference to the full text of the 2007 Incentive Plan, a copy of which is attached to this proxy statement/prospectus as Annex B.

Awards

The 2007 Incentive Plan provides for the grant of distribution equivalent rights, incentive stock options, non-qualified stock options, performance share awards, performance unit awards, restricted stock awards, stock appreciation rights, tandem stock appreciation rights and unrestricted stock awards for an aggregate of not more than 1,000,000 shares of Argyle's common stock, to directors, officers, employees and consultants of Argyle or its affiliates. If any award expires, is cancelled, or terminates unexercised or is forfeited, the number of shares subject thereto, if any, is again available for grant under the 2007 Incentive Plan. The number of shares of common stock, with respect to which stock options or stock appreciation rights may be granted to a participant under the 2007 Incentive Plan in any calendar year cannot exceed 150,000.

Assuming the merger is completed, there would be approximately ___ employees, directors and consultants who would be eligible to receive awards under the 2007 Incentive Plan. New officers, directors, employees and consultants would be eligible to participate in the 2007 Incentive Plan as well.

Argyle does not currently have any outstanding options or any intention, agreement or obligation to issue any options outside the 2007 Incentive Plan.

47

Administration of the 2007 Incentive Plan

The 2007 Incentive Plan will be administered by either Argyle's Board of Directors or its Compensation Committee (referred to as the committee), if the Board of Directors delegates the ability to administrate the plan. Among other things, the Board of Directors or, if the Board of Directors delegates its authority to the committee, the committee, has complete discretion, subject to the express limits of the 2007 Incentive Plan, to determine the employees, directors and consultants to be granted awards, the types of awards to be granted, the number of shares of Argyle common stock subject to each award, if any, the exercise price under each option, the base price of each stock appreciation right, the term of each award, the vesting schedule and/or performance goals for each award that utilizes such a schedule or provide for performance goals, whether to accelerate vesting, the value of the common stock, and any required withholdings. The Board of Directors or the Compensation Committee may amend, modify or terminate any outstanding award, provided that the participant's consent to such action is required if the action would materially and adversely affect the participant. The Board of Directors or the committee is also authorized to construe the award agreements and may prescribe rules relating to the 2007 Incentive Plan.

Options

The 2007 Incentive Plan provides for the grant of stock options, which may be either "incentive stock options" (ISOs), which are intended to meet the requirements for special U.S. federal income tax treatment under the Code, or "nonqualified stock options" (NQSOs). Options may be granted on such terms and conditions as the Board of Directors or the committee may determine; provided, however, that the exercise price of an option may not be less than the fair market value of the underlying stock on the date of grant, and the term of an ISO may not exceed ten years (110% of such value and five years in the case of an ISO granted to an employee who owns (or is deemed to own) more than 10% of the total combined voting power of all classes of capital stock of Argyle or a parent or subsidiary of Argyle). ISOs may only be granted to employees. In addition, the aggregate fair market value of common stock underlying one or more ISOs (determined at the time of grant) which are exercisable for the first time by any one employee during any calendar year may not exceed \$100,000.

Restricted Stock

A restricted stock award under the 2007 Incentive Plan is a grant or sale of Argyle common stock to the participant, subject to such transfer, forfeiture and/or other restrictions specified by the Board of Directors or the Compensation Committee in the award. Dividends, if any are declared by Argyle, will be paid on the shares, even during the period of restriction. The purchase price for each share of restricted stock may not be less than the par value of a share of Argyle's common stock.

Unrestricted Stock Awards

An unrestricted stock award under the 2007 Incentive Plan is a grant or sale of Argyle common stock to the participant that is not subject to transfer, forfeiture or other restrictions, in consideration for past services rendered thereby to Argyle or an affiliate or for other valid consideration.

Performance Unit Awards

Performance unit awards under the 2007 Incentive Plan entitle the participant to receive a specified payment in cash and/or Argyle common stock upon the attainment of specified individual or company performance goals.

Performance Share Awards

Performance share awards under the 2007 Incentive Plan entitle the participant to receive a specified number of shares of Argyle's common stock and/or cash upon the attainment of specified individual or company performance goals.

48

Distribution Equivalent Right Awards

A distribution equivalent right award under the 2007 Incentive Plan entitles the participant to receive bookkeeping credits, cash payments and/or Argyle common stock distributions equal in amount to the distributions that would have been made to the participant had the participant held a specified number of shares of Argyle common stock during the period the participant held the distribution equivalent right. A distribution equivalent right may be awarded under the 2007 Incentive Plan as a component of another award, where, if so awarded, such distribution equivalent right will expire or be forfeited by the participant under the same conditions as under such other award.

Stock Appreciation Rights (SARs)

The award of an SAR under the 2007 Incentive Plan entitles the participant, upon exercise, to receive an amount in cash, Argyle common stock or a combination thereof, equal to the increase in the fair market value of the underlying Argyle common shares between the date of grant and the date of exercise. SARs may be granted in tandem with, or independently of, options granted under the 2007 Incentive Plan. An SAR granted in tandem with an option under the 2007 Incentive Plan is granted at the same time as the related option and is exercisable only at such times, and to the extent, that the related option is exercisable and expires upon termination or exercise of the related option. In addition, the related option may be exercised only when the value of the stock subject to the option exceeds the exercise price under the option. An SAR that is not granted in tandem with an option is exercisable at such times as the committee may specify.

Additional Terms

Except as provided in the 2007 Incentive Plan, awards granted under the 2007 Incentive Plan are not transferable and may be exercised only by the participant or by the participant's guardian or legal representative. Each award agreement will specify, among other things, the effect on an award of the disability, death, retirement, authorized leave of absence or other termination of employment of the participant. Argyle may require a participant to pay Argyle the amount of any required withholding in connection with the grant, vesting, exercise or disposition of an award. A participant is not considered a stockholder with respect to the shares underlying an award until the shares are issued to the participant.

Amendments

Argyle's Board of Directors may at any time amend, alter, suspend or terminate the 2007 Incentive Plan; provided, that no amendment requiring stockholder approval will be effective unless such approval has been obtained, and provided further that no amendment of the 2007 Incentive Plan or its termination may be effected if it would materially and adversely affect the rights of a participant without the participant's consent.

Certain U.S. Federal Income Tax Consequences of the 2007 Incentive Plan

The following is a general summary of the U.S. federal income tax consequences under current tax law to Argyle and to individual participants in the 2007 Incentive Plan who are individual citizens or residents of the United States of ISOs, NQSOs, restricted stock awards, unrestricted stock awards, performance unit awards, performance share awards, distribution equivalent right awards and SARs granted pursuant to the 2007 Incentive Plan. It does not purport to cover all of the special rules that may apply, including special rules relating to limitations on the ability of Argyle to deduct certain compensation, special rules relating to deferred compensation, golden parachutes, participants subject to Section 16(b) of the Exchange Act and the exercise of an option with previously-acquired shares. In addition, this summary does not address the state or local income or other tax consequences inherent in the acquisition, ownership, vesting, exercise, termination or disposition of an award under the 2007 Incentive Plan or shares of Argyle common stock issued pursuant thereto.

A participant generally does not recognize taxable income upon the grant of an NQSO or an ISO. Upon the exercise of an NQSO, the participant generally recognizes ordinary income in an amount equal to the excess, if any, of the fair market value of the shares acquired on the date of exercise over the exercise price thereunder, and Argyle will generally be entitled to a deduction for such amount at that time. If the participant later sells shares acquired pursuant to the exercise of an NQSO, the participant generally recognizes a long-term or a short-term capital gain or loss, depending on the period for which the shares were held. A long-term capital gain is generally subject to more favorable tax treatment than ordinary income or a short-term capital gain. The deductibility of capital losses is subject to certain limitations.

Upon the exercise of an ISO, the participant generally does not recognize taxable income. If the participant disposes of the shares acquired pursuant to the exercise of an ISO more than two years after the date of grant and more than one year after the transfer of the shares to the participant, the participant generally recognizes a long-term capital gain or loss, and Argyle is not entitled to a deduction. However, if the participant disposes of such shares prior to the end of the required holding period, all or a portion of the gain is treated as ordinary income, and Argyle is generally entitled to deduct such amount.

In addition to the tax consequences described above, a participant may be subject to the alternative minimum tax, which is payable to the extent it exceeds the participant's regular tax. For this purpose, upon the exercise of an ISO, the excess of the fair market value of the shares over the exercise price thereunder is a preference item for purposes of the alternative minimum tax. In addition, the participant's basis in such shares is increased by such excess for purposes of computing the gain or loss on the disposition of the shares for alternative minimum tax purposes. If a participant is required to pay an alternative minimum tax, the amount of such tax which is attributable to deferral preferences (including any ISO adjustment) generally may be allowed as a credit against the participant's regular tax liability (and, in certain cases, may be refunded to the participant) in subsequent years. To the extent the credit is not used, it is carried forward.

A participant who receives an unrestricted stock award recognizes ordinary compensation income upon receipt of the award equal to the excess, if any, of the fair market value of the shares over any amount paid by the participant for the shares, and Argyle is generally entitled to deduct such payment at such time.

A participant who receives a restricted stock award that is subject to a substantial risk of forfeiture and certain transfer restrictions generally recognizes ordinary compensation income at the time the restriction lapses in an amount equal to the excess, if any, of the fair market value of the stock at such time over any amount paid by the participant for the shares. Alternatively, the participant may elect to be taxed upon receipt of the restricted stock based on the value of the shares at the time of grant. Argyle is generally entitled to a deduction at the same time as ordinary compensation income is required to be included by the participant and in the same amount. Dividends received with respect to such restricted stock are generally treated as compensation, unless the participant elects to be taxed on the receipt (rather than the vestings) of the restricted stock. Other restricted stock awards are taxed in the same manner as an unrestricted stock award.

A participant generally does not recognize income upon the grant of an SAR. The participant has ordinary compensation income upon exercise of the SAR equal to the increase in the value of the underlying shares, and Argyle will generally be entitled to a deduction for such amount.

A participant generally does not recognize income for a performance unit award, a performance share award or a distribution equivalent right award until payments are received. At such time, the participant recognizes ordinary compensation income equal the amount of any cash payments and the fair market value of any Argyle common stock received, and Argyle is generally entitled to deduct such amount at such time.

Conclusion of Argyle's Board of Directors. After careful consideration of all relevant factors, Argyle's Board of Directors has determined that the proposal to adopt the 2007 Omnibus Securities and Incentive Plan is in the best interests of Argyle and its stockholders. Argyle's Board of Directors has approved and declared advisable the proposal and recommends that you vote or give instructions to vote "FOR" the proposal.

PROPOSAL TO CHANGE NAME TO ARGYLE SECURITY, INC.

Pursuant to the merger agreement, Argyle proposes to amend its Second Amended and Restated Certificate of Incorporation to change its corporate name from Argyle Security Acquisition Corporation to Argyle Security, Inc. upon consummation of the merger. If the merger proposal is not approved, the name change amendment will not be presented at the meeting. In addition, if the merger is not subsequently consummated, Argyle's Board of Directors will not effect the name change.

In the judgment of Argyle's Board of Directors, if the acquisition is consummated, the change of Argyle's corporate name is desirable to reflect the fact that Argyle would then be an operating business. A copy of the amended and restated certificate of incorporation as it would be filed if the proposal to change Argyle's name and to amend Argyle's certificate of incorporation (pursuant to the immediately subsequent proposal) is attached to this proxy statement/prospectus as Annex C.

Stockholders will not be required to exchange outstanding stock certificates for new stock certificates if the amendment is adopted.

Conclusion of Argyle's Board of Directors. After careful consideration of all relevant factors, Argyle's Board of Directors determined that the proposal to amend Argyle's Second Amended and Restated Certificate of Incorporation to change Argyle's name to Argyle Security, Inc. is in the best interests of Argyle and its stockholders. The Board of Directors has approved and declared the proposal advisable and recommends that you vote or give instructions to vote "FOR" the approval of the name change.

PROPOSAL TO AMEND ARGYLE'S CERTIFICATE OF INCORPORATION TO REMOVE CERTAIN PROVISIONS THAT WOULD NO LONGER BE APPLICABLE TO ARGYLE

Argyle proposes to amend its Second Amended and Restated Certificate of Incorporation to remove those provisions of Argyle's Second Amended and Restated Certificate of Incorporation that will no longer be operative upon consummation of the merger (which constitutes a business combination for purposes of Argyle's Second Amended and Restated Certificate of Incorporation), but which were applicable at the time of Argyle's formation as a blank-check company. In order to accomplish this, the text of Article Sixth except for the text of paragraph (E) will be deleted in its entirety. If the merger proposal is not approved, this proposal will not be presented at the meeting. In addition, if the merger is not subsequently consummated, Argyle's Board of Directors will not effect this amendment to Argyle's Second Amended and Restated Certificate of Incorporation.

Article Sixth of Argyle's certificate of incorporation currently reads as follows:

"The following provisions (A) through (E) shall apply during the period commencing upon the filing of this Certificate of Incorporation and terminating upon the consummation of any "Business Combination," and may not be amended during the "Target Business Acquisition Period." A "Business Combination" shall mean the acquisition by the Corporation, whether by merger, capital stock exchange, asset or stock acquisition or other similar type of transaction, of an operating business ("Target Business"). The "Target Business Acquisition Period" shall mean the period from the effectiveness of the registration statement filed in connection with the Corporation's initial public offering of securities ("IPO") up to and including the first to occur of (a) a Business Combination or (b) the Termination Date (defined below).

(A) Prior to the consummation of any Business Combination, the Corporation shall submit such Business Combination to its stockholders for approval regardless of whether the Business Combination is of a type which normally would require such stockholder approval under the GCL. In the event that a majority of the shares cast at the meeting to approve the Business Combination are voted for the approval of such Business Combination, the

Corporation shall be authorized to consummate the Business Combination; provided that the Corporation shall not consummate any Business Combination if the holders of 20% or more of the Transaction Shares (as defined below) exercise their redemption rights described in paragraph B below.

(B) In the event that a Business Combination is approved in accordance with the above paragraph (A) and is consummated by the Corporation, any stockholder of the Corporation holding shares of Common Stock issued in the IPO (the "IPO Shares") who voted against the Business Combination may, contemporaneous with such vote, demand that the Corporation redeem his IPO Shares into cash. If so demanded, the Corporation shall, promptly after consummation of the Business Combination, redeem such shares into cash at a per share redemption price equal to the quotient determined by dividing (i) the amount in the Trust Fund applicable to the net proceeds from the sale of the Transaction Shares (as defined below), inclusive of any interest thereon (exclusive of taxes payable and interest released to the Corporation used to fund the Corporation's working capital), calculated as of two business days prior to the consummation of the Business Combination, by (ii) the total number of IPO Shares. "Transaction Shares" shall mean the IPO Shares, together with any shares of Common Stock issued by the Corporation in a private placement either concurrently with or within four business days prior to the IPO (the "Placement Shares"). "Trust Fund" shall mean the trust account established by the Corporation at the consummation of its IPO and into which, among other funds, a certain amount of the net proceeds of the IPO is deposited.

(C) In the event that the Corporation does not consummate a Business Combination by the later of (i) 18 months after the consummation of the IPO or (ii) 24 months after the consummation of the IPO in the event that either a letter of intent, an agreement in principle or a definitive agreement to complete a Business Combination was executed but was not consummated within such 18 month period (such later date being referred to as the "Termination Date"), the officers of the Corporation shall take all such action necessary to dissolve and liquidate the Corporation as soon as reasonably practicable. In the event that the Corporation is so dissolved and liquidated, only the holders of IPO Shares shall be entitled to receive liquidating distributions and the Corporation shall pay no liquidating distributions with respect to any other shares of capital stock of the Corporation.

(D) A holder of IPO Shares shall be entitled to receive distributions from the Trust Fund only in the event of a liquidation of the Corporation and/or the Trust Fund or in the event he demands redemption of his shares in accordance with paragraph (B), above. In no other circumstances shall a holder of IPO Shares have any right or interest of any kind in or to the Trust Fund. A holder of Placement Shares shall not have any right or interest of any kind in or to the Trust Fund.

(E) The Board of Directors shall be divided into three classes: Class A, Class B and Class C. The number of directors in each class shall be as nearly equal as possible. At the first election of directors by the incorporator, the incorporator shall elect a Class C director for a term expiring at the Corporation's third Annual Meeting of Stockholders. The Class C director shall then elect additional Class A, Class B and Class C directors. The directors in Class A shall be elected for a term expiring at the first Annual Meeting of Stockholders, the directors in Class B shall be elected for a term expiring at the second Annual Meeting of Stockholders and the directors in Class C shall be elected for a term expiring at the third Annual Meeting of Stockholders. Commencing at the first Annual Meeting of Stockholders, and at each annual meeting thereafter, directors elected to succeed those directors whose terms expire shall be elected for a term of office to expire at the third succeeding annual meeting of stockholders after their election. Except as the GCL may otherwise require, in the interim between annual meetings of stockholders or special meetings of stockholders called for the election of directors and/or the removal of one or more directors and the filling of any vacancy in that connection, newly created directorships and any vacancies in the Board of Directors, including unfilled vacancies resulting from the removal of directors for cause, may be filled by the vote of a majority of the remaining directors then in office, although less than a quorum (as defined in the Corporation's Bylaws), or by the sole remaining director. All directors shall hold office until the expiration of their respective terms of office and until their successors shall have been elected and qualified. A director elected to fill a vacancy resulting from the death, resignation or removal of a director shall serve for the remainder of the full term of the director whose death, resignation or removal shall have created such vacancy and until his successor shall have been elected and qualified."

If this proposal is approved by stockholders, Article Sixth will read in its entirety as follows:

“The Board of Directors shall be divided into three classes: Class A, Class B and Class C. The number of directors in each class shall be as nearly equal as possible. At the first election of directors by the incorporator, the incorporator shall elect a Class C director for a term expiring at the Corporation’s third Annual Meeting of Stockholders. The Class C director shall then elect additional Class A, Class B and Class C directors. The directors in Class A shall be elected for a term expiring at the first Annual Meeting of Stockholders, the directors in Class B shall be elected for a term expiring at the second Annual Meeting of Stockholders and the directors in Class C shall be elected for a term expiring at the third Annual Meeting of Stockholders. Commencing at the first Annual Meeting of Stockholders, and at each annual meeting thereafter, directors elected to succeed those directors whose terms expire shall be elected for a term of office to expire at the third succeeding annual meeting of stockholders after their election. Except as the GCL may otherwise require, in the interim between annual meetings of stockholders or special meetings of stockholders called for the election of directors and/or the removal of one or more directors and the filling of any vacancy in that connection, newly created directorships and any vacancies in the Board of Directors, including unfilled vacancies resulting from the removal of directors for cause, may be filled by the vote of a majority of the remaining directors then in office, although less than a quorum (as defined in the Corporation’s Bylaws), or by the sole remaining director. All directors shall hold office until the expiration of their respective terms of office and until their successors shall have been elected and qualified. A director elected to fill a vacancy resulting from the death, resignation or removal of a director shall serve for the remainder of the full term of the director whose death, resignation or removal shall have created such vacancy and until his successor shall have been elected and qualified.”

In the judgment of Argyle’s Board of Directors, if the acquisition is consummated, the amendment to Argyle’s Second Amended and Restated Certificate of Incorporation to remove those provisions of Argyle’s Second Amended and Restated Certificate of Incorporation that will no longer be operative upon consummation of the merger is desirable to reflect the fact that Argyle would then be an operating business. A copy of the amended and restated certificate of incorporation as it would be filed if the proposal to amend Argyle’s certificate of incorporation and to change Argyle’s name (pursuant to the immediately preceding proposal) is attached to this proxy statement/prospectus as Annex C.

Conclusion of Argyle’s Board of Directors. After careful consideration of all relevant factors, Argyle’s Board of Directors determined that the proposal to amend Argyle’s certificate of incorporation is in the best interests of Argyle and its stockholders. The Board of Directors has approved and declared the proposal advisable and recommends that you vote or give instructions to vote “FOR” the approval of the amendments to Article Sixth which remove certain paragraphs that were applicable to Argyle only until such time as Argyle consummated a business combination.

PROPOSAL TO ADJOURN OR POSTPONE THE SPECIAL MEETING FOR THE PURPOSE OF SOLICITING ADDITIONAL PROXIES

This proposal allows Argyle’s Board of Directors to submit a proposal to adjourn the special meeting to a later date or dates, if necessary, to permit further solicitation of proxies in the event there are not sufficient votes at the time of the special meeting to approve the proposed merger.

If this proposal is not approved by Argyle’s stockholders, its Board of Directors may not be able to adjourn the special meeting to a later date in the event there are not sufficient votes at the time of the special meeting to approve the proposed merger.

Conclusion of Argyle’s Board of Directors. After careful consideration of all relevant factors, Argyle’s Board of Directors determined that the proposal to allow adjournment or postponement of the special meeting for the purpose of soliciting additional proxies is in the best interests of Argyle and its stockholders. The Board of Directors has approved and declared the proposal advisable and recommends that you vote or give instructions to vote “FOR” the proposal.

INFORMATION ABOUT ISI

ISI's History and Current Business

ISI is the parent company of several subsidiaries, including three solution providers in the physical security industry: ISI Detention Contracting (referred to as ISI-Detention), Metroplex Control Systems (referred to as MCS-Detention), and Metroplex Fire and Security Alarms (referred to as MCS-Commercial).

1. **ISI-Detention** designs, engineers, supplies, installs, and maintains a full array of detention systems and equipment, targeting correctional facilities throughout the United States.

The product line for ISI-Detention primarily includes detention hardware (prison bars, locks and locking systems), security glass, security furniture (metal furniture), detention grade hollow metal doors, frames and windows, and labor to install these items. All of these items are purchased from third party vendors and sold through ISI-Detention to its customer. ISI-Detention does not manufacture the hardware installed as part of its security solutions. All of these products are sold to contractors that are building, expanding or renovating a jail or prison, or they are sold to the owner (governmental or private entity) of a jail or prison that is being built, expanded or renovated. In either situation, these products are installed in city lockups, county jails, state prisons or federal prisons.

At the beginning of a project (the design phase), ISI-Detention will help design the project by writing specifications, developing schedules (detailed lists) of doors, windows, door hardware and glazing for the customer. The design process provides all the vendors and contractors with a clear outline of what is needed for the project, without drawing every detailed plan that will be needed for construction. This provides the customer with a detailed list of the precise items that ISI-Detention will supply to the customer, and the cost for those items.

To determine the pricing of a project, ISI-Detention will obtain the design drawings of the project in question and determine the precise quantity of each item needed for the project. (For example, a list will be prepared showing exactly how many left-swinging 3 ft x 7 ft doors and frames, as well as how many right-handed doors and frames of the same size, are required on a project. A similar list is prepared for each type of door, window, lock, hinge, light fixture, toilet and every other detention product that will be required in the project.) ISI-Detention provides these lists of required items to the appropriate vendors. Some vendors perform their own quantity determinations ("take-offs") rather than relying upon the take-offs prepared by ISI-Detention. The vendor then provides ISI-Detention with the price for the items required. Once all the costs are received from vendors, and ISI-Detention determines the cost of the services that it will provide, ISI-Detention then adds profit and overhead, depending on many factors, including but not limited to what other competitors are known to be bidding on the project, local labor and other conditions, size of the project, complexity of the project, schedule for completion, etc. ISI-Detention then determines a sales price. This price is given to ISI-Detention's customer. That customer may be a general contractor, a sub-contractor or the owner of the project – a city, county, state or federal agency.

In many cases, ISI is part of a team that prepares a bid. This team works together to create a total construction bid. The head of the team is usually a general contractor or private prison operator. Typically, ISI is invited to be part of this team because of a repeat customer relationship. This allows ISI the ability to negotiate this work with its repeat customers. The team then competes for the contract as a group. This type of repeat customer relationship allows ISI the ability to negotiate most of the work sold to repeat customers.

Most governmental agencies require that their significant contracts be competitively bid. Typically they utilize the "Request for Proposal" (RFP) method where several competitors submit their sealed proposals for a particular project, or the "Request for Qualifications" (RFQ) process where competitors submit their qualifications for consideration by the customer. Some contracts are let upon the standard "Straight Bid" process where the detailed plans and specifications for a project are published and contractors submit a "Bid" or fixed price, for the contract to build the

project. Other competitive bidding processes may also be utilized, such as the Construction Manager at Risk model, where a Construction Manager is hired for a fee to build the project for a fixed price, or “cost plus profit and overhead” basis. When ISI-Detention responds to an RFP, RFQ, Straight Bid, or other competitive bidding process, it typically provides the response to a general contractor (where ISI-Detention is one of several subcontractors in different disciplines providing prices) or directly to the owner (governmental agency or private entity) of a correctional project. The quality of ISI-Detention’s estimating process, knowledge of the industry, knowledge of its customers and other issues requiring significant judgment and expertise are key factors in determining whether ISI-Detention will ‘win’ the competitive bid process and be offered the contract for the project.

When the customer sends ISI-Detention a contract, it contains typical construction contract terms and conditions, such as provision for retainage, certification of completion for progress payments, fixed markup on change orders, coordination responsibility, and similar provisions. Most contracts allow for progress payments on a monthly basis, and most contracts are fixed price.

Progress payments and retainage provisions control the amount and timing of payments to ISI-Detention. For example, upon execution of a contract, an agreed upon mobilization payment may be paid to ISI-Detention. Thereafter, each month ISI-Detention certifies to the customer the percentage of the total work that has been completed through the preceding month. A third party (typically an architect) also provides the owner of the project with a certification of the percentage of completion. If the third party agrees with ISI-Detention’s certification of its percentage of completion, then ISI-Detention is entitled to receive that percentage of the entire contract amount, less the amount of retainage (typically 5% to 10%). (For example, if ISI-Detention claims that 60% of its work under its contract has been completed, then ISI-Detention is entitled to be paid 60% of the contract amount, less the retainage amount). At the conclusion of the project, assuming no other changes or charges, ISI-Detention should have been paid the full contract amount less the retainage. When the owner of the project, ISI-Detention’s customer and the third party have all certified that the project is complete and that all sub-contractors of ISI-Detention have been paid or other appropriate documentation provided, the retainage amount is paid to ISI-Detention.

After a project is sold and ISI-Detention receives a contract, ISI prepares engineering drawings and schedules or lists creating more detail and information than in the design phase, which takes place early on in the development of a project. During the construction phase of the project, ISI orders materials from vendors and arranges for those materials to be shipped to the project site. Typically, ISI-Detention sends its employees to the job site to install this equipment. ISI-Detention’s projects usually take 9 to 14 months; some larger projects may run longer.

From time to time, ISI-Detention’s customers require that ISI-Detention provide not only the detention equipment but the security electronics as well. When this occurs, ISI-Detention uses MCS-Detention (a wholly-owned subsidiary of ISI) to provide the security electronics as a subcontractor to ISI-Detention. The price for the detention equipment and the price for the security electronics (closed circuit television, infra-red alarms, access control systems, etc.) are combined together and submitted by ISI-Detention to its customer as a package price.

2. **MCS-Detention**'s expertise lies in designing, engineering, supplying, installing and maintaining complex, customized security, access control, video and electronic security control system solutions at correctional and governmental facilities.

MCS-Detention provides electronic security systems for correctional facilities. MCS-Detention develops electronic security systems for its customers using door controls, intercoms, closed circuit television (CCTV) and other low voltage electronic security systems that can all be controlled from one location at one console. MCS-Detention does not manufacture the hardware installed as part of its security solutions. Many solutions are simultaneously provided for the customer because MCS-Detention determines the needs of its customer and puts systems together (from many different manufacturers) to fit those needs. More importantly, MCS-Detention can integrate the operation of those varied systems so that they work together without conflict. Because of the complexity of the systems involved, MCS-Detention regularly designs the security electronic systems and prepares the drawings for architects and engineers. This complex design work involves coordination of wiring and conduit on a project, developing the requirements for local control and satellite control stations.

MCS-Detention maintains its sales force in San Antonio, Texas and in Indianapolis, Indiana. Sales are pursued nationwide from those locations.

MCS-Detention estimates the cost and pricing of a project in a process that is similar to that of ISI-Detention. MCS-Detention will review the design drawings and written specifications, to create the same "take-offs," or lists, of products and materials that are required on a project. MCS-Detention will then distribute the lists to vendors, receive the vendors' bids on their respective portions of the project, and then MCS-Detention will calculate the costs to furnish and install the products required. MCS-Detention then adds profit and overhead to its calculations and determines the final price for the customer. In determining the final price, MCS-Detention uses the same subjective criteria that ISI-Detention uses.

The contracts that MCS-Detention secures are subject to similar competitive bidding processes as are the contracts entered into by ISI-Detention. All products supplied by MCS-Detention are purchased from third party vendors, assembled and prepared by MCS-Detention, and then sold by MCS-Detention to its customer. Typically, all MCS-Detention systems are installed and tested by MCS personnel. The terms of the contracts MCS-Detention enters into with its customers, are similar to the types of contracts entered into by ISI-Detention. The types of customers that are served by MCS-Detention are the same types of customers that are served by ISI-Detention. The electronic security products of MCS-Detention are linked into an integrated system using applications software developed and provided by MCS-Detention.

3. **MCS-Commercial** designs, engineers, supplies, installs, and maintains professional security, access control, video and fire alarm system solutions for large commercial customers.

MCS-Commercial supplies security electronic products to end-users and contractors. These products include, access control systems, fire alarms, video, CCTV, sound paging systems and structured cabling. In contrast to ISI-Detention and MCS-Detention, which sell their products to the corrections industry for jails and prisons, MCS-Commercial typically sells its products to contractors that are building or renovating commercial projects, or owners of commercial properties. MCS-Commercial does not manufacture the hardware installed as part of its security solutions. Although the products of MCS-Commercial and MCS-Detention are similar in many respects (access control systems, CCTV, etc.), MCS-Commercial sells products only to commercial customers for commercial projects.

MCS-Commercial maintains sales personnel in Dallas, San Antonio, Austin and Houston, Texas as well as in Denver, Colorado. Each sales person is responsible for selling MCS-Commercial products in his or her respective geographical area.

The process of estimating and pricing projects for MCS-Commercial is substantially the same process used by ISI-Detention and MCS-Detention. Additionally, MCS-Commercial enters into contracts that are similar, if not identical, in terms and conditions to the contracts entered into by ISI-Detention and MCS-Detention. The contracts that MCS-Commercial secures are generally subject to the same competitive bidding processes as are the contracts entered into by ISI-Detention and MCS-Detention. MCS-Commercial buys and resells all its products to its customers. Installation is performed by MCS-Commercial employees and also by subcontractors.

The costs incurred by ISI for research and development are not material. The rights to the third party software utilized by ISI are also not material. ISI secured an indefinite license to utilize the third-party software. The purpose of the third-party software is to provide shortcuts in the ISI software, and eliminate the need for ISI to develop rudimentary programs (such as clocks, timers, counters, etc.). ISI's proprietary software is configured around these third-party programs, and works with these programs. The third-party software used as a component of ISI software in creating solutions for the security needs of customers is not sold or licensed to customers.

When a computer is utilized in the solution of a client's security needs, ISI will provide the computer to the customer with all required software pre-loaded. The license for the required software is purchased by ISI and conveyed to the customer with the computer.

ISI has made a concerted effort to become the total solutions provider of security and detention for the corrections design/build market. In the security industry, a “total solutions provider” means that a vendor has the ability to design customized solutions for a wide range of security needs, and provide all of the hardware and software for those solutions, rather than designing a wide array of solutions, but only actually fulfilling the design in one or two areas. If a customer selects a series of security vendors, each providing a separate and independent system that addresses only a limited security need, then the numerous systems required to provide overall security can cause many unanticipated problems in operations, maintenance, and upgrades. ISI, as a “total solutions provider,” can provide its customers with one source for a wide range of security solutions that are tested and proven to work together.

ISI’s operating units provide a range of products as well as value-added services such as design assistance to architects, engineers and owners through writing specifications, providing CAD documents, equipment selection and vendor recommendation. The breadth of its offerings has enabled ISI to establish a leadership position in the design/build corrections market; in turn, this recognized expertise in providing customized, high-level solutions to the most demanding of customers has allowed ISI to acquire projects in other security-sensitive sectors, such as the healthcare industry, water treatment plants, federal courthouses and upscale private commercial buildings.

Through ISI’s design assistance and performance, ISI develops relationships that make repeat business with customers more likely. For example, more than 60% of the revenue for ISI-Detention and MCS-Detention during 2004, 2005, and 2006 has been the result of contracts with repeat customers. These repeat customers typically allow ISI to negotiate the work, especially on design-build projects. Design-build projects are contracts where ISI provides substantial design assistance to its customers.

Acquisitions

ISI has completed several acquisitions since 2000. Each of the businesses and the targeted personnel has been successfully assimilated into ISI’ operations. A summary of these transactions follows:

- In 2000, ISI purchased the assets of Metroplex Control Systems, for a purchase price of \$2.5 million. ISI assumed the obligation to perform an existing backlog of work for the pricing that had been estimated by others and convinced many of the key employees to move to San Antonio to integrate the corrections systems electronics business of the target with the corrections work of ISI already being done in San Antonio.
 - In 2002, ISI purchased certain service centers in Dallas, Texas and Denver, Colorado from Edwards System Technology for a purchase price of \$564,764.88. The business acquired in Denver was integrated into the existing Denver operations, and the business acquired in Dallas was merged into the existing Dallas office.
- In 2003, ISI purchased the assets of KMC/TL Services, LLC in Austin, Texas in consideration for the assumption of the obligation to complete the projects in the backlog of KMC. No additional cash consideration was paid to KMC. The business was converted into an office for MCS. The key risk in this transaction was the existing backlog of contracts, which was known to have difficulties and thin, if any, profit remaining in the completion of those contracts. ISI completed the troubled contracts, some at a loss, in order to acquire the repeat business from these customers, while establishing an office in Austin, Texas.
- In November 2004, ISI purchased the assets of Community Technical Solutions, Inc. for \$350,000. The operations were successfully merged into the Denver office and the key employee of the business integrated into ISI’s operations.
- In November 2005, ISI purchased the assets of Instant Photo, Inc. for \$750,000. In this acquisition, ISI assumed certain troubled contracts held by unsatisfied, but potentially very good customers. ISI merged the acquired Dallas operations into its existing Dallas office, expanded its existing Austin operations with the acquired Austin business,

and the acquired office in Houston, Texas gave ISI its first presence in that market. ISI focused its efforts on service to the disgruntled IPI customers and has completed this acquisition successfully.

Customers

ISI's diverse customer base consists primarily of contractors, construction companies and architects catering to publicly and privately run detention facilities and commercial construction. For fiscal 2005, ISI generated 8% of its revenue from its top customer, 16% from the top two and 21% from the top three. For fiscal 2005, ISI's largest client was Kelso/Gillbane, representing \$3.3 million of revenues. Other large clients represented 8%, 5% and 4% of revenues in fiscal 2005, respectively.

Competition

The security services industry is a large and competitive market. ISI competes for contracts based on its strong client relationships, successful past performance record, significant technical expertise and specialized knowledge. It often competes against defense contractors, as well as specialized information technology consulting and outsourcing firms. ISI-Detention's competitors include Norment Security Group (part of Compudyne), Cornerstone Detention Products, Sierra Steel, CCC Group, G-S Company, and Pauly Jail Building Company.

There are also several smaller regional companies that compete with ISI-Detention. MCS-Detention's competitors for its hardware/software solutions include: Norment Security Group, Stanley Integrator (part of Stanley Works), ESi Companies, Southwest Communications, and Accurate Controls. MCS-Commercial faces a much broader array of competitors such as: Koetter, Siemens, DSS, Fire Alarm Services, Fire Alarm Control Services, Tyco, Chubb and Lone Star. Management does not expect competition in any of the sectors to decline in the foreseeable future.

Employees

As of October 31, 2006, ISI had 249 full-time employees. Future success will depend significantly on ISI's ability to attract, retain and motivate qualified personnel. ISI is not a party to any collective bargaining agreement, has not experienced any strikes or work stoppages and considers its relationship with its employees to be satisfactory.

Health and Dental Insurance

ISI has a self-insured Health and Dental Insurance Plan that allows ISI to insure for a maximum cost (generally not exceeding what can be paid to a third-party insurance company), but also get the financial benefit of the medical expenses incurred if such expenses do not reach this maximum. For example, in 2004 the maximum aggregate stop loss was \$880,250; the company only incurred expenses of \$566,704. Since the maximum stop loss amount is the amount that ISI would have had to pay to a third-party to provide identical coverages, the difference between the maximum stop loss and the actual costs incurred represented costs savings to ISI. This self-insurance plan, in general, allows the company to get the benefits of lower medical costs without being at risk for excessive medical costs.

In addition to the aggregate insurance, ISI also obtains individual stop loss insurance. This insurance pays if any individual exceeds spending of \$65,000 per year. This additional insurance, when blended with the aggregate stop loss, allows ISI to provide good health care to its employees with a known medical expense, but leaves the potential for savings if expenses do not reach the maximum.

Self-insured health and dental insurance plan

	December 31,	
	2004	2005
Insurance Coverage		
Individual Stop Loss	65,000	65,000
Aggregate Stop Loss	880,250	857,359
Payments		
Third Party Administrator ⁽¹⁾	184,594	199,762
Claims Paid	566,704	829,675
Accruals		
Incurred But Not Reported	147,840	126,111

Note 1: The payments to Third Party Administrator covered the cost of both aggregate and individual stop loss coverage along with the cost of administering the plan.

Facilities

ISI's corporate headquarters, where all corporate functions are housed, is located at 12903 Delivery Drive in San Antonio, Texas. These facilities of approximately 16,000 square feet also house the headquarters for ISI-Detention and MCS-Detention. The headquarters for MCS-Commercial and the San Antonio Regional Office of MCS-Commercial are located in a leased building of approximately 8,000 square feet at 12918 Delivery Drive in San Antonio, Texas, across the street from the ISI corporate headquarters. These two buildings, comprising approximately 24,000 square feet, are leased by ISI for approximately \$16,667 per month. MCS-Detention occupies an additional building located at 12902 Flagship in San Antonio, Texas, of approximately 7,000 square feet, for approximately \$7,000 per month. MCS-Commercial also conducts operations in Austin, Dallas and Houston, Texas, and Denver, Colorado. The Austin facilities are located at 8711 Burnett Road, Suite D-40, Austin, Texas, 78757 and are comprised of 400 square feet of warehouse space, 800 square feet of office space for combined square footage of 1200 square feet, at a current monthly cost to ISI of \$960.00. MCS-Commercial conducts its operations in these offices. The Dallas facilities are located at 2472 Southwell Road, Dallas, Texas, 75229, and are comprised of 650 square feet of warehouse space, 14,350 square feet of office space, for a combined square footage of 15,000 square feet, at a current monthly cost to ISI of \$5,000.00. The Denver facilities are located at 7388 South Revere Parkway, Unit 603, Centennial CO, 80112, Denver, Colorado, comprised of 1,100 square feet of warehouse space and 6,680 square feet of office space, for a combined square footage of 7,780 square feet, at a current monthly cost to ISI of \$4,250.71. The Houston facilities, as of December 27, 2006, will be located at 10624 Rockley Road, Houston, Texas, 77009, and are comprised of 900 square feet of warehouse space, 4,328 square feet of office space for combined square footage of 5,228 square feet, at a monthly cost to ISI, commencing on April 1, 2007, of \$3,398.20. No rental is due for the period of December 27, 2006 to March 31, 2007. The current lease for office space for the Houston facilities was acquired in a 2005 acquisition, and was scheduled to terminate by its own terms on December 31, 2006. The move to new facilities in Houston is not a material event for ISI.

The following facilities are leased from Green Wing Management, Ltd., an entity owned and controlled by Sam Youngblood and Don Carr:

- 12903 Delivery Dr., San Antonio, Texas
- 12918 Delivery Dr., San Antonio, Texas
- 12902 Flagship Dr., San Antonio, Texas

The Merger Agreement between ISI and Argyle requires that the leases on these properties be amended to reflect a term of 12 years from the closing of the merger, and also requires that an appraisal be completed by a qualified appraiser to determine the market rate of the leases on these three properties. The Merger Agreement requires that the rental rate to be paid on these properties be limited to no more than 90% of the market rate determined by the third-party appraiser. Additional appraisals by a third-party appraiser are to be conducted every three years during the 12 year terms, pursuant to the Merger Agreement, and the annual lease rate in the leases can increase at the time of these appraisals, but only to a level that does not to exceed 90% of the market rate determined by the third-party appraiser.

Pursuant to the Merger Agreement, Argyle has the right to purchase these three properties at any time, at the then current market value; however, the purchase price cannot be less than the value determined in the last appraisal preceding the effective date of the closing.

Legal Proceedings

ISI and its subsidiaries are not presently subject to any material litigation, and management is not aware of any threatened material litigation. ISI is a party to routine litigation and administration proceedings that arise from time to time in the ordinary course of business, none of which, individually or in the aggregate, is expected to have a material effect on ISI's financial situation or ability to operate.

ISI-Detention

ISI-Detention's management has been involved in furnishing and installing detention equipment in more than 1,600 correctional facilities since the company's inception in 1976. Its expertise and track record position ISI-Detention favorably among the nation's leading providers of products and solutions for correctional facilities. Its custom-designed systems meet local standards and are in full compliance with the applicable standards of the American Correctional Association, a voluntary organization whose standards for correctional facility design, operation and construction are the recognized industry benchmark for quality and safety.

ISI-Detention offers a complete array of electronic security system solutions revolving around electronic locking systems and hardware, security doors and frames, jail furniture, security glazing and other security-based systems. Whether acting as prime contractor or as a subcontractor for projects spanning all levels of security. More than 60% of the revenue for ISI-Detention and MCS-Detention during 2004, 2005, and 2006 has been the result of contracts with repeat customers.

ISI-Detention's product offerings include security locking systems, security hollow metal doors and wall panels, security windows, security glass and glazing, security furnishings and accessories, design support and full installation capabilities.

Beginning in the design phase, ISI-Detention works with architects, engineers and contractors to help design and develop plans and specifications for a given correctional facility. During this stage of development, ISI-Detention writes specifications for specific locking systems, analyzes particular conditions and requirements and recommends products that correspond to the needs of that correctional facility, depending on the type of security that is required and the underlying budget.

In many cases, ISI negotiates the contract with a repeat customer on a team approach (as described on page 54).

When competitive bids are solicited in connection with the construction of a correctional facility, ISI-Detention bids for the detention equipment portion of the overall project as a direct contractor or as one of the subcontractors for a general contractor. The furnished and installed package proposed by ISI-Detention typically includes security locking systems and hardware, security hollow metal (doors and frames), detention furniture (tables, bunks, benches, mirrors, etc.), security electronic controls (closed circuit television, intercom, etc.) and security glass and glazing. By providing this complete package furnished and installed, ISI-Detention is able to provide a warranty program and insure that all the pieces and components are fully integrated and inter-operate correctly.

ISI-Detention's typical warranty is a limited warranty of one year and is provided in more than 95% of the contracts entered into. This warranty provides for repair or replacement of defective materials or workmanship, if a failure occurs within one year of installation of the product. In very limited circumstances, ISI-Detention will provide an extended warranty of two years (with the same repair and replacement obligations as the one year warranty) when it is demanded by a significant customer or is otherwise required to secure a contract. In even more limited circumstances, an extended warranty of three years (with the same repair and replacement obligations as the one year warranty) will be provided.

The aggregate cost of fulfilling ISI Detention's warranty obligations on completed contracts in 2005 and 2006 has been less than \$150,000 for those years combined, and there have been no claims asserted by customers or users of ISI's products that are outside the normal scope of warranty work required. Additionally, since all of the products sold by ISI are manufactured by others, the ultimate burden for warranty of those items is passed on to the manufacturers by ISI.

MCS-Detention and MCS-Commercial

Metroplex Control Systems (or MCS) was formed in 1988 in Dallas and was subsequently acquired by ISI in 2000. After the acquisition, MCS was restructured into two separate subsidiary entities (each under its own management): MCS-Detention and MCS-Commercial. MCS-Detention shares its headquarters with ISI and also has a neighboring 7,000 square foot facility. MCS-Commercial currently operates out of its own San Antonio headquarters and five regional offices. The offices in Austin, Houston and Denver resulted from acquisitions made by ISI. The operations in Dallas and Denver were enhanced and complemented by the acquisition of several Edwards System Technology centers.

MCS-Detention specializes in turnkey installations for public and privately owned/operated detention facilities. MCS-Commercial has built a parallel business targeting commercial and industrial facilities.

MCS-Detention designs, manufactures, supplies, installs and maintains access control, video and integrated electronic control systems for correctional and government facilities throughout the United States. It also provides the above goods and services to detention market integrators, electrical contractors and competitors that lack their own in-house electronic solutions.

MCS Products and Solutions

MCS-Detention and MCS-Commercial offer turnkey installations, using components which cover the full spectrum of electronic security and low voltage systems. Included in their offerings are access control, closed circuit television (including cameras, camera management and video image mass storage), detention control, fire alarm, intercom, perimeter protection, sound/paging, video visitation and other custom designed systems. Experience in planning, installation and service, combined with state-of-the-art equipment, provides MCS-Detention and MCS-Commercial with a distinct advantage in marketing and developing customized solutions for clients.

MCS-Detention and MCS-Commercial utilize programming and testing tools that are proprietary, which they believe provide faster and better solutions, installation, and updates than the competition.

The products and services of MCS-Detention and MCS-Commercial provide solutions for the combination and integration of disparate security systems, including a software suite called TotalWerks, user-friendly touch screens, PDA wireless control/displays, hardened (against physical abuse) control panels that use Internet protocol to communicate (rather than hard wire to each controlled device), computer-based door control systems, access control systems (Internet based and third party), guard watch tour devices, perimeter protection, panic and duress systems, nurse call systems, closed circuit television (including DVRs) and fire alarm and video visitation systems.

The TotalWerks suite of software tools is proprietary and is used to create and program security solutions for customers. The TotalWerks suite is not sold to customers; it is used by MCS-Commercial and MCS-Detention to efficiently solve security problems. One of the elements of TotalWerks is the OneFab development suite that contains three programs - the OneFab application, the OneMessage Client and the OneFab simulator. These proprietary development tools allow MCS-Detention and MCS-Commercial engineering and fabrication staffs to write software for, Input/Output (I/O) simulation, point confirmation and the ability to test each I/O point before the project leaves the factory. In short, these are software applications that assist MCS-Detention and MCS-Commercial in creating sophisticated security programs quickly and accurately.

The OneFab application's "drag and drop" interface uses custom macros (software functional modules) for different security features. These macros can be reused on different projects, thereby cutting development time by as much as 75% versus competitors' products. These macros are all stored in a digital library and classified, and can be retrieved and re-used at will.

Typical security programming is accomplished by the completion of a complex set of sophisticated spreadsheets that compile all of the security devices in a given project with all possible uses, applications and other requirements. The spreadsheet data is then converted to an equally complex and rough computer language ("ladder-logic") that the specialized industrial computers utilize to harmonize, operate, control and monitor the many often disparate security systems from many different manufacturers. This conversion process to ladder-logic is typically a time consuming and error-prone process. By using the macros, and other features available in the OneFab application, the spreadsheet data can be quickly converted into ladder-logic that is fully useable by industrial grade computers required for complex and sophisticated security systems.

MCS Markets

MCS has developed a strong competence in both markets it serves, detention and commercial, in large part due to its team's expertise in particular fields of the security industry. Supported by its sophisticated engineering and software design capabilities and solutions, MCS has developed a strong reputation for technical leadership. MCS-Detention's first project was a renovation of the Lew Sterrett Tower (County Jail) in Dallas, Texas in August of 1988.

MCS has been selling products and providing the services necessary to support these products for over 18 years. MCS also uses a mobile OneLink satellite van that allows the firm to establish a live connection with the system programmers anywhere in the United States. This means quicker installations, modifications and additions to the systems as needed or required. With over 900 installations nationwide, management believes that MCS has established itself as a leader in the correctional security market.

MCS Employees

MCS management's attention to recruiting, employee retention, training and support has enhanced the company's ability to develop increasingly advanced proprietary technological solutions while demonstrating a service-oriented culture. In addition, MCS has evolved into a widespread organization with multiple offices, a structured sales organization and demonstrable service and maintenance abilities. MCS has 207 employees, multiple offices and multiple turnkey installation crews, 7,000 square feet of onsite fabrication area and a separate quality control room.

Market

Detention Market

At the end of 2005, there were 2,320,359 prisoners being held in federal or state prisons or in local jails or juvenile facilities. Statistically, 1 in every 136 U.S. residents was in prison or jail in 2005. The latter was an increase of 2.7% from year end 2004. The average growth in both the prison and jail populations during the previous ten years has been approximately 3% per year. At the end of 2005, state prisons were operating between 1% below and 14% above capacity, and federal prisons were operating at 34% above capacity. As a result of this situation, some states have had to ship their excess prisoners to other states where detention facilities have some excess capacity to absorb additional prisoners. Management believes that ISI is well positioned to take advantage of the continued growth in population in detention facilities. The statistics presented above were obtained from publicly available U.S. Department of Justice Bureau of Justice Statistics Bulletins.

Commercial Security Market

The North American electronic security market reached \$23.8 billion by the end of 2005, of which 70% was in the commercial/industrial sector - MCS-Commercial's market. The fastest growing sectors within that market are video (10% per year) and access control (8-9% per year), both areas in which MCS-Commercial competes. MCS-Commercial also competes in the fire protection area. MCS-Commercial is also able to design and provide fire alarm products and services. The fire alarm market is a potential catalyst for garnering video and access control business because of the unique licensing requirements mandated by state and local authorities which oversee an industry that is focused more on life-safety than on property protection. Many of the organizations vying for commercial/industrial business lack the fire alarm certification licensing needed to provide a total system solution.

Note: The statistics presented above were obtained from documents originally published by JP. Freeman & Co., IMS Research, and The Freedonia Group, market research organizations serving the physical security industry

Business Strategy

Solutions Focus

ISI plans to focus its growth efforts on the design-build/negotiated market sector. In order to accomplish that growth, management will need to hire additional personnel. ISI's management has slated specific positions in sales and project development that must be filled with quality people to meet this growth goal. Although no firm targets have been set, benchmarks to determine the progress will be based on the increase of the backlog of work and in new customers from new territories and markets. How successfully the plan is being executed will be determined by whether ISI is able to stay within budget, maintain its planned growth in sales and earnings and by periodically checking on new projects. New projects will be monitored to determine increased sales activity and to determine probable sales closing success rates.

ISI anticipates that focusing on growth in the design build/negotiated sector will consume the majority of ISI's available resources. ISI is attempting to expand in this sector, because the company can add value through its design expertise that allows the company to satisfy its customers and eliminate the "bid and chase," or competitive bidding environment, where the company is not always able to provide its higher added value services to the customer.

In the detention sector, concentrating on the design-build/negotiated market offers the company the following advantages applicable to the detention market customer base:

- Develops a customer relationship at the initiation of projects, thereby maximizing the probability of success in the sales opportunity.
- Limits the exposure to competition, since the project requirements can be written around unique company product capabilities.
- Positions the company on the "customer's side of the table" for a consolidated team sales effort relative to the facility operator/owner.
- Avoids the "low bidder take all" sector of the market in which reduced margins are typical in order to position the company for better margin returns.

The greatest risks associated with ISI's growth strategy involve the hiring of employees. ISI must try to employ high-caliber sales and management personnel with professional expertise and past real-world practical experience. If these positions are filled with non-performing or under-performing people, the company will not be able to grow as it

anticipates. In addition, ISI must hire an appropriate number of persons so that its customers can be appropriately serviced, but not so many persons such that its employees are working at substantially below capacity. ISI's failure to appropriately hire personnel could result in slower growth than anticipated, or in less profit.

Key Alliances

In the detention sector, creating, maintaining and enhancing key alliances with prime contractors involved in the development and construction of detention facilities is critical for the development of a steady and recurring revenue stream in a market that is steadily growing.

In the commercial sector, the focus is to develop alliances with very large and multi-site regional or national organizations that will then utilize the company's capabilities for their security needs in growth/expansion projects and/or in many locations, so as to provide a steady and profitable revenue stream for the company.

Geographic Expansion and Strategic Acquisitions

In both sectors of the business, the acquisition of comprehensive video development/manufacturing capability that can be tightly integrated with the company's other products will greatly enhance the competitive posture of the company in capturing business and will also result in more of the project revenue remaining in-house for enhanced margin.

In the commercial sector, either acquisition of existing solution providers in some of the larger metropolitan markets in the U.S., or internal expansion to address those markets, will greatly enlarge the company's national footprint and better enable it to service the multi-site organizations that are being sought as customers. External acquisitions will give the company access to new customers in the regions that are of interest and would give the company a running start as opposed to the slower build-up that would ensue from internal expansion.

Marketing Initiatives

ISI intends to develop a market for its integrated detention electronic security solution that is developed utilizing ISI's proprietary software system. ISI plans to focus on two markets not significantly penetrated at this time -- the Midwest and the Northeast -- by establishing a local sales presence in these markets to sell ISI's detention solutions to contractors and integrators there. It has enlisted the support of a very strong sales professional with a background in the detention systems market to spearhead this effort.

Sales and Marketing

The ISI Sales and Marketing organization and structure can be characterized as follows:

1 Niche target market focused sales and marketing to maximize return.

1 Dedicated national account selling team with impressive credentials to capture larger scale and multi-site commercial security opportunities.

1 Dedicated selling team to sell the company's hardware/software solutions to organizations that compete with the parent but that lack their own in-house capabilities and to organizations operating in portions of the national market not currently addressed by ISI.

1 Highly motivated and organized sales organization that is keyed to profitability, rewards excellence, and that quickly weeds out non-performers.

Competitive Strengths

ISI management believes that it has a number of strengths versus the organizations with which it competes:

1 Ability to react to changing technological needs.

1 A software platform that lends itself to very rapid adaptation to the specific requirements of individual facilities and to the use of the two major operating systems in the market-Windows and Linux, with minimal effort.

1 A broad array of software drivers that allow the company's solutions to utilize a wide variety of security system peripherals from many different third-party suppliers.

1 A solid reputation in both the detention and the commercial market sectors with its customers for on-time project execution, security solution performance and customer service that results in a significant amount of repeat business

being garnered. For example, more than 60% of the revenue for ISI-Detention and MCS-Detention during 2004, 2005, and 2006 has been the result of contracts with repeat customers.

IA number of ISI's competitors for entire detention facilities that do not have in-house electronic system solutions purchase their electronics systems from ISI based upon their knowledge that ISI has leading edge solutions, including touchscreen and PDA wireless control for the detention industry, plus a software development process that provides timely and efficient security solutions for customers.

Research and Development

A software development team within MCS provides the operating arms of the company with new features and capabilities in developing security solutions.

Government Regulations

Various states within the United States require companies performing the type of work performed by ISI in detention facilities to be licensed. ISI maintains active licenses in every state in which it does do business that requires licensing. Outside of detention facilities, many states and local municipalities require companies that provide turnkey electronic security systems for commercial facilities to obtain and maintain special security licenses.

The process of obtaining specialty security licenses is bureaucratic. ISI has designated personnel to oversee the process for maintaining all the licenses for the company. Obtaining new licenses typically requires that a test be taken in that state, if it requires a state license. If a state license expires or is revoked for any reason, it could prevent ISI from being authorized to enter into a contract in that state. If a local license expires or is revoked for any reason, ISI may be assessed a fine, depending on the delinquency in regard to that license. The following is a list of the specialty licenses that ISI has secured as of December 31, 2006:

- Alabama - Detention & Security Equipment
- Arkansas - Sound & Intercom Systems, Fire Detection Systems, Signal & Burglar Alarm Systems, Computer Cabling
 - Arizona - Low Voltage Communication Systems
 - California - Low Voltage Systems
 - Florida - Alarm System Contractor
 - Georgia - Unrestricted Low Voltage
 - Iowa - Subcontractor
 - Idaho - Electrical Limited Energy Specialty Contractor
 - Louisiana - Electrical Controls
 - Minnesota - Technology Systems Contractor
 - Mississippi - Security, Burglar & Fire Alarms
 - Montana - Subcontractor
 - North Carolina - Low Voltage Electrical and Alarm
 - North Dakota - Subcontractor
 - Nebraska - Subcontractor
 - New Mexico - Sound, Intercommunication, Alarm System
 - Nevada - Low Voltage Systems
 - Tennessee - Electrical Controls
 - Texas - Private Security Alarm License and Fire Alarm License
 - Virginia - Electronic Communications
 - City of Arvada - Building Subcontractor
 - City of Aurora - Fire Alarm Contractor and Fire Alarm Supervisor
 - City of Boulder - Fire Alarm Systems
 - City of Broomfield - Contractor
 - City of Centennial - Business license and Access Control and Security
 - City of Colorado Springs - Fire Alarm
 - City of Denver - Access Control System and Electrical Signal
 - City of Lakewood - Contractor
 - City of Littleton - Miscellaneous
 - City of Loveland - Fire Alarm

- City of Thornton - Contractor - Fire Alarm
- City of Westminster - General Building Contractor
- City of Wheat Ridge - Electrical Signal

ISI has and maintains its security licensing in every locale where required and where business is being conducted by the company. ISI's management believes that the acquisition will have no material adverse affect upon the licensing of ISI or its subsidiaries.

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

Business Overview

General

ISI is one of the nation's largest providers of detention equipment products and service solutions for private and public-sector correctional and related facilities. ISI is the parent company of several subsidiaries; however, its primary business operates through three segments that are service and solution providers in the physical security industry: ISI-Detention Contracting, or ISI-Detention; Metroplex Control System, or MCS-Detention; and MCFSA, Ltd., or MCS-Commercial.

Results of Operations

Management analyzes ISI's results of operations, by identifying those critical items that impact each segment on a standalone basis, since such items are different for each sector. More than 85% of ISI's revenue is generated by fixed-price contracts. The success of a fixed-price contract is based in large part upon the quality of the process utilized when estimating the costs that will be incurred in performing the contract. The larger the project and the longer the term of completion of the contract, the greater the number of variable factors there are to be considered and evaluated in estimating costs. A successful estimating process requires substantial experience and judgment. Management is aware of the significant need for experience and qualified estimating personnel and regularly monitors the estimating process and its results.

The most obvious benchmark that management considers in evaluating the estimating process is whether the amount estimated, and submitted as a bid, was reasonably similar to the amount bid by ISI's competitors on the same project. Other bidders may bid exceptionally low (even at a loss) in order to secure a contract that the competitor may desperately need in order to maintain at least a modest level of cash flow, or for other reasons. Management must evaluate the bids that were submitted in competition with ISI's bid, based on their knowledge of each competitor's history and character (for example, some typically bid high, some typically bid low), the condition of the market, the complexity of the project, the type of construction and other factors. This review, conducted regularly, provides management with an ongoing general basis for evaluating the estimating process that results in fixed price contracts. Evaluating the results of bidding competitions allows management to evaluate the company's estimating capabilities at the beginning or "front-end" of a new contract or project. Other benchmarks are used to evaluate the estimating process while a project is ongoing.

One of the key indicators in evaluating the ISI's performance is whether the budget for the individual projects is being met. These budgets are, in large part, based upon, the estimation of costs utilized in the preparing the bid. If the budget for a project is not met, then the budget may be faulty, which may indicate that the estimating process being used needs to be reviewed and adjusted. Management regularly monitors the status of budget compliance on every project. One of the many benefits provided to management from this exercise is that this provides management with an ongoing tool to evaluate the effectiveness of the ISI estimating process during the course of completing a contract and at the "back-end" of each contract, when the final budget analysis is completed on each project.

Since ISI's founding, the costs to complete a material fixed price contract, which is a contract that results in more than \$50,000 in gross revenue, have never exceeded the amount of the contract price, which would result in a loss position. While this has occasionally occurred with regard to smaller contracts of \$50,000.00 or less in gross revenue, those losses have not been deemed to be material. No loss position has ever been suffered by ISI with regard to any material contract. Management is not aware of any current contract of ISI that is in a loss position, or that with the passage of time is expected to result in a loss position.

Below is a table breaking down ISI's operations into three primary reportable segments.

Operating Segments	Revenue	Inter-segment Revenue	Operating Income (Loss)	Depreciation/Amortization	Total Assets	Capital Expenditures
ISI						
December 31, 2005	\$ 10,995,182	\$ 3,312,691	\$ (562,750)	\$ 561,992	\$ 17,627,240	\$ 130,620
December 31, 2004	\$ 14,756,861	\$ 7,046,554	\$ (4,162,230)	\$ 237,792	\$ 15,604,775	\$ 202,498
December 31, 2003	\$ 13,163,247	\$ 5,663,144	\$ 1,508,498	\$ 133,787	\$ 12,634,439	\$ 17,917
September 30, 2006*	\$ 14,714,767	\$ 6,571,221	\$ 480,406	\$ 76,994	\$ 25,273,735	\$ 93,159
September 30, 2005*	\$ 8,109,530	\$ 2,025,675	\$ (89,800)	\$ 104,757	\$ 15,376,843	\$ 142,195
MCS Detention						
December 31, 2005	\$ 10,891,378	\$ -	\$ 1,803,595	\$ 181,936	\$ 1,704,762	\$ 130,627
December 31, 2004	\$ 11,031,267	\$ -	\$ 2,284,252	\$ 176,858	\$ 1,836,695	\$ 250,528
December 31, 2003	\$ 8,021,813	\$ -	\$ 1,370,311	\$ 111,791	\$ 1,803,344	\$ 43,465
September 30, 2006*	\$ 9,919,561	\$ -	\$ 1,294,702	\$ 152,585	\$ 2,614,884	\$ 295,932
September 30, 2005*	\$ 7,275,493	\$ -	\$ 914,198	\$ 129,672	\$ 2,839,082	\$ 68,107
MCS Commercial						
December 31, 2005	\$ 17,347,927	\$ -	\$ 219,813	\$ 259,641	\$ 3,253,702	\$ 36,809
December 31, 2004	\$ 14,386,858	\$ -	\$ (164,544)	\$ 255,688	\$ 2,895,194	\$ 167,045
December 31, 2003	\$ 13,540,535	\$ -	\$ 423,126	\$ 245,999	\$ 1,435,514	\$ 390,658
September 30, 2006*	\$ 16,599,478	\$ -	\$ 636,322	\$ 268,169	\$ 4,913,177	\$ 37,425
September 30, 2005*	\$ 13,045,057	\$ -	\$ 41,564	\$ 231,605	\$ 2,756,029	\$ 20,826
Eliminations						
December 31, 2005	\$ -	\$ (3,312,691)	\$ -	\$ -	\$ -	\$ -
December 31, 2004	\$ -	\$ (7,046,554)	\$ -	\$ -	\$ -	\$ -
December 31, 2003	\$ -	\$ (5,663,144)	\$ -	\$ -	\$ -	\$ -
September 30, 2006*	\$ -	\$ (6,571,221)	\$ -	\$ -	\$ -	\$ -
September 30, 2005*	\$ -	\$ (2,025,675)	\$ -	\$ -	\$ -	\$ -
Total Company						
December 31, 2005	\$ 39,234,487	\$ -	\$ 1,460,658	\$ 1,003,569	\$ 22,585,704	\$ 298,056
December 31, 2004	\$ 40,174,986	\$ -	\$ (2,042,522)	\$ 670,338	\$ 20,336,664	\$ 620,071
December 31, 2003	\$ 34,725,595	\$ -	\$ 3,301,935	\$ 491,577	\$ 15,873,297	\$ 452,040
September 30, 2006*	\$ 41,233,806	\$ -	\$ 2,411,430	\$ 497,748	\$ 32,801,796	\$ 426,516
September 30, 2005*	\$ 28,430,080	\$ -	\$ 865,962	\$ 466,034	\$ 20,971,954	\$ 231,128

*Unaudited

ISI-DETENTION

The key element to monitor in analyzing how ISI-Detention's business has performed or will perform during a period is market demand for the construction of correctional facilities. Management must engage in aggressive marketing to governmental entities and private prison operators that are at the earliest stages of considering the design or construction of a new correctional or related facility. Several factors are taken into consideration by management when determining which projects management is most likely to pursue, including location, how much work is available in the marketplace, the bidding process, the type of bidding (such as negotiated or competitive), the needs of the customer to use ISI-Detention's design services, the complexity of the project and the clarity of the project.

Once a project is under contract, management uses several tools to evaluate pending projects to anticipate future sales revenue. Management uses backlog, which is the amount of revenue and gross margin left to earn on a contract, to determine (1) potential revenue and margin earned in the future from this work and (2) manpower requirements and also requirements of the company's vendors to determine if more vendors are needed because of the workload. Using the amount of contracted backlog as a guide, management is able to monitor when the gross margins will be earned and the workload that will be required. In order to provide the best possible prediction of the earning of gross margin and incurrence of costs, all the costs and projected revenues for a project are calculated by "spreading" them over the estimated life of the project, on a monthly basis. This generates a prediction of profit margin and costs by month for each project.

By analyzing backlog, management can make a decision to execute new strategies, such as hiring new people, starting training programs or, if management determines that by spreading the backlog there is a dip in revenues or margins, they can go to the marketplace and acquire a contract, possibly with less margin, to fill a void that will cover some or all of the fixed costs at that time. This process may cause a fluctuation in revenues, gross margin and percentages, which can be seen in ISI's results of operations. Further fluctuation is a result of the time frame over which contracts are sold and completed. Each project has its own schedule for completion, which could be anywhere from 90 days to two years or more. Revenue and gross margin for each project is earned over the course of such project's schedule. Accordingly, if a significant number of projects have a short schedule, which come to a completion around the same time, the revenues for that period could be significantly higher than the next period where project schedules may not complete for several months.

The timing of the delivery of projects is based on customer needs. Since ISI does not manufacture the products, but relies on third parties to manufacture and then ship directly to customers, there may be significant fluctuations as to when revenue is earned, based on when these products are shipped and ultimately received by the customer. Management knows that this type of fluctuation exists, but proper scheduling and regular monitoring of these projects tends to manage the risks successfully.

Another key indicator for evaluating ISI-Detention's performance is whether the budget for each individual project has been met. If a project meets, or is under budget, then gross margin percentages will be predictable. ISI carefully monitors the budget for each project to look for fluctuations and determine ways to protect from "overruns" that may result from mis-estimates in sales and construction risks, such as a defect at a project site that was not able to be determined during the estimating period, which causes excessive manhours on the project or possible mis-performance or financial instability of a subcontractor. These variables are managed carefully by a specific group of project managers with principal responsibility to oversee budgets and control costs, but can cause fluctuations in gross margins earned on projects by over running these projects.

MCS-DETENTION

MCS-Detention is a subcontractor for ISI-Detention in many projects. Although a majority of MCS-Detention's subcontracting business is sold to ISI-Detention, MCS-Detention also sells its services to ISI-Detention competitors, which provides additional revenue..

The key factors used to monitor the operation and financial condition of MCS-Detention are the same factors used to analyze ISI projects, such as monitoring sales, bidding and the pending work to determine what contracts MCS will obtain. Typically, this analysis has taken place at the ISI-Detention level, and since the majority of the ISI-Detention projects will be subcontracted to MCS-Detention. MCS-Detention also has a backlog similar to ISI-Detention, and the measurement and spreading of its backlog is similar to the processes used for ISI-Detention

MCS-Detention produces Head End Systems (the complex industrial grade computer brains behind a total security system), which have risks in regard to production scheduling, including assembly and software development that do not impact ISI-Detention. These Head End Systems are command and control stations, typically for correctional facilities that integrate a myriad of systems, door controls, intercom, CCTV, fire alarm, man down systems, access control systems, etc., all into one control station that is operated from a control room. The software to integrate this is developed by MCS and must be scheduled from the backlog of production scheduling to accomplish these tasks so that the Head End System is completed and tested and shipped on time in order to meet construction schedules.

As with ISI-Detention, meeting the delivery schedules is essential and is a key indicator for MCS-Detention management to use in determining if budgets are going to be met and when revenue will be earned. Determining how much manpower will be needed, and when it will be needed, is done through the scheduling of a project. Therefore, if the projects are on schedule, the manpower is usually also already built into the budget. Management is continually reviewing the demand for new employees based on the increasing backlog, and has developed a training program to insure that employee performance and customer satisfaction are maintained.

MCS-Commercial

MCS-Commercial is staffed with its own sales people. Its pending work is regularly reviewed by management to insure that the sales force is out quoting projects. The backlog for MCS-Commercial typically burns (turns over) at a faster rate than ISI-Detention and MCS-Detention. MCS-Commercial generates a higher percentage of its revenue from recurring revenue, sales from existing customers, rather than from one-time long term contracts.

MCS-Commercial depends upon the information from its sales department as to manpower requirements for potential future sales. Management mitigates the risk of fluctuating revenues, by monitoring whether projects are meeting budget. This is similar to the process utilized to evaluate the performance by MCS-Detention and ISI-Detention.

Management believes that MCS-Commercial has the potential to acquire large long-term contracts, similar to the ISI-Detention and MCS-Detention contracts. Management's strategy for growing this segment of the business would change if MCS-Commercial's servicing contracts change from the current model. However, management believes that larger contracts will make it easier to monitor future sales, since the backlog will take longer to burn, providing management more time to react to growth and anticipate the future with a bit more clarity.

Critical Accounting Policies

ISI's discussion and analysis of its financial condition and results of operations for the purposes of this proxy statement/prospectus are based upon historical combined financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America.

ISI's significant accounting policies are summarized in Note 1 to its historical combined 2005 financial statements, and the following summaries should be read in conjunction with the historical combined financial statements and related notes contained elsewhere herein. While all accounting policies affect the financial statements, certain policies may be viewed as critical. Critical accounting policies are those that are most important to the presentation of the financial statements and results of operations and that required ISI's management's most subjective and complex judgments and estimates. ISI's management believes the policies that fall within this category are percentage of completion estimates, allowance for doubtful accounts and IBNR estimates for health insurance.

Percentage of Completion Estimates. ISI uses percentage of completion accounting to determine revenue and gross margin earned on projects. Estimating the percentage completion on a project is a major critical estimate that ISI depends on. This estimate is determined as follows:

1. The contract amount and all contract estimates are input into a job cost accounting system with detail of all significant estimates of purchases by vendor type, subcontractor, and labor.
2. As the project is performed and purchases and costs are incurred, these are recorded in the same detail as the original estimate.
3. The contract amount and estimated contract costs are updated monthly to record the effect of any contract change order received.
4. On a monthly basis, management, along with its project managers, who are overseeing the contracts, review these estimated costs to complete the project and compare them to the original estimate and the estimate that was used in the prior month to determine the percentage of completion. If the cost to complete, determined by management and the project managers for the current month, confirms that the estimate used in the prior month is correct, then no action is taken to change the estimate and/or the percentage complete in that current month. However, if the current cost to complete estimate calculated by the management and the project managers, differs, then adjustments are made. If the costs are in excess of the estimate used in the prior month, then a decrease in the percentage complete on the project through the current month in the accounting period is made. If the costs are less than the estimate used in the prior accounting period, then the new estimate increases the percentage complete on the project.
5. Revenue is recorded monthly based upon the contract amount, adjusted for change orders, if any, times the percentage of completion. This revises the revenue on a monthly basis for any changes in estimates.

These estimates of percentage completion of a project determine how much revenue and gross margin is earned to date on a project. For example, if a contract is \$100,000 with a 20% gross margin of \$20,000, then a project that is estimated to be 50% complete accrues \$50,000 in revenue and \$10,000 in gross margin. If the percent complete is adjusted to 25%, then the revenue on the contact would be \$25,000 and the earned gross margin would be \$5,000. These estimates would be changed in the current month, and the actual accrual of the revenue and gross margin earned on this project would be reduced in the current month.

Another effect of the change in the estimated costs and percent complete, is that it changes the percentage of gross margin earned. For example, in the project mentioned above, if the estimated costs changed to 90% from 80% because of projected cost overruns, this would then reduce the gross margin percentage to 10% from 20%. Management attempts to recognize losses (over runs of cost estimates) as soon as they can be quantified. Management attempts to recognize gains (under runs of cost estimates) when they can be quantified and are certain.

Allowance for Doubtful Accounts. The allowance for doubtful accounts is accrued each month and is analyzed at the end of the year for adequacy. A careful analysis is made of each customer and each situation, along with the lien right and bond rights. Any adjustments are made at the end of the year.

IBNR Estimates for Health Insurance. Incurred but not reported (IBNR) is an estimate of claims to be processed and paid after year-end, even though the claims were actually incurred prior to year-end. The company has historically estimated the IBNR based on the first three months of the year in question.

Results of Operations for Nine Months Ended September 30, 2006 and 2005

Revenues

ISI had revenues of \$41.2 million and \$28.4 million for the nine months ended September 30, 2006 and 2005, respectively, representing an increase of \$12.8 million, or 45%. As discussed below, revenues have increased across ISI's primary business segments.

ISI-Detention

Revenues were \$14.7 million for the nine months ended September 30, 2006, or 81% higher than 2005. ISI-Detention is largely a construction driven-business. Much of its revenues are generated by working on new and retrofit construction projects in the corrections industry, as opposed to relying on repeat customers as a source of recurring revenue. The increase in revenue is largely attributable to ISI-Detention participating in a greater number of new long term projects in 2005 than it did in 2004. Better market conditions, increased marketing efforts and new products and services provided by ISI-Detention were all factors in ISI-Detention's ability to compete and secure new projects in 2005. Fluctuation in revenues results from repeat customers that do not typically have the ability to increase spending on goods and services provided by ISI-Detention, and in certain instances have decreased spending. ISI-Detention must engage in aggressive marketing efforts to add new customers to increase revenues, while continuing to provide services to maintain its current customer base.

MCS-Detention

Revenues were \$9.9 million for the nine months ended September 30, 2006 and \$7.3 million for the nine months ended September 30, 2005. This represents an increase of 36% in revenue. MCS-Detention generates much of its revenue by working on new and retrofit construction projects in the corrections industry, as opposed to relying on repeat customers as a source of recurring revenue. The increase in revenue is largely attributable to MCS-Detention participating in a greater number of new projects due to better market conditions, increased marketing efforts, new products, and services. In addition, because MCS-Detention sells its products and services to certain of ISI-Detention's

competitors, it has a larger group of potential customers than other companies in its industry. The improved market conditions, marketing efforts, new products and services, in combination with increased sales to ISI-Detention and the sale of products and services to competitors, resulted in MCS-Detention's increase in revenues for the period.

MCS-Commercial

Revenues from the MCS-Commercial segment were \$16.6 million for the nine months ended September 30, 2006 and \$13.0 million for the nine months ended September 30, 2005. This represents a \$3.6 million, or 28%, increase. A significant portion of the increase is due to the acquisition of Instant Photo, Inc. in November 2005. The Instant Photo revenues contributed approximately \$1.5 million to revenue. The Instant Photo revenue was made up of approximately \$1 million in additional service revenue primarily from photo ID equipment, and approximately \$500,000 in access control related contract revenue.

Expenses

ISI had cost of goods sold of \$32.6 million for the nine months ended September 30, 2006 and \$22.7 million for the nine months ended September 30, 2005. This is an increase of \$9.9 million or 44%. Gross margin percentage was 21% for the nine months ended September 30, 2006 and 20% for the nine months ended September 30, 2005.

ISI-Detention

The cost of goods sold for the nine months ended September 30, 2006 was \$11.8 million and \$6.1 million for the nine months ended September 30, 2005, which is an increase of \$5.7 million or 93%. This increase is due to increased sales of products resulting from a greater number of new construction projects during the period. The gross margin percentage decreased to 20% for the nine months ended September 30, 2006, which was down from 25% for the same period for 2005.

The reduction in gross margin percentage was the result of several factors. (1) ISI management determined that to reduce margins to be more competitive it would have to increase its sales at a lower margin. Since the corrections construction work was decreasing nationally, to remain competitive, ISI sold a larger percentage of work at a reduced margin. (2) ISI sold some projects with large turnkey vendors that allow for less risk. These projects earn lower margins than other projects. Some of the projects ISI completed during this period would be classified as such projects, which reduced gross margin. (3) From time to time, ISI completed work for less than the initial estimated cost. This occurred in September, 2005, to a greater degree than in September, 2006. Therefore, the margin in September, 2005 was higher because the cost of sales was less.

MCS-Detention

The cost of goods sold for the nine months ended September 30, 2006 was \$7.4 million, an increase of \$2.2 million from the \$5.2 million reported in the same period for 2005. The gross profit percentage was 25% for the nine months ended September 30, 2006 as compared to 28% for the same period in 2005. The reduction in gross profit margin resulted from an increase in production costs on the backlog of work that was sold in prior years.

MCS-Commercial

The cost of goods sold for the nine months ended September 30, 2005 was \$13.4 million, an increase of \$2 million from the \$11.4 million in the same period for 2005. The gross profit percentage was 19% for the nine months ended September 30, 2006, as compared to 13% for the same period in 2005. The increase in gross profit margin resulted from a change in estimating procedures that raised MCS -Commercial's estimated cost of performance to more accurate levels and increased service revenues, which carry a higher gross profit margin. The change in estimating was accomplished through initiating an operations pre-bid review process, changing labor rates and standards and adding commissions to the cost of sales. MCS-Commerical continues to estimate using this enhanced procedure at this time.

Selling, General and Administrative Expenses.

Selling, general and administrative expenses for ISI were \$6.2 million for the nine months ended September 30, 2006, an increase from \$4.9 million for the same period of 2005. The increase is primarily due to additional administrative needs of ISI due to the overall increase in business.

ISI-Detention

Selling, general and administrative expenses were \$2.5 million for the nine months ended September 30, 2006, an increase of \$.4 million or 19% from \$2.1 million for the same period of 2005. The increase is primarily due to additional administrative needs as a result of the growth in ISI-Detention business.

MCS-Detention

Selling, general and administrative expenses were \$1.2 million for the nine months ended September 30, 2006 and \$1.1 million for the same period of 2005. Significant additional expense was not required to support the 36% increase in revenue.

MCS-Commercial

Selling, general and administrative expenses for were \$2.5 million for the nine months ended September 30, 2006 and \$1.6 million for the same period of 2005. This is an increase of \$.9 million or 56%. This increase resulted from higher levels of marketing, sales and training expenses.

Interest Expense

Interest expense for ISI was \$2.8 million for the nine months ended September 30, 2006, an increase of \$.4 million or 17% from \$2.4 million for the same period of 2005.

Income Tax

As a result of the above, there was a small income tax provision of \$10,000 for the nine months ended September 30, 2006, as compared to an income tax benefit of \$.5 million for the nine months ended September 30, 2005.

Net Loss

ISI reported a net loss of \$0.4 million for the nine months ended September 30, 2006 as compared to a net loss of \$1.1 million for the same period of 2005. Weighted average number of shares outstanding, basic and diluted, for September 30, 2006 was 104.91, and for September 30, 2005 was 104.91. Income (Loss) per share, basic and diluted, for September 30, 2006 was \$(3,606.03) and for September 30, 2005 was \$(10,778.78).

Results of Operations for Years Ended December 31, 2005 and 2004

Revenues

ISI had revenues of \$39.2 million and \$40.1 million for the years ended December 31, 2005 and December 31, 2004, respectively, representing a decrease of \$.9 million or 2%. As discussed below, the decrease occurred primarily due to reduced revenues at ISI-Detention, which was partially offset by increased revenue from MCS-Commercial.

ISI-Detention

Revenues were \$11.0 million for the year ended December 31, 2005, a decrease of \$3.8 million from the \$14.8 million recorded for the year ended December 31, 2004. ISI-Detention is largely a construction driven business. A significant portion of its revenues is obtained by working on new and retrofit construction projects in the corrections industry, relying on repeat customers as a source of recurring revenue. The decrease is the result of slow bidding periods for ISI-Detention for new projects. Although the gross amount of construction in the corrections area remained relatively flat between 2004 and 2005, the types of projects that ISI-Detention solicits, namely large-scale medium to maximum security installations, declined significantly in 2004 and 2005. This situation was further compounded by the general state and local governmental budget deficits which caused these governmental units to rethink and delay many of their pending corrections projects.

MCS-Detention

Revenues were \$10.9 million for the year ended December 31, 2005 and \$11.0 million for the year ended December 31, 2004. This represents a decrease of 1%. The factors that affected ISI-Detention's revenues during 2004 and 2005, also had a negative impact on revenues for MCS-Detention. MCS-Detention has many repeat customers that stay in the correctional construction marketplace. As these customers develop and complete projects, they purchase goods from MCS-Detention. However, each project is under a separate contract. MCS-Detention does not have the benefit of recurring revenue, such as maintenance contracts that are renewable or several years long. Once a contract is complete, there is no additional revenue stream from that contract that could be regularly renewed over a significant time.

MCS-Commercial

Revenues from were \$17.3 million for the year ended December 31, 2005 and \$14.4 million for the year ended December 31, 2004. This \$2.9 million dollar increase in revenues was primarily attributable to an increased sales staff, and the acquisition of CTS. Management's decision to hire additional sales staff to increase marketing for sales at MCS-Commercial was in response to the slowdown in business at ISI-Detention. In analyzing the backlog spread management perceived a decline in revenues at ISI-Detention, To offset this decline in revenues for ISI, management increased sales efforts in the commercial security sector, which showed strong market potential.

Expenses

ISI's cost of good sold of \$30.9 million for the year ended December 31, 2005 increased \$0.3 million or 1% from \$30.6 million during the same period of 2004. Gross margin percentage was 21% for December 31, 2005 and 24% for December 31, 2004. The decrease in this percentage was caused primarily by the reallocation of sales commissions to cost of sales.

The reallocation of the sales commissions to cost of sales was the result of management's decision to change the way the company estimates costs of a project when bidding. Prior to 2005, the commissions were deducted from estimated gross margin that was added onto a project once the costs were determined. Beginning in 2005, and forward,

management changed the estimating procedures and included sales commissions in the estimated costs of sales. As a result this added additional costs to a project in the estimating phase, which has resulted in an increase in gross margin percentages, since the commissions are not expensed out of the gross margin, but are accounted for in the project before bidding. This reallocation has significantly helped the MCS-Commercial division to increase its earnings in gross dollars and in percentages.

ISI-Detention

The cost of goods sold was \$8.7 million for the year ended December 31, 2005, compared to \$11.6 million for the same period in 2004. This decrease was a result of the overall reduction in business and is consistent with the decrease in ISI-Detention revenues for the same period.

MCS-Detention

The cost of goods sold for MCS-Detention was \$7.3 million for the year ended December 31, 2005 and \$7.5 million for the year ended December 31, 2004, a decrease of \$0.2 million or 3%. The gross margin percentage for MCS-Detention for the 12 months ended December 31, 2005 of 32% was consistent with 2004 results.

The cost of goods for MCS-Detention was flat from 2004 to 2005, even though ISI-Detention revenues decreased. Typically in the past, MCS-Detention revenues have fluctuated in almost direct relationship to the fluctuation in revenues of ISI-Detention, since ISI-Detention is such a large customer of MCS-Detention. However, management's implemented a strategy to increase MCS-Detention's revenue by hiring additional sales staff to sell to third parties, including to competitors of ISI-Detention, resulted in stable revenue and cost of sales, rather than a dip, as occurred at ISI-Detention.

MCS-Commercial

The cost of goods sold was \$14.9 million for the year ended December 31, 2005 and \$11.6 for the year ended December 31, 2004, a difference of \$3.3 million or a 28% increase. This increase was primarily due to increased sales. The gross margin percentage for the 12 months ended December 31, 2005 was 14% as compared to 20% for the 12 months ended December 31, 2004. This decrease was due primarily to the reallocation of sales commission cost to cost of sales from selling, general and administrative expenses. The reallocation of sales commissions was due to a change in the estimating procedure, which allowed MCS-Commercial to match costs to the way a project was estimated. Additionally, upon review of MCS-Commercial projects that were partially completed in 2004, management found that there were significant costs yet to be incurred that had not been estimated correctly in 2004. Accordingly, management revised the percentage completions in the year 2005, which also reduced the gross margin percentage in 2005.

Selling, General and Administrative Expenses

Selling, general and administrative expenses for ISI were \$6.9 million for the year ended December 31, 2005, an increase of \$0.4 million, from \$6.5 million for the same period of 2004. There was an additional special management bonus of \$5.2 million in the year ended December 31, 2004. This special bonus was incurred during the recapitalization of ISI in October 2004.

ISI-Detention

Selling, general and administrative expenses were \$2.9 million for the year ended December 31, 2005, an increase of \$0.6 million from \$2.3 million for the same period of 2004. This change was primarily the result of increased marketing and sales efforts which led to increased sales in 2006.

MCS-Detention

Selling, general and administrative expenses were \$1.7 million for the year ended December 31, 2005, an increase of \$0.4 million or 31 % from \$1.3 million for the same period of 2004. This increase was the result of additional sales and marketing efforts which led to increased sales in 2006.

MCS-Commercial

Selling, general and administrative expenses were \$2.2 million for the year ended December 31, 2005, a decrease of \$0.7 million or 24% from \$2.9 million for the same period of 2004. This decrease occurred because sales commissions were reallocated to cost of sales and significant cost cutting actions were taken to reduce overall selling, general and

administrative costs.

MCS-Commercial had an operating loss of \$164,000 for the year ended December 31, 2004. Management was not happy with the performance of this segment at the time, and used 2005 as a readjustment and reorganization year which included hiring a new direct manager for MCS-Commercial. Significant overhead was reduced, estimating procedures were changed, and several mid-level and lower-management were outplaced and assessed. These were all directives that management put in place to renew the profitability of this business segment. All of these actions produced the significant decrease in the SG&A expenses for MCS-Commercial.

69

Interest Expense

Interest expense for ISI was \$3.2 million for the year ended December 31, 2005, an increase of \$2.4 million from \$0.8 million for the same period of 2004. This increase was due to ISI entering into a subordinated mezzanine debt instrument and a warrant agreement in connection with the recapitalization of ISI in October 2004.

Income Tax

As a result of the above, the \$0.5 million tax benefit for the year ended December 31, 2005 was approximately \$0.4 million lower than the benefit in 2004. The tax benefit in 2005 was primarily attributable to the increased interest expense, and in 2004, primarily attributable to the special management bonus.

Net Loss

ISI reported a net loss of \$1.2 million for the year ended December 31, 2005 and a net loss of \$2.0 million for the year ended December 31, 2004. The weighted average number of shares outstanding, basic and diluted, for December 31, 2005 was 104.91, and for December 31, 2004 was 104.91. Income (Loss) per share, basic and diluted, for December 31, 2005 was \$(11,281.12) and for December 31, 2004 was \$(19,512.47).

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

Revenues

ISI had revenues of \$40.1 million and \$34.7 million for the years ended December 31, 2004 and December 31, 2003, respectively, representing an increase of \$5.4 million or 16%.

ISI-Detention

Revenues were \$14.8 million for the year ended December 31, 2004, an increase of \$1.6 million or 12% from the \$13.2 million earned in 2003. ISI-Detention is largely a construction driven business. Much of its revenues are obtained by working on new and retrofit construction projects in the corrections industry, as opposed to relying on repeat customers as a source of recurring revenue. The increase in revenues experienced by this segment is largely attributable to its greater participation in such projects. Revenue from backlog at the beginning of January 2003, was approximately \$18 million. In January 2004, the backlog was approximately \$23 million. This increase in backlog directly affected the increase in the revenue from 2003 to 2004.

MCS-Detention

Revenues were \$11.0 million for the year ended December 31, 2004 and \$8.0 million for the year ended December 31, 2003. This represents an increase of 38% in revenues. MCS-Detention generates much of its revenue by working on new and retrofit construction projects in the corrections industry, as opposed to relying on repeat customers as a source of recurring revenue. The increase in revenues experienced by this segment is largely attributable to greater participation in projects than in the previous year. Revenue from backlog at January 2003, was approximately \$8.4 million, as compared to approximately \$12.1 million at January 2004. This increase in backlog from 2003 to 2004, corresponds to the increase in revenues between these two years.

MCS-Commercial

Revenues for MCS-Commercial were \$14.4 million for the year ended December 31, 2004 and \$13.5 for the year ended December 31, 2003. This represents a \$0.9 million increase in revenues, or an increase of 7%.

Expenses

ISI's cost of goods sold of \$30.5 million for the year ended December 31, 2004 increased by \$5.4 million or 22% from \$25.1 million during the same period of 2003. Gross margin percentage was 24% for the year ended December 31, 2004 and 28% for the year ended December 31, 2003.

ISI-Detention

The cost of goods sold of \$11.6 million for the year ended December 31, 2004 increased \$2.1 million or 22% from \$9.5 million during the same period of 2003. The gross margin decreased to 22% for the 12 months ended December 31, 2004 as compared to 28% for the 12 months ended December 31, 2003, primarily as a result of pricing pressure within the industry. Gross margin declined from 28% in 2003, to 22% in 2004 as a result of ISI completing some projects under budget. In addition, the average gross margin in the backlog at the beginning of 2003, was higher than the average gross margin of the backlog at the beginning of 2004.

MCS-Detention

The cost of goods sold was \$7.5 million for the year ended December 31, 2004 and \$5.4 million for the year ended December 31, 2003, an increase of \$2.1 million or 39%. The gross margin percentage reduction from 39% in 2003, to 32% in 2004, was primarily due to MCS-Detention reducing the gross margin in its project pricing. Management determined that it was necessary to reduce the price of projects being bid, in order to generate revenues from additional work that was needed to cover fixed costs.

MCS-Commercial

The cost of goods sold was \$11.6 million for the year ended December 31, 2004 and \$10.1 million for the year ended December 31, 2003, a difference of \$1.5 million or a 15% increase. The gross margin for the year ended December 31, 2004 was 20% as compared to 25% for the year ended December 31, 2003. The decrease in the gross margins was primarily due to estimated cost overruns from significant work that had been sold in 2003 and was completed in 2004.

Selling, General and Administrative Expenses

Selling, general and administrative expenses for ISI were \$6.5 million for the year ended December 31, 2004, an increase of \$0.2 million or 3% from \$6.3 million for the same period of 2003. There was an additional special management bonus of \$5.2 million in the year ended December 31, 2004. This special bonus was incurred during the recapitalization of the company in October 2004.

ISI-Detention

Selling, general and administrative expenses were \$2.3 million for the year ended December 31, 2004, as compared to \$2.2 million for the same period of 2003. During the period ended December 2004, management decided not to add any significant costs to overhead, especially in the area of sales expense, since they saw that there were fewer new correctional projects to be sold in the corrections market at that time. Therefore, the general administrative expenses did not go up.

MCS-Detention

Selling, general and administrative expenses were \$1.3 million for the year ended December 31, 2004, as compared to \$1.2 million for the same period of 2003. During the period ended December 2004, management decided not to add any significant costs to overhead, especially in the area of sales expense, since they saw that there were fewer new correctional projects to be sold in the corrections market at that time. Therefore, the general administrative expenses did not go up.

MCS-Commercial

Selling, general and administrative expenses were \$2.9 million for the years ended December 31, 2004 and 2003.

Interest Expense

Interest expense for ISI was \$0.8 million for the year ended December 31, 2004. There was no significant interest expense in 2003. The 2004 interest expense is the result of the debt incurred in 2004 associated with the recapitalization of ISI.

Income Tax

As a result of the above, a tax benefit of \$0.9 million was recorded in 2004 as compared to an expense of \$1.2 million in 2003. The tax benefit in 2004 was primarily due to the interest expense on debt and the special management bonus described above.

Net Loss

ISI reported a net loss of \$2.0 million for the year ended December 31, 2004 and a net income of \$2.1 million for the year ended December 31, 2003. The weighted average number of shares outstanding, basic and diluted, for December 31, 2004 was 104.91, and for December 31, 2003 was 100.00. Income (Loss) per share, basic and diluted, for December 31, 2004 was \$(19,512.47), and for December 31, 2003 was \$20,817.48.

Liquidity and Capital Resources

ISI's primary liquidity needs are for financing working capital and purchase of computers and related equipment. The nature of its business and operations as a detention contractor causes cash flow from operations to be highly volatile. Its large construction contracts can produce or consume cash. The production or consumption of cash is dependent on factors inherent to the construction industry including billing and payment terms of the contracts. ISI has in place a credit facility to allow it to manage its cash flows. ISI expects it will generate sufficient cash flow from operations, supplemented from borrowings on its credit facility, as needed to meet its normal working capital and capital expenditure requirements for at least the next 12 months.

The major liquidity components of ISI's cash flow relate to several of the sources and uses of cash and material changes.

As would be expected, net income after interest payments and tax payments is the first source of liquidity for the company. However, this income is reduced by interest accretion on the warrants. This interest accretion is a non-cash item which has reduced net income and must be added back as a source of funding.

Since the company has a continued pattern of increased growth, receivables have increased in the past years. These receivables are determined to be a use of working capital as they increase; however, as the volume of the business increases, accounts payable also increase on contract terms which allows the receivables increase to be offset and the increase in payables to increase working capital.

Cost and estimated earnings in excess of billings on incomplete contracts and billings in excess of cost and estimated earnings on incomplete contracts are items of ISI's sources and uses of cash that relate to billing practices and cost incurred on contracts. For example, if a project has costs incurred that are required to complete an MCS-Detention head-end system and these costs cannot be billed until the system is complete, this necessitates a use of cash to fund this cost until the equipment is completed so that billing can be made to the customer. Conversely, if a project has a schedule of values which allows billing for a line item where the cost incurred is much less than the comparative revenue, this excess billing over the revenue is a source of cash which can be used in financing operations.

Supplemental disclosures of cash flow, including cash paid for interest is a use of cash, the majority of which is primarily related to the long term borrowings.

Cash and working capital. The following table sets forth ISI's cash and working capital, defined as current assets less current liabilities, as of December 31, 2004 and 2005 and September 30, 2006, respectively:

	December 31, 2004	December 31, 2005	September 30, 2006
		(in thousands)	
Cash and cash equivalent	\$ 1,308	\$ 416	\$ 254
Working capital	5,230	5,523	6,395

ISI considers cash and liquid investments with maturities of three months or less to be cash equivalents. ISI maintains minimal cash balances and has substantially all available cash credited against its borrowings under its line of credit.

Credit facility. As of September 30, 2006, ISI had a line of credit with LaSalle Bank, N.A. In December 2006, ISI amended its credit facility to increase its line of credit to \$9 million and extend the maturity date of the line of credit to October 21, 2008. The line of credit is secured by all tangible and intangible assets of ISI, excluding vehicles. The line of credit requires all accounts receivable collections to be deposited directly into a lockbox. Interest is payable quarterly and is calculated at the lender's base rate (greater of prime or federal funds rate) plus 0.5%, or 350 basis

points in excess of LIBOR for the applicable period. The outstanding balance of the line of credit, which is recorded as a long-term liability, as of December 31, 2004 and 2005 and September 30, 2006, was \$4,429,335, \$4,450,850 and \$4,662,850, respectively. The agreement contains restrictive and affirmative covenants as well as the following financial covenants:

- ISI shall have a fixed charge ratio of not less than 1.10:1.00 based on the trailing 12 months.
- ISI shall have a senior cash flow leverage ratio of more than 1.75:1.00 based on the trailing 12 months.
- ISI shall not make capital expenditures during any fiscal year in excess of \$500,000.
- ISI shall not incur purchase money indebtedness during any fiscal year in excess of \$200,000.

In January 2006, ISI was not in compliance with the fixed charge ratio. However, under the terms of the line of credit agreement, ISI had a period of 30 days to cure such non-compliance. Since ISI regained compliance with the covenant with respect to its February 2006 financial statements, no violation occurred.

Subordinated debt. Gross proceeds of \$15,300,000 were received from a subordinated lender in 2004. Of such gross proceeds, \$11,335,104 was allocated to debt and \$3,964,896 was allocated to a common stock warrant, which granted the subordinated lender the right to acquire 30% of ISI stock for approximately \$310,000 based on an assessment of fair values. Additional funds totaling \$651,609 were advanced in 2005. The gross proceeds of \$15,951,609 is due and payable in one payment in October 2011. The debt discount of \$3,964,896 is being accreted as interest expense over the life of the debt. Interest is payable quarterly and is computed on the gross proceeds, non-discounted, at a rate of 11.58%. The financial statement balance of the subordinated debt as of December 31, 2004 and 2005 and September 30, 2006 was \$11,445,240, \$12,757,665 and \$13,275,777, respectively. The subordinated notes are unsecured, contain restrictive and affirmative covenants as well as the following financial covenants:

ISI shall not make capital expenditures during any fiscal year in excess of \$600,000.

ISI shall have a fixed charge coverage ratio of not less than 1.00 to 1.00.

ISI shall have a leverage ratio of not more than 2.00 to 1.00.

Operating cash flows. Net cash used in operations was \$0.7 million and \$0.1 million for the year ended December 31, 2005 and nine months ended September 30, 2006, respectively. Net cash used in operations is attributable to a net loss of \$1.2 million and \$0.4 million for the year ended December 31, 2005 and nine months ended September 30, 2006, respectively, adjusted by the following non-cash items included in net income and the following working capital changes:

	Year Ended December 31, 2005	Nine Months Ended September 30, 2006
	(in thousands)	
Non-cash items:		
Interest accretion and fair value adjustment of stock warrants	\$ 920	\$ 902
Depreciation and amortization of property and equipment	1,004	498
Deferred income taxes	(78)	—
Working capital charges which contributed to cash used in operations:		
(Increase) Decrease in assets:		
Contracts and other receivables	\$ (2,677)	\$ (8,330)
Inventory	(454)	31
Refundable income taxes	531	(169)
Costs and estimated earnings in excess of billings on incomplete contracts	(681)	(1,386)
Deposits and other assets	(9)	—
Increase (Decrease) in liabilities:		
Accounts payable and accrued liabilities	2,241	5,387
Billings in excess of costs and estimated earnings on incomplete contracts	(298)	3,378

Accounts Receivable. ISI's accounts receivable has historically varied greatly between accounting periods due to various factors. The fluctuation in accounts receivable is the result of billings that are "lumpy", collection periods that vary greatly between contracts, and the fact that ISI's revenues are not based on billing, but rather based on the percent complete of each project. The accounts receivable balance is based on billing to the customers and cash collected. These amounts can vary greatly with the difference showing up on the balance sheet as Cost and estimated earnings in excess of billings on incomplete contracts *or* billings in excess of cost and estimated earnings on incomplete contracts.

Allowance for doubtful accounts. The allowance for doubtful accounts is accrued each month and is analyzed at the end of the year for adequacy. A careful analysis is made of each customer and each situation along with the lien right and bond rights. Any adjustments are made at the end of the year. At December 31, 2005, an adjustment was made to increase the allowance for doubtful accounts due to the uncertainty of three customers. In June of 2006, the three customers were deemed uncollectible and charged off against the reserve. The decrease in allowance for doubtful accounts as of September 2006 was due to the chargeoff of accounts receivable totaling \$228,107 deemed uncollectible in June 2006. The chargeoff was concentrated among three customers, which accounted for \$179,163 of the total amount written off. In prior years, the amount of the chargeoff was \$42,900 and \$38,221 for 2004 and 2005, respectively.

Backlog. Based on the percentage of completion method of accounting utilized by ISI, each project has an amount referred to as "earned gross margin" and "earned revenue" for the total contract. The earned revenue and the amount of earned gross margin are subtracted from the total contract amount and the total estimated gross margin. The net difference is the backlog available for each project. The total of these sums for all projects makes up the amount of total backlog. Each business segment is totaled together to calculate the total backlog for the company. The company is unaware of any projects in the backlog that are not funded. Historically, the company has not removed any projects due to the lack of funding. Approximately 84% of the backlog at the end of December 31, 2004 was turned into revenues in 2005. Due to the make up of the backlog, the percentage of turnover each year can vary, due to such factors as contracts that are fast tracked as opposed to contracts that are phased in over time. Also, the product mix of contracts can vary over the time required to complete them.

Investing activities. Cash flow from investing activities relate to leasehold improvements and other expenses on property, plant and equipment. Net cash used in investing activities was \$766,867 and \$345,613 for the year ended December 31, 2005 and nine months ended September 30, 2006, respectively. Net cash used in investing activities is primarily related to purchases of property and equipment.

Financing activities. Cash flows from financing activities relate to the net change in terms of banking arrangements, both short term and long term. As described, the line of credit and long term borrowings increased to fund primarily a stockholder distribution in the year 2004. The stockholder distribution consisted of proceeds taken by the shareholders of the company at that time. Net cash provided by financing activities was \$558,515 and \$250,513 for the year ended December 31, 2005 and the nine months ended September 30, 2006, respectively. Cash provided by financing activities primarily related to additional long-term borrowings in 2005 and additional line of credit borrowings in 2006. In the fourth quarter of 2005, ISI entered into a long term debt instrument in the aggregate principal amount of \$15,300,000 and increased its line of credit facility to \$6,000,000. The proceeds of this new debt were used to distribute dividends of approximately \$16.9 million to its existing shareholders.

Non-cash Investing and Financing Activities. The consolidated statements of cash flows do not reflect the following non-cash investing and financing activities:

- Direct financing of \$118,551 was used for the purchase of equipment and vehicles during the year ended December 31, 2005 (\$136,099 in 2004).
- Debt totaling \$1,544,095 was assumed by a partnership owned by the Company's stockholders during the year ended December 31, 2004.

- Goodwill of \$15,913 was funded by the issuance of 2.2 shares of common stock during the year ended December 31, 2004.
- Direct financing of \$220,335 was used for the purchase of vehicles during the year ended December 31, 2003.
- Direct financing of \$624,950 was used for the addition of the new facilities during the year ended December 31, 2003.

Acquisition by Argyle. ISI's acquisition by Argyle is expected to be consummated in the first half of 2007, assuming that Argyle's stockholders approve the acquisition. If the acquisition is consummated, and ISI can provide no assurance that the acquisition will be consummated, the ISI line of credit will remain in place, and the debt to the subordinated lender will be reduced to \$5,951,609, with an anticipated due date of 18 months after the closing of the transaction.

Although projects vary in size and duration, ISI's management believes that its backlog of orders is a key indicator of how future revenues will trend. Historically, over 90% of ISI's revenues have been generated from the backlog. The following table shows ISI's backlog of orders at the end of the periods shown:

Date	ISI Backlog					
	ISI Detention	MCS Detention	MCS Commercial	Consolidated ⁽¹⁾	Intercompany Elimination	Backlog
12/31/2003	\$ 15,026,143	\$ 10,085,849	\$ 6,646,742	\$ 31,758,733	\$ (5,042,596)	\$ 26,716,137
12/31/2004	14,308,348	6,829,299	8,870,082	30,007,729	(4,166,421)	25,841,308
9/30/2005	37,011,837	16,870,344	7,667,101	61,549,283	(9,305,791)	52,243,492
12/31/2005	33,522,159	14,697,586	9,410,114	57,629,859	(12,190,414)	45,439,445
9/30/2006	47,402,373	18,984,696	9,429,238	75,816,308	(10,769,159)	65,047,149

(1) The February 28, 2006 Backlog as defined in the merger agreement will be calculated on this column before intercompany eliminations. This is consistent with past practices.

Based on ISI's percentage of completion method of accounting, each project has an amount that is earned in gross margin and revenue with regard to the total contract. This amount of revenue earned to date and the amount of gross margin earned to date are subtracted from the total contract amount and the total estimated gross margin. The net difference is the backlog available for each project. The total for all projects makes up the total backlog. Each business segment is totaled together to calculate the total backlog for the company.

The company is unaware of any projects in the backlog that are not funded or incrementally funded. ISI does not record in its backlog any ID/IQ or Option year contracts. Historically, ISI has not removed any projects due to the lack of funding.

Contractual Obligations and Commercial Commitments. ISI has various contractual obligations that will affect its liquidity. The following table sets forth the contractual obligations of ISI as of September 30, 2006:

Contractual Obligations	Total	Payments due by period			
		Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-Term Debt Obligations	\$ 18,254	\$ 80.8	\$ 288.3	N/A	\$ 17,884.9
Capital Lease Obligations	\$ 271.1	\$ 33.6	\$ 237.5	N/A	N/A
Operating Lease Obligations	\$ 154.1	\$ 10.3	\$ 113.9	\$ 21.1	\$ 8.8
Purchase Obligations	N/A - none				
Other Long-Term Liabilities Reflected on the Registrant's Balance Sheet under GAAP	\$ 4,820	-	-	-	\$ 4,820
Total	23,499.2	124.7	639.7	21.1	22,713.7

Off-Balance Sheet Arrangements

ISI does not have any off-balance sheet arrangements.

Quantitative and Qualitative Disclosures about Market Risk

ISI's exposure to market risk primarily relates to changes in interest rates for borrowings under its line of credit. Borrowing under this line of credit accrue interest at a variable rate. Based upon ISI's borrowings under the facility in 2005, a hypothetical 10% increase in interest rates would have increased interest expense by approximately \$34,000 and would have decreased annual cash flow by a comparable amount.

75

INFORMATION ABOUT ARGYLE

Argyle's History and Business Plans

Argyle Security Acquisition Corporation is a Delaware corporation that was incorporated on June 22, 2005 in order to serve as a vehicle for the acquisition of an operating business through a merger, capital stock exchange, asset acquisition or other similar business combination. To date, Argyle's efforts have been limited to organizational activities, completion of its initial public offering and the evaluation of possible business combinations. Argyle does not currently have any operations.

On January 24, 2006, Argyle completed a private placement of 125,000 units to Ron Chaimovski, one of its Co-Chief Executive Officers, and Argyle New Ventures, LP, an entity controlled by Bob Marbut, Argyle's other Co-Chief Executive Officer, and received net proceeds of \$892,500. On January 30, 2006, Argyle consummated its initial public offering of 3,700,046 units (which includes 75,046 units sold as part of the underwriter's over-allotment option). Each unit in both the private placement and the public offering consisted of one share of common stock and one redeemable common stock purchase warrant. Each warrant entitles the holder to purchase from Argyle one share of Argyle's common stock at an exercise price of \$5.50. Argyle's common stock and warrants started trading separately as of March 2, 2006.

The net proceeds from the sale of Argyle's units, after deducting certain offering expenses of approximately \$2,387,706, including underwriting discounts of approximately \$1,836,022, were approximately \$28,212,662. Approximately \$27,344,346 of the proceeds from the initial public offering and the private placement was placed in a trust account for Argyle's benefit. Except for \$600,000 in interest that was earned on the funds contained in the trust account and that was released to Argyle to be used as working capital, and the amounts that may be released to Argyle for the payment of taxes, Argyle is not be able to access the amounts held in the trust until it consummates a business combination. The trust account also contains \$1,377,016 of the compensation of Argyle's underwriters in its initial public offering which will be paid to them only in the event of a business combination. The amounts held outside of the trust account are being used by Argyle to provide for business, legal and accounting due diligence on prospective acquisitions and continuing general and administrative expenses. The net proceeds deposited into the trust fund remain on deposit in the trust account earning interest. In connection with the initial public offering and the private placement, Argyle's officers and directors placed all the shares owned by them before the private placement and the initial public offering into an escrow account. Except in certain circumstances, the shares held in escrow may not be released prior to January 24, 2009.

The segments of the security industry on which Argyle indicated it would focus in its prospectus relating to its initial public offering included perimeter security (to detect unauthorized entrance or exit to/from the grounds or campus), video surveillance (to monitor all areas of interest with video cameras and to capture images of activity in these areas) and access control (to control physical access to/from facilities or areas within facilities using electronically operated locks controlled by the use of PIN codes, proximity cards, or biometric identification). The security industry was further described as encompassing the development, sale, or distribution of software solutions and equipment components, as well as consulting in the design of said security systems. ISI participates in the perimeter security, access control and video and design consultation segments in the correctional sector through its ISI-Detention and MCS-Detention subsidiaries and in the commercial/industrial/educational sectors through its MCS-Commercial subsidiary. In addition, the MCS-Commercial operation is also engaged in providing its sectors with fire detection security system solutions.

The Initial Public Offering and Trust Account. The funds held in the trust account are not to be released until the earlier of the consummation of a business combination or liquidation of Argyle, although, as noted elsewhere in this proxy statement/prospectus, claims might be made against Argyle as a result of extending the period in which it may complete a business combination in order to avoid liquidation (or in other circumstances not now anticipated by Argyle). The trust account contained approximately \$29,073,971 as of September 30, 2006. If the acquisition is

consummated, the trust account, reduced by amounts paid to stockholders of Argyle who do not approve the acquisition and elect to redeem their shares of common stock into their pro rata shares of net funds in it, will be released to Argyle.

Fair Market Value of Target Business. Pursuant to Argyle's Second Amended and Restated Certificate of Incorporation, the initial target business that Argyle acquires must have a fair market value equal to at least 80% of Argyle's net assets at the time of such acquisition, determined by Argyle's Board of Directors based on standards generally accepted by the financial community, such as actual and potential sales, earnings, cash flow and book value. Argyle is not required to obtain an opinion from an investment banking firm as to fair market value if its Board independently determines that the target business has sufficient fair market value.

Limited Ability to Evaluate The Target Business' Management. Although Argyle closely examined the management of ISI, Argyle cannot assure you that its assessment of ISI's management will prove to be correct, or that future management will have the necessary skills, qualifications or abilities to manage its business successfully. Essentially, all of ISI's current management will remain with the combined company, and will for the most part run its day-to-day operations. Argyle's current Board of Directors will remain directors of Argyle subsequent to the acquisition.

Stockholder Approval of Business Combination. Provided that a quorum exists, Argyle will proceed with the acquisition only if a majority of the shares of common stock voted at the special meeting are voted in favor of the acquisition and holders of shares sold in Argyle's initial public offering, representing no more than 20% of the shares sold in the initial public offering and the private placement, exercise their redemption rights, and if the 2007 Incentive Plan is approved or the Board of Directors of ISI chooses to waive the condition to the merger that the 2007 Incentive Plan be adopted. The holders of Argyle common stock issued prior to its initial public offering have agreed to vote 956,261 of their shares in accordance with the holders of a majority of the public shares voting in person or by proxy at the meeting and have agreed to vote the 125,000 of their shares purchased in the private placement that took place immediately prior to Argyle's initial public offering and all shares acquired after such initial public offering in favor of all of the acquisition. The 125,000 shares that Argyle's initial stockholders will vote in favor of the proposals presented in this prospectus represent 2.6% of Argyle's outstanding shares of common stock. By voting these shares for the merger, Argyle's initial stockholders increase the number of shares held by Argyle's public stockholders that must be voted against the merger proposal to reject the proposal. If holders of 765,009 shares of Argyle's common stock purchased in Argyle's initial public offering (which number represents 20% or more of the shares of Argyle common stock issued in Argyle's initial public offering and private placement) vote against the acquisition and exercise their right to redeem their shares for cash, the acquisition will not be consummated.

If the Acquisition is Not Consummated. If Argyle does not consummate the business combination with ISI, it will continue to seek another target business until it is required to liquidate and dissolve pursuant to its certificate of incorporation. As provided in its Second Amended and Restated Certificate of Incorporation, Argyle is required, by July 30, 2007, to consummate a business combination or enter a letter of intent, agreement in principle or definitive agreement relating to a business combination, in which case Argyle would be allowed an additional six months to complete the transactions contemplated by such agreement. Under its Second Amended and Restated Certificate of Incorporation as currently in effect, if Argyle does not acquire at least majority control of a target business by January 30, 2008, Argyle will dissolve and distribute to its public stockholders the amount in the trust account plus any remaining net assets.

Redemption rights. Each holder of public shares who votes against the acquisition has the right to have his or her public shares redeemed for cash, if the acquisition is approved and completed.

The actual per share redemption price will be equal to the amount in the trust account, inclusive of any interest, as of two business days prior to the consummation of the acquisition, less taxes payable, \$600,000 of interest released to us from the trust account to fund our working capital and the payment of the deferred underwriting fees, divided by the number of shares issued in Argyle's initial public offering and the private placement, which, as of September 30, 2006 would be \$7.20 per share. The redemption amount (approximately \$7.20) is less than the liquidation amount (approximately \$7.84) you would receive if we fail to timely consummate a business combination, since the liquidation amount will include certain amounts held in trust that will not be paid to stockholders upon a redemption, such as the deferred portion of the underwriters' discount from Argyle's initial public offering and the deferred private placement fee proceeds attributable to the units sold in Argyle's private placement that took place immediately prior to its initial public offering. An eligible stockholder may request redemption at the time the vote is taken with respect to the acquisition, but the request will not be granted unless the stockholder votes against the acquisition and the acquisition is approved and completed. Any request for redemption, if made by proxy prior to the date of the special meeting, may be withdrawn at any time up to the date of the meeting. Funds to be distributed to stockholders who elect redemption will be distributed promptly after consummation of the acquisition. Any stockholder who redeems stock into a portion of the trust account still has the right to exercise any warrants to purchase Argyle common stock that he or she owns. Argyle will not complete the acquisition if holders 765,009 or more of shares of Argyle's common stock purchased in Argyle's initial public offering (which number represents 20% or more of the shares of Argyle common stock issued in Argyle's initial public offering and private placement) vote against the acquisition and exercise their redemption rights.

Competition. If the acquisition is completed, Argyle will become subject to competition from competitors of ISI. For more information of the competition ISI faces, please see the section entitled, "Information About ISI—Competition" elsewhere in this document.

Facilities. Argyle maintains executive offices at Concord Plaza, Suite 700, San Antonio, TX 78216. The base rental cost for this space is approximately \$5,500 per month. Argyle considers its current office space adequate for current operations.

Employees

Argyle has two officers. They are not obligated to contribute any specific number of hours per week on Argyle's affairs, and they devote only as much time as they deem necessary to Argyle's affairs. Argyle has no other employees.

Periodic Reporting and Audited Financial Statements

Argyle has registered its securities under the Securities Exchange Act of 1934 and has reporting obligations, including the requirement to file annual and quarterly reports with the SEC. In accordance with the requirements of the Securities Exchange Act of 1934, Argyle's annual report contains financial statements audited and reported on by Argyle's independent accountants.

Legal Proceedings

Argyle is not currently a party to any pending material legal proceedings.

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

The following discussion should be read in conjunction with Argyle's financial statements and related notes thereto included elsewhere in this proxy statement/prospectus.

Forward Looking Statements

The statements discussed in this proxy statement/prospectus include forward looking statements that involve risks and uncertainties, including the risks detailed from time to time in Argyle's reports filed with the Securities and Exchange Commission.

Critical Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates.

Management does not believe that any recently issued, but not yet effective, accounting standards if currently adopted would have a material effect on the accompanying financial statements.

Results of Operations for the Nine-Month Period Ended September 30, 2006

Argyle reported net income of \$71,066 for the nine-month period ended September 30, 2006, before the deduction of \$152,941 of interest income, net of taxes, attributable to common stock subject to possible redemption. Argyle incurred a net loss of \$4,538 for the period from inception (June 22, 2005) through September 30, 2005. Argyle's net income consists of interest earned on the trust account.

Argyle's trust account earned interest of \$952,609 for the nine months ended September 30, 2006 and its funds outside the trust account earned interest of \$11,409. Until Argyle enters into a business combination, it will not generate operating revenues. Argyle had no funds in trust as of September 30, 2005.

For the nine months ended September 30, 2006, Argyle incurred expenses of \$372,008 for consulting and professional fees, \$130,632 for stock compensation, \$108,991 for franchise taxes, \$60,411 for insurance expense, \$44,363 for rental expense pursuant to Argyle's lease of office space and other operating costs of \$92,873.

The consulting and professional fees of \$372,008 for the nine months ended September 30, 2006 relate primarily to monthly consulting fees that, cumulatively, totaled approximately \$216,000, legal fees of approximately \$46,000,

auditing, tax and accounting fees of approximately \$83,000 and bankers' fees and expenses of approximately \$22,000.

On February 1, 2006, Argyle's officers and directors exercised options and purchased 18,761 shares of common stock for an aggregate cost of \$507. The compensation cost associated with these options of \$130,632 was recorded in the first quarter of 2006 and was computed utilizing the Black-Scholes pricing model.

The franchise tax expense of \$108,991 for the first nine months of 2006 is due to the state of Delaware, and the entire amount due for 2006 will be paid in the first quarter of 2007.

The insurance expense of \$60,411 for the first nine months of 2006 relates to the amortization of the pre-paid directors and officers insurance policy which was acquired in January 2006.

The other operating costs of \$92,873 for the first nine months of 2006 relate primarily to travel expenses of approximately \$32,000, computer server hosting expense of approximately \$15,000, communications expenses of approximately \$9,000, stock transfer fees of \$9,000, office supplies and expenses of approximately \$5,000 and other miscellaneous costs of approximately \$23,000.

Results of Operations for the Period from June 22, 2005 (inception) to December 31, 2005

Argyle had a net loss of \$7,743 for the period ended December 31, 2005 as a result of formation and operating costs. Additionally, deferred offering costs of approximately \$295,000 were incurred in 2005. These costs consisted of professional fees of approximately \$203,000, road show and travel expenses of approximately \$25,000, and regulatory and filing fees of approximately \$67,000. Argyle had no income in 2005. Until Argyle enters into a business combination, it will not have revenues and will continue to incur losses due to management's expenses relating to locating a target business to acquire.

Liquidity and Capital Resources

On January 24, 2006, Argyle completed a private placement of 125,000 units to its executive officers and their affiliates and received net proceeds of approximately \$900,000. On January 30, 2006, Argyle consummated its initial public offering of 3,700,046 units (which includes 75,046 units sold as part of the underwriter's over-allotment option). Each unit in both the private placement and the public offering consisted of one share of common stock and one redeemable common stock purchase warrant. Each warrant entitles the holder to purchase from Argyle one share of Argyle's common stock at an exercise price of \$5.50 per share commencing on the later of the completion of a business combination or January 24, 2007 and expiring January 24, 2011. Argyle's common stock and warrants started trading separately as of March 2, 2006.

The net proceeds from the sale of Argyle's units, after deducting certain offering expenses of approximately \$2.4 million, including underwriting discounts of approximately \$1.8 million, were approximately \$28.2 million. Approximately \$27.3 million of the proceeds from the initial public offering and the private placement was placed in a trust account for Argyle's benefit. Except for reimbursement of taxes payable and \$600,000 in interest from the trust account that was released to Argyle in September 2006 for working capital, Argyle will not be able to access the amounts held in the trust until it consummates a business combination. The \$29.1 million held in trust as of September 30, 2006 includes approximately \$1.4 million of underwriter's and placement agent's compensation from Argyle's private placement and initial public offering that will be paid to the underwriters and placement agent only in the event of a business combination. The trust account earned interest income of \$952,609 during the nine months ended September 30, 2006. The amounts held outside of the trust account are available to be used by Argyle to provide for business, legal and accounting due diligence on prospective acquisitions and continuing general and administrative expenses. As of December 31, 2006, Argyle had approximately \$.7 million outside the trust account to fund its working capital requirements.

Argyle expects to use up to approximately \$20.5 million (including Argyle and ISI transaction costs) of the net proceeds of the initial public offering to acquire ISI. After paying off any expenses relating to the identification and evaluation of prospective acquisition candidates, the structuring, negotiation and consummation of the business combination and paying for the redemption of the stock of any of Argyle's stockholders who choose to exercise their redemption rights, any residual proceeds from Argyle's initial public offering will be used by the company as working capital.

Argyle anticipates that it will incur total transaction costs of approximately \$1.3 million. Such costs do not include those transaction costs of approximately \$1.0 million to be incurred by ISI (related primarily to anticipated attorney, brokerage and accounting fees). Of the \$1.3 million of Argyle anticipated transaction costs, approximately \$.4 million relate to certain Giuliani Capital Advisors' advisory fees which are contingent upon the closing of the transaction. Approximately \$.5 million of the \$.9 million in non-contingent anticipated costs had been incurred and recorded as of December 31, 2006. The \$.9 million primarily relates to Loeb and Loeb legal expenses, fees for Giuliani Capital Advisors' fairness opinion, accountants and valuation consultants' fees, road show expenses, printer fees and other miscellaneous expenses. Argyle's cash outside the trust and accrued expenses as of December 31, 2006 was approximately \$.7 million and \$.6 million, respectively. Argyle expects to incur the remaining anticipated non-contingent transaction costs of \$.4 million over the first two quarters of 2007. Additionally, recurring monthly operating expenses of approximately \$75,000 per month will continue to accrue after December 31, 2006, and in January 2007, Argyle renewed its directors and officers insurance policy, incurring a premium of \$88,000.

As a result of the foregoing, Argyle anticipates that the costs to consummate the acquisition will greatly exceed its available cash outside of the trust, and that Argyle will not be able to consummate the merger without receiving additional funds and/or reaching agreements with Argyle's service providers to defer their fees and expenses. Argyle expects these expenses would ultimately be borne by the combined company from the funds held in trust if the proposed ISI acquisition is completed. If it is not, they would be subject to the potential indemnification obligations of

Argyle's officers and directors to the trust account related to expenses incurred for vendors or service providers. If these obligations are not performed or are inadequate, it is possible that vendors or service providers could seek to recover these expenses from the trust account, which could ultimately deplete the trust account and reduce a stockholder's current pro rata portion of the trust account upon liquidation. As of January 31, 2007, Argyle has not entered into any formal arrangements with its professional service providers to defer their fees; however, they anticipate that certain providers may be agreeable to such deferral. Additionally, the officers of Argyle are considering various potential funding mechanisms; however, as of January 31, 2007, no additional financing has been provided or agreements reached.

Upon going public in late January 2006, Argyle has focused its attention on the search for a target business in the security industry. The expense related to this effort is primarily comprised of certain monthly consulting fees paid to parties identified below for the research and investigation of potential target companies, and professional fees and travel expenses associated with targets which are no longer being pursued. Argyle has recorded these expenses as either part of the disclosed consulting and professional fees, or as travel expenses which are classified as other operating costs. The costs directly associated with the ISI acquisition, excluding the recurring monthly consulting fees which are expensed, have been capitalized as transaction costs. Two of Argyle's consultants work exclusively on the research, investigation and targeting of security companies while one of the other consultants spends approximately one-half of his time on acquisitions. Argyle believes that the amounts recorded as expenses associated with its search during 2006 were approximately \$.2 million. Additionally, transaction costs associated with the ISI acquisition of approximately \$.5 million were capitalized during 2006 and approximately \$.4 million of additional non-contingent transaction costs associated with the ISI acquisition are anticipated. In the prospectus related to Argyle's initial public offering, Argyle estimated legal, accounting and other expenses attendant to the structuring and negotiation of a business combination, and the preparation and filing of the related proxy statement of \$.15 million and due diligence of prospective target businesses of \$.225 million. The majority of the difference is related primarily to the cost of a fairness opinion from Giuliani Capital Advisors and legal fees which are accumulating at a higher rate than those estimated in the Form S-1.

Argyle's accrued expenses, as of September 30, 2006, totaled \$166,141. The majority of this total is represented by an accrual to the state of Delaware for franchise taxes in the amount of approximately \$106,000 and accruals for professional fees, associated with attorneys, accountants and bankers and related expenses of approximately \$48,000. The franchise tax and banker fees are not specifically disclosed in the use of proceeds section of Argyle's prospectus related to its initial public offering, but expenses for legal and accounting are disclosed.

Assuming the completion of the ISI acquisition, Argyle will assume approximately \$6.0 million in long term debt, in addition to the \$9.0 million ISI line of credit which had an outstanding balance of approximately \$5.0 million as of December 31, 2006. Additionally, Argyle will assume the capital lease obligation related to ISI's offices in San Antonio, Texas which had a balance of approximately \$2.1 million as of December 31, 2006. At closing, Argyle will pay certain ISI obligations totaling approximately \$1.9 million as of December 31, 2006, relating to ISI*MCS and notes payable to ISI shareholders. Argyle will also assume the current liabilities relating to accounts payable, accrued liabilities and billings in excess of costs and estimated earnings on incomplete contracts.

As of February 1, 2006 Argyle entered into a lease for Argyle's office space in San Antonio, Texas and began to pay a base rental of approximately \$5,500 per month. The lease was originally scheduled to terminate on January 31, 2007; however, it was amended to extend the termination date by six months. In connection with its operations, in March 2006, Argyle paid an outstanding obligation to a consultant for approximately \$53,000 and is currently paying approximately \$24,000 per month in consulting fees for services assisting Argyle in the identification of a target business and with securities compliance. The consulting agreements entered into thus far may be terminated by either party for any reason upon 15 days notice.

Presently, Argyle is utilizing four consultants on a monthly basis. Alan Wachtel and Graham Wallis perform research and investigation of target companies in the security industry and assist in the performance of due diligence on potential acquisition candidates. Cindy Kittrell is the office manager and performs associated administrative functions. Mark Mellin is a financial consultant who assists Argyle in its SEC reporting responsibilities, accounting matters and also assists in the investigation and due diligence of potential acquisition candidates.

Off Balance Sheet Arrangements

Argyle does not have any off-balance sheet arrangements.

UNAUDITED PRO FORMA

CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The following unaudited pro forma condensed consolidated balance sheet combines Argyle's historical balance sheets and those of ISI as of September 30, 2006, giving effect to the transactions described in the purchase agreement as if they had occurred on September 30, 2006. The following unaudited pro forma condensed consolidated statements of operations combine (i) Argyle's historical statement of operations for the nine months ended September 30, 2006 with those of ISI and (ii) Argyle's historical statement of operations from inception (June 22, 2005) to December 31, 2005 with those of ISI for the year ended December 31, 2005, in each case giving effect to the acquisition as if it had occurred on January 1, 2005.

The unaudited pro forma condensed consolidated financial statements have been prepared using two different levels of approval of the transaction by the Argyle stockholders, as follows:

- Assuming Maximum Approval: This presentation assumes that no stockholder exercised their redemption rights
- Assuming Minimum Approval: This presentation assumes that holders of 19.99% of Argyle's common stock exercised redemption rights

Under the purchase method of accounting, the preliminary purchase price has been allocated to the net tangible and intangible assets acquired and liabilities assumed, based upon preliminary estimates. Management estimates that a substantial portion of the excess purchase price will be allocated to non-amortizable intangible assets. These estimates are subject to change upon the finalization of the valuation of certain assets and liabilities.

Argyle is providing this information to aid you in your analysis of the financial aspects of the acquisition. The unaudited pro forma condensed consolidated financial statements described above should be read in conjunction with the historical financial statements of Argyle and ISI and the related notes thereto. The pro forma adjustments are preliminary and the unaudited pro forma information is not necessarily indicative of the financial position or results of operations that may have actually occurred had the acquisition taken place on the dates noted, or Argyle's future financial position or operating results.

Argyle Security Acquisition Corporation

Unaudited Pro Forma Condensed Consolidated Balance Sheet
September 30, 2006
Assuming Maximum Approval

	Argyle	ISI	Pro Forma Adjustments	Pro Forma Combined
Assets				
Cash	\$ 920,429	\$ 254,483	\$ 29,073,971 a	\$ -
	-	-	(20,500,000) c	
	-	-	(1,422,740) e	
	-	-	(2,084,447) g	6,241,696
Cash and cash equivalents, held in trust	29,073,971	-	(29,073,971) a	-
Contract receivables (net of reserve for doubtful accounts of \$264,488)	-	16,694,584	-	16,694,584
Contract receivables - related party	-	4,160,046	-	4,160,046
Other receivables	-	377,098	-	377,098
Prepaid expenses	29,333	-	-	29,333
Inventory	-	324,464	-	324,464
Refundable federal income taxes	-	655,843	-	655,843
Costs and estimated earnings in excess of billings on incomplete contracts	-	4,178,225	-	4,178,225
Total current assets	\$ 30,023,733	\$ 26,644,743	\$ (24,007,187)	\$ 32,661,289
Deferred income taxes	34,442	-	-	34,442
Property and equipment:				
Land and buildings	-	2,645,438	-	2,645,438
Furniture, fixtures and equipment	6,520	2,506,579	-	2,513,099
Vehicles	-	1,767,351	-	1,767,351
	\$ 6,520	\$ 6,919,368	\$ -	\$ 6,925,888
Accumulated depreciation and amortization	(1,075)	(3,195,984)	-	(3,197,059)
Net property and equipment	\$ 5,445	\$ 3,723,384	\$ -	\$ 3,728,829
Other assets:				
Tradename	-	-	4,912,000 c	4,912,000
Customer relationships	-	-	6,905,000 c	6,905,000
Backlog	-	-	2,232,000 c	2,232,000
Software	-	-	300,000 c	300,000
Goodwill	-	1,254,306	(1,254,306) c	
	-	-	23,280,917 c	23,280,917
Loan origination fees, net of accumulated amortization of \$649,815	-	1,008,008	(1,008,008) c	-
Deposits and other assets	-	171,355	-	171,355
Total other assets	\$ -	\$ 2,433,669	\$ 35,367,603	\$ 37,801,272

Total assets	\$	30,063,620	\$	32,801,796	\$	11,360,416	\$	74,225,832
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See notes to unaudited pro forma condensed consolidated financial statements.

Argyle Security Acquisition Corporation

Unaudited Pro Forma Condensed Consolidated Balance Sheet
September 30, 2006
Assuming Maximum Approval

	Argyle	ISI	Pro Forma Adjustments	Pro Forma Combined
Liabilities and stockholders' equity				
Accounts payable and accrued liabilities	\$ 166,141	\$ 11,175,091	\$ 166,000 o	\$ 11,507,232
Accounts payable - related party	-	1,986,056	(1,986,056) g	-
Accrued income taxes	71,926	-	(64,000) o	7,926
Current maturities of long-term debt	-	80,814	-	80,814
Current portion of capital lease obligations	-	95,580	-	95,580
Deferred underwriting costs	1,422,740	-	(1,422,740) e	-
Billings in excess of costs and estimated earnings on incomplete contracts	-	6,912,067	-	6,912,067
Total current liabilities	\$ 1,660,807	\$ 20,249,608	\$ (3,306,796)	\$ 18,603,619
Long-term liabilities				
Line of credit	-	\$ 4,662,850	-	\$ 4,662,850
Long-term debt less current maturities	-	13,510,651	(10,000,000) b	-
	-	-	2,675,832 c	-
	-	-	(98,391) g	6,088,092
Long-term portion of capital lease obligations	-	2,011,705	-	2,011,705
Deferred income taxes	-	255,188	5,524,365 c	5,779,553
Warrants subject to redemption	-	4,819,615	(4,819,615) c	-
Total long-term liabilities	\$ -	\$ 25,260,009	\$ (6,717,809)	\$ 18,542,200
Total liabilities	\$ 1,660,807	\$ 45,509,617	\$ (10,024,605)	\$ 37,145,819
Common stock subject to possible conversion -764,627 shares at \$7.14 per share				
	\$ 5,459,435	-	(5,459,435) d1	-
Deferred interest attributable to common stock subject to possible redemption (net of taxes of \$37,484)	152,941	-	(152,941) d1	-
Stockholders' equity:				
ISI preferred stock	-	-	10,000,000 b	-
	-	-	(10,000,000) c	-
Preferred stock - \$.0001 par value; 1,000,000 shares authorized; 0 shares issued and outstanding	-	-	-	-
	478	-	118 c	596

Common stock - \$.0001 par value;
89,000,000 shares authorized; issued
and outstanding 4,781,307 (including
764,627 shares of common stock
subject to possible redemption)

Common Stock - \$1 par value; 3,000
shares authorized; 105 shares issued
and outstanding

	-	105	(105) c	-
Additional paid in capital	22,726,636	16,808	(16,808) c	
	-	-	8,779,082 c	
	-	-	5,459,435 d1	36,965,153
Retained earnings during the development stage	63,323	-	(63,323) f	-
Accumulated deficit	-	(12,724,734)	12,724,734 c	-
Retained earnings	-	-	152,941 d1	
	-	-	63,323 f	
	-	-	(102,000) o	114,264
Total stockholders' equity	\$ 22,790,437	\$ (12,707,821)	\$ 26,997,397	\$ 37,080,013
Total liabilities and stockholders' equity	\$ 30,063,620	\$ 32,801,796	\$ 11,360,416	\$ 74,225,832

See notes to unaudited pro forma condensed consolidated financial statements.

Argyle Security Acquisition Corporation

Unaudited Pro Forma Condensed Consolidated Balance Sheet
September 30, 2006
Assuming Minimum Approval

	Argyle	ISI	Pro Forma Adjustments	Pro Forma Combined
Assets				
Cash	\$ 920,429	\$ 254,483	\$ 29,073,971 a	\$ -
	-	-	(20,500,000) c	
	-	-	(5,612,376) d2	
	-	-	(1,422,740) e	
	-	-	(2,084,447) g	629,320
Cash and cash equivalents, held in trust	29,073,971	-	(29,073,971) a	-
Contract receivables (net of reserve for doubtful accounts of \$264,488)	-	16,694,584	-	16,694,584
Contract receivables - related party	-	4,160,046	-	4,160,046
Other receivables	-	377,098	-	377,098
Prepaid expenses	29,333	-	-	29,333
Inventory	-	324,464	-	324,464
Refundable federal income taxes	-	655,843	-	655,843
Costs and estimated earnings in excess of billings on incomplete contracts	-	4,178,225	-	4,178,225
Total current assets	\$ 30,023,733	\$ 26,644,743	\$ (29,619,563)	\$ 27,048,913
Deferred income taxes	\$ 34,442	\$ -	\$ -	\$ 34,442
Property and equipment:				
Land and buildings	-	2,645,438	-	2,645,438
Furniture, fixtures and equipment	6,520	2,506,579	-	2,513,099
Vehicles	-	1,767,351	-	1,767,351
	\$ 6,520	\$ 6,919,368	\$ -	\$ 6,925,888
Accumulated depreciation and amortization	(1,075)	(3,195,984)	-	(3,197,059)
Net property and equipment	\$ 5,445	\$ 3,723,384	\$ -	\$ 3,728,829
Other assets:				
Tradenname	-	-	4,912,000 c	4,912,000
Customer relationships	-	-	6,905,000 c	6,905,000
Backlog	-	-	2,232,000 c	2,232,000
Software	-	-	300,000 c	300,000
Goodwill	-	1,254,306	(1,254,306) c	
	-	-	23,280,917 c	23,280,917
Loan origination fees, net of accumulated amortization of \$649,815	-	1,008,008	(1,008,008) c	-
Deposits and other assets	-	171,355	-	171,355
Total other assets	-	\$ 2,433,669	\$ 35,367,603	\$ 37,801,272

Total assets	\$	30,063,620	\$	32,801,796	\$	5,748,040	\$	68,613,456
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See notes to unaudited pro forma condensed consolidated financial statements.

Argyle Security Acquisition Corporation

Unaudited Pro Forma Condensed Consolidated Balance Sheet
September 30, 2006
Assuming Minimum Approval

	Argyle	ISI	Pro Forma Adjustments	Pro Forma Combined
Liabilities and stockholders' equity				
Accounts payable and accrued liabilities	\$ 166,141	\$ 11,175,091	\$ 166,000	o \$ 11,507,232
Accounts payable - related party	-	1,986,056	(1,986,056)	g -
Accrued income taxes	71,926	-	(64,000)	o 7,926
Current maturities of long-term debt	-	80,814	-	80,814
Current portion of capital lease obligations	-	95,580	-	95,580
Deferred underwriting costs	1,422,740	-	(1,422,740)	e -
Billings in excess of costs and estimated earnings on incomplete contracts	-	6,912,067	-	6,912,067
Total current liabilities	\$ 1,660,807	\$ 20,249,608	\$ (3,306,796)	\$ 18,603,619
Long-term liabilities				
Line of credit	\$ -	\$ 4,662,850	\$ -	\$ 4,662,850
Long-term debt less current maturities	-	13,510,651	(10,000,000)	b -
	-	-	2,675,832	c -
	-	-	(98,391)	g 6,088,092
Long-term portion of capital lease obligations	-	2,011,705	-	2,011,705
Deferred income taxes	-	255,188	5,524,365	c 5,779,553
Warrants subject to redemption	-	4,819,615	(4,819,615)	c -
Total long-term liabilities	-	25,260,009	(6,717,809)	18,542,200
Total liabilities	\$ 1,660,807	\$ 45,509,617	\$ (10,024,605)	\$ 37,145,819
Common stock subject to possible conversion -764,627 shares at \$7.14 per share				
	\$ 5,459,435	\$ -	\$ (5,459,435)	d2 \$ -
Deferred interest attributable to common stock subject to possible redemption (net of taxes of \$37,484)	152,941	-	(152,941)	d2 -
Stockholders' equity:				
ISI preferred stock	-	-	10,000,000	b -
	-	-	(10,000,000)	c -
Preferred stock - \$.0001 par value; 1,000,000 shares authorized; 0 shares issued and outstanding	-	-	-	-
Common stock - \$.0001 par value; 89,000,000 shares authorized; issued and outstanding 4,781,307 (including 764,627 shares of common stock subject to possible redemption)	478	-	118	c -
			(76)	d2 520

Common Stock - \$1 par value; 3,000
shares authorized; 105 shares issued and
outstanding

	-	105	(105)	c	-
Additional paid in capital	22,726,636	16,808	(16,808)	c	
	-	-	8,779,082	c	
	-	-	76	d2	31,505,794
Retained earnings during the development stage	63,323	-	(63,323)	f	-
Accumulated deficit	-	(12,724,734)	12,724,734	c	-
Retained earnings	-	-	63,323	f	
	-	-	(102,000)	o	(38,677)
Total stockholders' equity	\$ 22,790,437	\$ (12,707,821)	\$ 21,385,021		\$ 31,467,637
Total liabilities and stockholders' equity	\$ 30,063,620	\$ 32,801,796	\$ 5,748,040		\$ 68,613,456

See notes to unaudited pro forma condensed consolidated financial statements.

Argyle Security Acquisition Corporation

Unaudited Pro Forma Condensed Consolidated Statement of Operations
Nine Months Ended September 30, 2006
Assuming Maximum Approval

	Argyle	ISI	Pro Forma Adjustments	Pro Forma Combined
Revenues:				
Contract revenues	\$ -	\$ 22,729,085	\$ -	\$ 22,729,085
Contract revenues - related party	-	13,586,044	-	13,586,044
Service revenues	-	4,881,879	-	4,881,879
Other revenues	-	36,798	-	36,798
	- \$	41,233,806	-	\$ 41,233,806
Cost of revenues:				
Contract costs	\$ -	\$ 29,018,321	\$ -	\$ 29,018,321
Other costs	-	3,554,670	-	3,554,670
	\$ -	\$ 32,572,991	\$ -	\$ 32,572,991
Gross profit	\$ -	\$ 8,660,815	\$ -	\$ 8,660,815
General and administrative expenses	\$ 809,278	\$ 6,249,385	-	\$ 7,058,663
Amortization of intangibles	-	-	1,148,000 j	1,148,000
Operating income / (loss)	\$ (809,278)	\$ 2,411,430	\$ (1,148,000)	\$ 454,152
Other income and expense:				
Interest income	\$ 11,409	\$ -	\$ (680,000) k	\$ -
	-	-	952,609 n	284,018
Interest on cash and cash equivalents held in trust	952,609	-	(952,609) n	-
Interest expense	(46,190)	(2,779,773)	8,855 l	-
	-	-	1,815,887 m	(1,001,221)
Investment and other income (loss) - net	-	346	-	346
Total other income and expense	\$ 917,828	\$ (2,779,427)	\$ 1,144,742	\$ (716,857)
Income / (loss) before provision for income taxes	\$ 108,550	\$ (367,997)	\$ (3,258)	\$ (262,705)
Income tax expense (benefit)				
Current	\$ 71,926	\$ 10,312	\$ (157,821) p	\$ (75,583)
Deferred	(34,442)	-	-	(34,442)
	\$ 37,484	\$ 10,312	\$ (157,821)	\$ (110,025)
Net income / (loss)	\$ 71,066	\$ (378,309)	\$ 154,563	\$ (152,680)
Deferred interest (net of taxes), attributable to common subject to possible redemption	\$ 152,941	\$ -	\$ (152,941) h	\$ -
Net income / (loss) allocable to holders of non-redeemable common stock	\$ (81,875)	\$ (378,309)	\$ 307,504	\$ (152,680)

See notes to unaudited pro forma condensed consolidated financial statements.

Argyle Security Acquisition Corporation

Unaudited Pro Forma Condensed Consolidated Statement of Operations
Nine Months Ended September 30, 2006
Assuming Maximum Approval

	Argyle	ISI	Pro Forma Adjustments	Pro Forma Combined
Earnings / (loss) per share:				
Basic	\$ 0.02	\$ (3,606.03)		\$ (0.03)
Diluted	\$ 0.02	\$ (3,606.03)		\$ (0.03)
Weighted-average number of shares outstanding:				
Basic	4,375,600	104.91	q	5,961,307
Diluted	4,375,600	104.91		6,916,620
Earnings per share exclusive of interest and shares subject to redemption:				
Basic	\$ (0.02)			
Diluted	\$ (0.02)			
Weighted-average number of shares outstanding exclusive of shares subject to possible redemption:				
Basic	3,692,197			
Diluted	3,692,197			

See notes to unaudited pro forma condensed consolidated financial statements.

Argyle Security Acquisition Corporation

Unaudited Pro Forma Condensed Consolidated Statement of Operations
Nine Months Ended September 30, 2006
Assuming Minimum Approval

	Argyle	ISI	Pro Forma Adjustments	Pro Forma Combined
Revenues:				
Contract revenues	\$ -	\$ 22,729,085	-	\$ 22,729,085
Contract revenues - related party	-	13,586,044	-	13,586,044
Service revenues	-	4,881,879	-	4,881,879
Other revenues	-	36,798	-	36,798
	\$ -	\$ 41,233,806	-	\$ 41,233,806
Cost of revenues:				
Contract costs	-	29,018,321	-	29,018,321
Other costs	-	3,554,670	-	3,554,670
	\$ -	\$ 32,572,991	-	\$ 32,572,991
Gross profit	\$ -	\$ 8,660,815	\$ -	\$ 8,660,815
General and administrative expenses	809,278	6,249,385	-	7,058,663
Amortization of intangibles	-	-	1,148,000 j	1,148,000
Operating income / (loss)	\$ (809,278)	\$ 2,411,430	\$ (1,148,000)	\$ 454,152
Other income and expense:				
Interest income	\$ 11,409	\$ -	\$ (186,000) i	\$ -
	-	-	(680,000) k	-
	-	-	952,609 n	98,018
Interest on cash and cash equivalents held in trust	952,609	-	(952,609) n	-
Interest expense	(46,190)	(2,779,773)	8,855 l	(1,001,221)
	-	-	1,815,887 m	(1,001,221)
Investment and other income (loss) - net	-	346	-	346
Total other income and expense	\$ 917,828	\$ (2,779,427)	\$ 958,742	\$ (902,857)
Income / (loss) before provision for income taxes	\$ 108,550	\$ (367,997)	\$ (189,258)	\$ (448,705)
Income tax expense (benefit)				
Current	71,926	10,312	(229,431) p	(147,193)
Deferred	(34,442)	-	-	(34,442)
	\$ 37,484	\$ 10,312	\$ (229,431)	\$ (181,635)
Net income / (loss)	\$ 71,066	\$ (378,309)	\$ 40,173	\$ (267,070)
Deferred interest (net of taxes), attributable to common subject to possible redemption				
	\$ 152,941	\$ -	\$ (152,941) h	\$ -
	\$ (81,875)	\$ (378,309)	\$ 193,114	\$ (267,070)

Net income / (loss) allocable to holders of
non-redeemable common stock

See notes to unaudited pro forma condensed consolidated financial statements.

88

Argyle Security Acquisition Corporation

**Unaudited Pro Forma Condensed Consolidated Statement of Operations
Nine Months Ended September 30, 2006
Assuming Minimum Approval**

	Argyle	ISI	Pro Forma Adjustments	Pro Forma Combined
Earnings / (loss) per share:				
Basic	\$ 0.02	\$ (3,606.03)		\$ (0.05)
Diluted	\$ 0.02	\$ (3,606.03)		\$ (0.05)
Weighted-average number of shares outstanding:				
Basic	4,375,600	105	q	5,196,680
Diluted	4,375,600	105		6,151,993
Earnings per share exclusive of interest and shares subject to redemption:				
Basic	\$ (0.02)			
Diluted	\$ (0.02)			
Weighted-average number of shares outstanding exclusive of shares subject to possible redemption:				
Basic	3,692,197			
Diluted	3,692,197			

See notes to unaudited pro forma condensed consolidated financial statements.

Argyle Security Acquisition Corporation

Unaudited Pro Forma Condensed Consolidated Statement of Operations
Twelve Months Ended December 31, 2005
Assuming Maximum Approval

	Argyle	ISI	Pro Forma Adjustments	Pro Forma Combined
Revenues:				
Contract revenues	\$ -	\$ 20,905,409	\$ -	\$ 20,905,409
Contract revenues - related party	-	14,475,895	-	14,475,895
Service revenues	-	3,771,050	-	3,771,050
Other revenues	-	82,133	-	82,133
	\$ -	\$ 39,234,487	\$ -	\$ 39,234,487
Cost of revenues:				
Contract costs	\$ -	\$ 28,213,117	\$ -	\$ 28,213,117
Other costs	-	2,652,272	-	2,652,272
	\$ -	\$ 30,865,389	\$ -	\$ 30,865,389
Gross profit	\$ -	\$ 8,369,098	\$ -	\$ 8,369,098
General and administrative expenses	\$ 7,743	\$ 6,908,440	-	\$ 6,916,183
Amortization of intangibles	-	-	2,516,000	j 2,516,000
Operating income / (loss)	\$ (7,743)	\$ 1,460,658	\$ (2,516,000)	\$ (1,063,085)
Other income and expense:				
Interest expense	\$ -	\$ (3,177,891)	1,968	l 1 \$
	-	-	2,022,215	m (1,153,708)
Investment and other income (loss) - net	-	7,915	-	7,915
Loss before income taxes	\$ (7,743)	\$ (1,709,318)	\$ (491,817)	\$ (2,208,878)
Income tax expense (benefit)				
Current	\$ -	\$ (448,249)	\$ (289,085)	p \$ (737,334)
Deferred	-	(77,567)	-	(77,567)
	\$ -	\$ (525,816)	\$ (289,085)	\$ (814,901)
Net loss	\$ (7,743)	\$ (1,183,502)	\$ (202,732)	\$ (1,393,977)
Loss per share:				
Basic and diluted	\$ (0.01)	\$ (11,281.12)	\$	\$ (0.23)
Weighted-average number of shares outstanding:				
Basic and diluted	937,500	104.91	q	5,961,307

See notes to unaudited pro forma condensed consolidated financial statements.

Argyle Security Acquisition Corporation

Unaudited Pro Forma Condensed Consolidated Statement of Operations
Twelve Months Ended December 31, 2005
Assuming Minimum Approval

	Argyle	ISI	Pro Forma Adjustments	Pro Forma Combined
Revenues:				
Contract revenues	\$ -	\$ 20,905,409	-	\$ 20,905,409
Contract revenues - related party	-	14,475,895	-	14,475,895
Service revenues	-	3,771,050	-	3,771,050
Other revenues	-	82,133	-	82,133
	\$ -	\$ 39,234,487	-	\$ 39,234,487
Cost of revenues:				
Contract costs	\$ -	\$ 28,213,117	-	\$ 28,213,117
Other costs	-	2,652,272	-	2,652,272
	\$ -	\$ 30,865,389	-	\$ 30,865,389
Gross profit	\$ -	\$ 8,369,098	-	\$ 8,369,098
General and administrative expenses	\$ 7,743	\$ 6,908,440	-	\$ 6,916,183
Amortization of intangibles	-	-	2,516,000 j	2,516,000
Operating income / (loss)	\$ (7,743)	\$ 1,460,658	\$ (2,516,000)	\$ (1,063,085)
Other income and expense:				
Interest expense	\$ -	\$ (3,177,891)	1,968 l	\$ (1,153,708)
	-	-	2,022,215 m	(1,153,708)
Investment and other income (loss) - net	-	7,915	-	7,915
Loss before income taxes	\$ (7,743)	\$ (1,709,318)	\$ (491,817)	\$ (2,208,878)
Income tax expense (benefit)				
Current	\$ -	\$ (448,249)	\$ (289,085) p	\$ (737,334)
Deferred	-	(77,567)	-	(77,567)
	\$ -	\$ (525,816)	\$ (289,085)	\$ (814,901)
Net loss	\$ (7,743)	\$ (1,183,502)	\$ (202,732)	\$ (1,393,977)
Loss per share:				
Basic and diluted	\$ (0.01)	\$ (11,281.12)	-	\$ (0.27)
Weighted-average number of shares outstanding:				
Basic and diluted	937,500	105	q	5,196,680

See notes to unaudited pro forma condensed consolidated financial statements.

NOTES TO UNAUDITED PRO FORMA CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

- a. To record the reclassification of funds held in trust by Argyle.
- b. To record the conversion of \$10 million of ISI long-term debt to preferred stock.
- c. To record the purchase of the outstanding common stock and preferred stock of ISI and the allocation of the purchase price to the assets acquired and liabilities assumed as follows:

Calculation of allocable purchase price(i):

Cash	\$	18,200,000
Stock		8,779,200(ii)
Transaction costs		2,300,000
Total allocable purchase price	\$	29,279,200

Estimated allocation of purchase price(iii):

ISI net assets acquired (book value after conversion of \$10 million ISI debt to ISI preferred stock)	\$	(2,707,821)
Fair value adjustments to assets acquired / liabilities assumed:		
ISI goodwill		(1,254,306)
ISI loan origination fees		(1,008,008)
Warrants subject to redemption (iv)		4,819,615
Adjustments to long-term debt to reflect transaction (v)		(2,675,832)
Fair value of tangible assets acquired	\$	(2,826,352)
Fair value of intangible assets acquired		
Intangible assets:		
Trade name (vi)	\$	4,912,000
Customer relationships (vi)		6,905,000
Backlog (vi)		2,232,000
Software (vi)		300,000
Deferred taxes on intangible assets (vii)		(5,524,365)
Goodwill		23,280,917
Total allocable purchase price	\$	29,279,200

- (i) Assumes that the adjusted EBITDA of ISI for the year ending December 31, 2006 is \$4,500,000 or greater and the amount of the February 28, 2007 backlog is \$80 million or greater.
- (ii) 1,180,000 shares of Argyle common stock at a price per share of \$7.44, which was the closing price of a share of Argyle common stock on the OTC market on December 14, the date the transaction was announced.
- (iii) The purchase price allocation has not been finalized and is subject to change upon recording of actual transaction costs and completion of appraisals of tangible and intangible assets. The purchase price allocation will be finalized when all necessary information is obtained which is expected to occur within one year of the consummation of the transaction.

(iv)

Upon completion of the ISI acquisition and in accordance with the merger agreement, the ISI warrant holder will receive its share of the total consideration paid by Argyle. As a result, the warrant will no longer be outstanding after the completion of the acquisition.

- (v) This pro forma adjustment to long term debt is necessary to reflect the amount which will be due the lender, in accordance with the merger agreement, upon completion of the acquisition transaction. As there will be no warrants associated with this remaining debt, there will be no debt discount as there was in the historical financial statements of ISI.
- (vi) For financial reporting purposes, it is required that purchasers allocate the total consideration paid in a business combination under purchase accounting to the fair value of the acquired company's assets and liabilities. The purchase price should first be allocated to the current assets, but not in excess of their fair values and then to non-current assets, again not in excess of their fair values. If after allocation to non-current assets a portion of the purchase price remains unallocated, it is assigned to identifiable intangible assets and goodwill. Trade name, customer relationships, backlog and software were identified as intangible assets. Argyle engaged a valuation consultant to assist them in this purchase price allocation.

A trade name valuation was performed for each of the ISI entities including ISI Detention, MCS Detention and MCS Commercial. The relief from royalty method was used to value the trade name. This methodology utilizes market royalty rates and trade name terminal values.

Customer relationships valuations were performed for each of the ISI entities. The excess earnings method is typically used to value customer relationships. Similar to the discounted cash flow method, the excess earnings method estimates the fair value of an intangible asset by discounting its future cash flows and applying charges related to the company's other contributory assets.

Backlog valuations were performed for each of the ISI entities. Based on an excess earnings analysis, the present values of the cash flows were calculated.

The valuation of the MCS Detention software, which is utilized within detention facilities, was estimated based upon the costs to create the software.

- (vii) FASB 109, "Accounting for Income Taxes" requires the recognition of deferred tax assets and liabilities for the tax effects of differences between the assigned values in the purchase price allocation and the tax basis of assets acquired and liabilities assumed in a purchase business combination (except for the goodwill which is not deductible for tax purposes). As a result, Argyle has reflected a \$5,524,365 deferred tax pro forma adjustment which represents the total value assigned to the intangible assets tax effected at 38.5%

- d1. Assuming maximum approval to reclassify common stock subject to possible conversion as permanent equity \$(5,459,435) and to record related deferred interest as income \$(152,941) for the nine months ended September 30, 2006).
- d2. Assuming minimum approval, to record refund to dissenting shareholders \$(5,612,376) and to reclassify common stock \$(76) as additional paid-in-capital.
 - e. To reflect the payment of the deferred underwriting fees associated with Argyle's initial public offering.
 - f. To reclassify retained earnings during the development stage to retained earnings.
 - g. To reflect the repayment of amounts due to ISI* MCS and to shareholders.
 - h. To eliminate the deferred interest income recorded on the income statements.
- i. To reduce interest income on the minimum approval income statement for the nine months ended September 30, 2006 to reflect the cash paid to the dissenting shareholders.
- j. To record amortization of intangible assets recorded in the purchase price allocation. Customer relationships for ISI-Detention and MCS-Detention are being amortized over a 12-year period. Customer relationships for MCS-Commercial are being amortized over a 5-year period. Backlog is being amortized over a 16-month period for ISI-Detention and MCS-Detention and over a 12-month period for MCS-Commercial. Software is being amortized over a 5-year period and the trade names have an indefinite life.
- k. To reduce interest income to reflect the payment of \$20.5 million as the cash portion of the acquisition including transaction costs.
 - l. To reduce interest expense on the long-term shareholder debt.
- m. To reduce interest expense to reflect the reduction of long-term debt and the elimination of the warrant.
 - n. To reclassify interest on cash and cash equivalents held in trust to interest income.
- o. To record additional Argyle consulting fees which become due upon completion of the transaction.
 - p. To adjust income taxes due to pro forma income adjustments.

- q. Pro forma net income per share was calculated by dividing pro forma net income by the weighted average number of shares outstanding as follows:

	Maximum Approval	Minimum Approval
Nine months ended September 30, 2006:		
Basic - Assuming initial public offering as of January 1, 2005	4,781,307	4,016,680
Shares issued in connection with the transaction	1,180,000	1,180,000
Basic - Total	5,961,307	5,196,680
Incremental shares on exercise of warrants*	955,313	955,313
Diluted	6,916,620	6,151,993

* Assuming stock price of \$ 7.31 per share based on the average share price from January 1, 2006 to September 30, 2006.

	Maximum Approval	Minimum Approval
Twelve months ended December 31, 2005:		
Basic - Assuming initial public offering as of January 1, 2005	4,781,307	4,016,680
Shares issued in connection with the transaction	1,180,000	1,180,000
Basic - Total **	5,961,307	5,196,680

** No diluted shares could be calculated for 2005 as Argyle's stock did not trade publicly until 2006.

DIRECTORS AND MANAGEMENT**Directors, Management and Key Employees Following the Acquisition**

Upon consummation of the acquisition, Argyle and ISI intend the Board of Directors, executive officers and key employees of Argyle to be as follows:

Name	Age	Position
Bob Marbut	71	Chairman of the Board and Co-Chief Executive Officer
Ron Chaimovski	47	Vice Chairman of the Board and Co-Chief Executive Officer
Wesley Clark	61	Director
John J. Smith	58	Director
Sam Youngblood	51	Chief Executive Officer of ISI
Donald Carr	55	President of ISI
Mark McDonald	51	President of MCS-Detention
Robert Roller	54	President of MCS-Commercial
Tim Moxon	46	Chief Financial Officer of ISI
Neal Harmon	41	Senior Software Developer of ISI

Bob Marbut has been Argyle's Chairman of the Board and Co-Chief Executive Officer since Argyle's inception. From November 2004 to the present, Mr. Marbut has been the Executive Chairman of Electronics Line 3000 Ltd., an intrusion protection security company, and from July 2002 to the present he has been the Executive Chairman of SecTecGLOBAL, Inc., a sales and marketing subsidiary of Electronics Line 3000 Ltd., and was the Chief Executive Officer of SecTecGLOBAL from July 2002 to February 2006. From October 2001 to the present, Mr. Marbut has served as the Managing Director of Argyle Global Opportunities, LP, an investment partnership which owns a 41% interest in Electronics Line 3000 Ltd. From January 2001 to January 2003, Mr. Marbut served as the Chairman of Hearst-Argyle Television, Inc., a non-network owned television group and, from August 1997 to January 2001, served as its Chairman and Co-Chief Executive Officer. From January 1995 to August 1997, Mr. Marbut was the co-founder, Chairman and controlling partner of Argyle Television, Inc., which became a Nasdaq traded company and was merged with Hearst Broadcasting in August 1997 to form Hearst-Argyle Television, Inc. From 1993 to 1995, Mr. Marbut founded and was the Chief Executive Officer of Argyle Television Holding, Inc., a private television group that was sold in 1995. From August 1970 through 1990, Mr. Marbut served as the President and Chief Executive Officer of Harte-Hanks Communications, Inc., and concurrently as its Chief Operating Officer from April 1973 to September 1984, and as Vice-Chairman in 1991. During the period that Mr. Marbut was CEO, Harte-Hanks developed from a family-owned newspaper company into a Fortune 500 company listed on the New York Stock Exchange that Mr. Marbut took private in 1984 in a management buyout that he led. In addition to the Board of Directors of Electronics Line 3000 Ltd., Mr. Marbut currently serves on the boards of directors of Hearst-Argyle Television, Tupperware Corporation and Valero Energy Corporation. Mr. Marbut, through control of the general partner of Argyle Joint Venture, manages Argyle Joint Venture, one of Argyle's stockholders which was formed to make equity investments in companies. Mr. Marbut is the sole investor and manager of Argyle New Ventures, which manages Mr. Marbut's personal family investments. He has a Masters of Business Administration degree with Distinction from Harvard University and was a registered engineer in the State of California and holds a Bachelors of Industrial Engineering from Georgia Tech.

Ron Chaimovski has been Argyle's Vice Chairman of the Board and Co-Chief Executive Officer since Argyle's inception. Mr. Chaimovski has served as the Vice Chairman of Electronics Line 3000 Ltd. since May 2005 and as a partner in Argyle Global Opportunities, LP since January 2001. From October 1998 to August 2001 Mr. Chaimovski served as the Israeli Economic Minister to North America. From 1991 to 1998, Mr. Chaimovski was a partner in an Israeli law firm. Mr. Chaimovski was the co-founder of Transplan Enterprises Group, an investment group, and served as its Co-Chairman from 1993 to 1998. Mr. Chaimovski served in the Israeli Navy from 1977 to 1983 in various command roles, including those of combat officer and flotilla commander. Mr. Chaimovski, through entities controlled by him or his spouse, owns limited partnership interests in Argyle Joint Venture. Mr. Chaimovski is a member of the Israeli Bar. Mr. Chaimovski received an LLB from Tel Aviv University and an LLM from the University of London.

Gen. (Ret.) Wesley K. Clark joined Argyle's Board of Directors in September 2005. Since March 2003, he has been the Chairman and Chief Executive Officer of Wesley K. Clark & Associates, a business services and development firm based in Little Rock, Arkansas. In February 2006, Gen. Clark joined Rodman & Renshaw Holdings, LLC, which controls Rodman & Renshaw, LLC, one of the co-managing underwriters in the initial public offering, as Chairman of the Board and as a member of their Advisory Board. From March 2001 to February 2003 he was the Managing Director of the Stephens Group Inc., an emerging company development firm. From July 2000 to March 2001 he was a consultant for Stephens Group Inc. Prior to that time, Gen. Clark served as the Supreme Allied Commander of NATO and Commander-in-Chief for the United States European Command and as the Director of the Pentagon's Strategic Plans and Policy operation. Gen. Clark retired from the United States Army as a four-star general in July 2000 after 38 years in the military and received many decorations and honors during his military career. Gen. Clark is a graduate of the United States Military Academy and studied as a Rhodes Scholar at the Magdalen College at the University of Oxford.

John J. "Chip" Smith has been one of Argyle's directors since Argyle's inception. He has been the Director of Security for the Bank of New York since February 2000. At the Bank of New York, Mr. Smith directs and supervises a worldwide security program that encompasses the investigation and prevention of fraud-related activities, as well as the physical protection of corporate assets, employees, customers and executives. Mr. Smith retired from the United States Secret Service in January 2000 after 24 years of service. He held a variety of positions in field offices and headquarters, culminating with his appointment as the Special Agent in Charge of the New York Field Office, the Service's largest and busiest office. During his career, Mr. Smith was assigned to the Vice Presidential Protective Division, the Presidential Protective Division and as the Special Assistant to the Treasury Secretary. He served as the security coordinator for several high profile protective venues, including: the U.S. delegation attending the Olympic Games in Barcelona, Spain, 1992; the Presidential Inaugural activities of 1993; the dedication of the Holocaust Museum, Washington, DC, 1994; and the visit of Pope John Paul II to New York, 1995. In 1996, he supervised the protective detail assigned to Presidential Candidate Robert Dole. Mr. Smith holds bachelors and masters degrees in Criminal Justice from West Chester University in West Chester, Pennsylvania.

Sam Youngblood has been the chief Executive Officer of ISI since 1991. During that 15 year span Mr. Youngblood acted as the Project Manager on many projects. As the company grew, he became responsible for all acquisitions. From 1984 to 1991, he founded and was the Chief Executive Officer of ADTEC, Inc. From 1974 to 1984, he served in several managerial positions with Southern Steel Company, lastly as its President. Mr. Youngblood graduated from Baylor University in 1978 with a BBA in Accounting and a minor in Finance. Mr. Youngblood has served on the Board of the Baptist Center for Ethics (BCE) from 2001 to 2005.

Donald Carr has been the President of ISI since 1991. During this time, Mr. Carr has been responsible for project management, sales and estimating. Over time, Mr. Carr built a sales team and relinquished his project management responsibilities to focus on the sales growth of the business. From 1987 to 1991, Mr. Carr served as the Project Manager of American Detention Services, Inc. a subsidiary of ADTEC, Inc. Prior to that time, from 1985 to 1987, Mr.

Carr served as the Director of Contract Administration of Southern Steel Company. Mr. Carr attended St. Edwards University.

Mark McDonald has been the President of MCS-Detention since 2000. MCS-Detention was acquired by ISI in 2000 and it is currently one of ISI's subsidiaries. During this period Mr. McDonald was responsible for Sales, Marketing and Product Development. Mr. McDonald oversaw development of the OneFab product line which opened MCS to a much larger market. Prior to 2000, Mr. McDonald was Vice President of Sales of Metroplex-Control Systems operating in Dallas Texas. He served in this capacity from 1990 to 2000. Prior to that time, from 1983 to 1990, he was the General Manager of Dilok, Inc. From 1980 to 1983 he was the Service Manager of Edwards Company. Mr. McDonald received an Associated Arts Degree in Electronics from Chabot College in 1979.

Robert Roller has been the President of MCS-Commercial since January 2006. During this period Mr. Roller has focused his time on developing the Sales and Operations for that subsidiary necessary to build the revenues relating to access control and video. Prior to that, from November 2004 to December 2005, Mr. Roller was Vice President of Operations for MCS-Commercial. Mr. Roller performed the duties of Operational Vice President and produced significant changes to make this company more profitable. After the execution of these initiatives by Mr. Roller, MCS-Commercial began to increase its profits. Prior to that time, from February 2002 to October 2004, Mr. Roller was the District Operations Manager Pacific Northwest of Siemens Building Technologies, having more than 40 direct employees and managers reporting to him. From 1999 to January 2002 he was the Vice President Western Region of Pinkerton Systems Integration, and from 1992 to 1999 he was the Operations Manager/Project Manager of ASSI Security. Mr. Roller received a Bachelor of Aeronautics from Embry Riddle Aeronautical University.

Tim Moxon has been the Chief Financial Officer of ISI since November 2004. During this period, Mr. Moxon has been responsible for all banking and other financial requirements of the company. Prior to that time from 2000 to October 2004 Mr. Moxon served as Comptroller of ISI Security. From 1993 to 2000, Mr. Moxon was Comptroller of Metroplex-Control Systems operating in Dallas, Texas. From 1989 to 1993, Mr. Moxon was the Controller for Texas Lime Company and, from 1988 to 1989, he was the Assistant Controller for Food City, Inc. Mr. Moxon has a BBA in accounting from Baylor University.

Neal Horman has been the Head Programmer of MCS-Detention since June 2001. During this period Mr. Horman developed the software for the OneFab product line. Prior to that time, from 1999 to 2000, Mr. Horman was a Programmer for Intelli-Site. From 1997 to 1999, he was a Software/Computer Programmer for American Express. From 1996 to 1997, he was a Programmer for Internet Now. From 1993 to 1996, he was a Programmer and Systems Engineer for MCS. From 1989 to 1992, he was a Programmer for Dilok, and from 1985 to 1988, he was a Programmer for Spectrum West.

None of the persons named above is or was affiliated with another blank check company similar to Argyle.

Argyle's Board of Directors is divided into three classes, with only one class of directors being elected in each year and each class serving a three-year term. The term of office of the first class of directors, consisting of John J. Smith, will expire at Argyle's first annual meeting of stockholders. The term of office of the second class of directors, consisting of Wesley Clark, will expire at the second annual meeting. The term of office of the third class of directors, consisting of Bob Marbut and Ron Chaimovski, will expire at the third annual meeting.

The Board of Directors has not determined whether anyone on the Board is an "audit committee financial expert," as such term is defined by SEC rules. Since the Board does not have a separately designated Audit Committee and Argyle will not have any operating activities until such time as Argyle enters into a business combination (meaning that its financial statements are relatively simple), Argyle's Board of Directors did not feel it was necessary to determine if anyone on Argyle's Board of Directors was an audit committee financial expert. Argyle's Board of Directors will make a determination if there is an audit committee financial expert on its Board of Directors after a business combination with a target business is consummated.

Director Independence

Argyle's Board of Directors has not determined if any of its directors qualifies as independent, although Argyle's management believes that Gen. Clark and Mr. Smith would qualify as independent directors under the rules of the American Stock Exchange because they do not currently own a large percentage of Argyle's stock, are not currently employed by Argyle, have not been actively involved in the management of Argyle and do not fall into any of the enumerated categories of people who cannot be considered independent in the American Stock Exchange Rules. Argyle's Board of Directors will make a determination about independence after the business combination is consummated. Argyle does not have an audit committee, nominating committee or compensation committee and therefore the entire Board of Directors performs those functions for Argyle.

Compensation Committee Interlocks and Insider Participation

During the last fiscal year, no officer and employee of Argyle, and no former officer of Argyle, during the last completed fiscal year, participated in deliberations of Argyle's Board of Directors concerning executive officer compensation. Bob Marbut and Ron Chaimovski are each officers and directors of SecTecGlobal and Electronics Line 3000 Ltd.

ISI's management team will remain substantially the same, and Sam Youngblood, its current Chief Executive Officer, will remain the Chief Executive Officer of ISI.

Argyle's Principal Accountant

During the fiscal year ended December 31, 2005, Argyle's principal independent auditor was Goldstein Golub Kessler LLP, the services of which were provided in the following categories and amount:

Audit Fees

The aggregate fees billed by Goldstein Golub Kessler LLP for professional services rendered for the audit of Argyle's balance sheet at January 30, 2006 included in Argyle's Current Report on Form 8-K, for the audit of Argyle's annual financial statements for the fiscal year ended December 31, 2005 and for services performed in connection with Argyle's registration statement on Form S-1 initially filed in 2005, were \$47,460.

Audit -Related Fees

Other than the fees described under the caption “Audit Fees” above, Goldstein Golub Kessler LLP did not bill any fees for services rendered to Argyle during fiscal year 2005 for assurance and related services in connection with the audit or review of Argyle’s financial statements.

Tax Fees

There were no fees billed by Goldstein Golub Kessler LLP for professional services rendered during the fiscal year ended December 31, 2005 for tax compliance, tax advice, and tax planning.

All Other Fees

There were no fees billed by Goldstein Golub Kessler LLP for other professional services rendered during the fiscal year ended December 31, 2005.

Pre-Approval Of Services

Argyle does not have an Audit Committee. The Board of Directors does not have any pre-approval policies and procedures described in Rule 2-01(c)(7)(i)(C) in place.

Change in Auditors

On April 18, 2006, Argyle’s Board of Directors terminated Goldstein Golub Kessler LLP as Argyle’s principal accountants.

During Argyle’s fiscal year ended December 31, 2005 and the subsequent interim period ended April 18, 2006, there were no disagreements with Goldstein Golub Kessler LLP on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedures, which disagreements, if not resolved to their satisfaction, would have caused them to make reference in connection with their opinion to the subject matter of the disagreement.

The audit reports of Goldstein Golub Kessler LLP on the financial statements of Argyle as of and for the year ended December 31, 2005 and as of and for the interim period ended January 30, 2006 did not contain any adverse opinion or disclaimer of opinion, nor were they qualified or modified as to uncertainty, audit scope, or accounting principles.

There were no “reportable events”, as that term is described in Item 304(a)(1)(v) of Regulation S-K, for the year ended December 31, 2005 and the subsequent interim period ended April 18, 2006.

On May 1, 2006, Argyle engaged Ernst & Young LLP as its independent registered public accounting firm for the fiscal year ending December 31, 2006, and such engagement was approved by Argyle’s Board of Directors.

During the fiscal year ended December 31, 2005, and in the subsequent interim period, Argyle did not consult with Ernst & Young LLP regarding (i) the application of accounting principles to a specific completed or contemplated transaction, or the type of audit opinion that might be rendered on Argyle’s consolidated financial statements and no written or oral advice was provided by Ernst & Young LLP that was an important factor considered by Argyle in reaching a decision as to any accounting, auditing or financial reporting issue or (ii) any matter that was either the subject of a disagreement or event, as set forth in Item 304(a)(1)(iv) or Item 304(a)(1)(v) of Regulation S-K.

Code of Ethics

Argyle does not have a formal code of ethics. Upon consummation of a business combination, Argyle intends to adopt a code of ethics that applies to Argyle's principal executive officers, principal financial officer, principal accounting officer or controller or persons performing similar functions.

Director Compensation

Argyle will compensate its Board of Directors based on policies put into place after the acquisition, but which are expected to include a per diem for each Board meeting attended, an annual fee, reimbursement of expenses incurred in attending meetings and equity awards pursuant to the 2007 Incentive Plan, if the 2007 Incentive Plan is approved by Argyle's stockholders. The amounts of compensation, numbers of shares subject to awards and other terms of director compensation have not been finally determined.

98

Argyle's current directors do not currently receive any compensation for their services.

Executive Compensation

ISI Compensation Discussion and Analysis. ISI's Board of Directors bases the salaries it pays its executive officers on the amounts other companies pay their executive officers for similar performance. In, general, if an executive performs exceptionally well, the performance and, if applicable, the increase in responsibilities would also merit a salary increase.

ISI's Board of Directors conducts reviews informally, and compensation is not typically changed on a regimented time-frame.

The Board of Directors has granted certain rights to Mark McDonald, Robert Roller, and Tim Moxon to acquire shares of ISI's common stock (valued at \$_____ if ISI is acquired by Argyle) immediately prior to an acquisition of ISI of greater than \$6,000,000. The Board of Directors believes that these rights have given these executive officers an incentive for the executives to help make the company prosper so that they can obtain the equity. The amount of the equity incentive was determined by ISI in consultation with William Blair Mezzanine Capital Fund III, L.P., who would not agree to be diluted above a certain amount. The persons who received the right were selected based on their relative importance to ISI, and the total rights were distributed relatively equally among such persons. These rights terminate if the executive is no longer employed by ISI at the time of an acquisition.

Tim Moxon receives his bonus as a part of a cash bonus pool which is based on ISI's profits. Mr. Moxon would receive a smaller percentage of the bonus pool as additional people become eligible for that bonus. In theory, as more people become eligible for the option pool, ISI's profits should increase.

Robert Roller receives a bonus equal to 2% of EBITDA for MCS-Commercial. This gives Mr. Roller an incentive to increase MCS-Commercial's EBITDA. Since Mr. Roller is directly responsible for the overall operations of the commercial business, but not responsible for ISI or MCS-Detention, segmenting his bonus directly to what he affects pinpoints his performance.

Mark McDonald receives a bonus equal to 5% of earned gross margin greater than a base amount equal to \$1.5 million plus \$.4 million for every sales person under his control for more than 12 months for MCS-Detention. Since Mr. McDonald is directly responsible for the sales of MCS-Detention, basing his bonus on gross margin removes selling, general and administrative decisions from the calculation. MCS-Detention is dependent on proper estimating of costs on a project to make a profit. Mr. McDonald acquired equity when ISI purchased MCS, so Mark has a vested interest in ISI increasing profits.

Sam Youngblood and Don Carr do not currently receive any bonus. However, both Mr. Youngblood and Mr. Carr have a large equity stake in ISI and therefore have sufficient incentives to have ISI be successful.

All executives are involved in decisions relating to their compensation. ISI believes that, for the most part, its executives believe they are fairly compensated.

ISI's Executive Officers. The following sets forth summary information concerning the compensation paid by ISI to its chief executive officer and its other four most highly compensated officers during the last three fiscal years.

Summary Compensation Table

Name	Salary	Bonus	Option	All other	Total
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and Principal Position	(b)	(\$) (c)	(\$) (d)	Awards (\$) (f)	Compen- sation (\$) (i)	(\$) (j)
Sam Youngblood	2006	368,225				368,225
Chief Executive Officer	2005	357,500			3,891,793.37(1)	4,249,293.37
	2004	350,000			60,292.94(1)	410,292.94
Don Carr	2006	242,050				242,050
President	2005	235,000			1,258,746.20(1)	1,493,746.2
	2004	220,385			84,512.33(1)	304,897.33
Mark McDonald	2006	144,008	45,835	217,335		407,178
President	2005	144,008	79,850	217,335	79,850	521,043
	2004	144,008		169,949		313,957
Tim Moxon	2006	125,000	24,038	61,065		210,103
Chief Financial Officer	2005	105,000	13,721	61,065	13,720.94	193,506.94
	2004	90,000	30,648	65,258	30,648.31	216,554.31
Butch Roller	2006	135,000	9,330	94,431		238,761
	2005	115,000		94,431		209,431

(1) This consideration was paid in connection with the recapitalization of ISI.

The following table shows the outstanding option awards for our named executive officers as of December 31, 2006.

Outstanding Option Awards at Fiscal Year-End Table

Name	Option Awards			
	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Option Exercise Price (\$)	Option Expiration date
(a)	(b)	(c)	(e)	(f)
Sam Youngblood	0	0	0	0
Don Carr	0	0	0	0
Mark McDonald	0	7.4673	29,104.9162	None*
Tim Moxon	0	2.0981	29,104.9162	None*
Butch Roller	0	3.2445	29,104.9162	None*

* These options do not expire until ISI is acquired by a third party.

The following table sets forth aggregate information regarding ISI's equity compensation plans in effect as of December 31, 2006:

ISI Equity Compensation Plan Information

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
(a)	(b)	(c)	(c)
Equity compensation plans approved by security holders	0.00	\$0.00	0.00
Equity compensation plans not approved by security holders	14.9729(1)	\$36,302.34	0.00
Total	14.9729	\$36,302.34	0.00

(1) ISI made verbal agreements with certain key employees to provide stock incentive compensation for enhancement of company and stockholder value and to share in the future economic success of the Company. Under these agreements, ISI committed to issue common stock shares to the key employees if ISI is sold, the employees are employed by the Company at time of the sale, and the sale price of the Company exceeds \$6,000,000.

Director Compensation

ISI does not have any independent directors and does not pay its directors any amounts in excess of the amounts it pays them for services as officers of ISI.

Employment Agreements

The following discussion summarizes the material terms of current employment agreements between ISI and its executive officers:

Sam Youngblood

Mr. Youngblood's employment agreement, effective as of October 19, 2004, with Detention Contracting Group, Ltd., a wholly owned limited partnership subsidiary of ISI (referred to below as Detention Contracting), provides that Mr. Youngblood will be employed as the Company's Chief Executive Officer, Vice President, and the Secretary of Detention Contracting's general partner for a period of five years with an automatic renewal of one year unless either party gives notice to the contrary to the other party. During the employment period, Mr. Youngblood is prohibited from serving as a consultant, employee, officer, manager, agent, or director of any other entity and from owning more than 5% of any other entity if Detention Contracting's Board of Directors determines that such service or ownership would have a material adverse effect on Mr. Youngblood's ability to perform his duties under the employment agreement. This restriction does not, however, apply to Mr. Youngblood's service to and ownership of ISI*MCS, Ltd.

Mr. Youngblood receives an annual salary of not less than \$350,000.00, to be increased by Detention Contracting's Board of Directors annually by an amount of at least the amount of change in the Consumer Price Index. Mr. Youngblood is also eligible for benefits and bonuses in accordance with Detention Contracting's executive benefits and bonus plans and those of its parent company. Other benefits include membership dues for the Plaza Club of San Antonio; tickets to the San Antonio Stock Show and Rodeo, San Antonio Spurs, and Majestic Theatre; and an automobile allowance of \$900.00 per month.

Mr. Youngblood agrees to a perpetual confidentiality provision and a non-competition and non-solicitation provision that lasts for two years from the date Mr. Youngblood's employment is terminated for any reason. If Mr. Youngblood breaches these restrictive covenants, then the agreement requires disgorgement of benefits derived from such breach and injunctive relief, as well as other rights and remedies available to ISI.

If Mr. Youngblood's employment is terminated without cause, then Mr. Youngblood is entitled to receive payment of his annual salary for one year following the date of termination. Immediately following the final payment of the one-year post-termination salary, Mr. Youngblood is released from the non-solicitation and non-competition covenants contained in the agreement, unless the Company elects to continue severance payments, including salary prorated over the extension period.

If Mr. Youngblood voluntarily resigns or is terminated for cause during the period of employment, then he is not entitled to receive any benefit or compensation following the date of termination.

Don Carr

Mr. Carr's employment agreement with Detention Contracting, effective as of October 19, 2004, provides that Mr. Carr will be employed as President of Detention Contracting and the Treasurer of its general partner for a period five years with an automatic renewal of one year unless either party gives notice to the contrary. During the employment period, Mr. Carr is prohibited from serving as a consultant, employee, officer, manager, agent, or director of any other entity and from owning more than 5% of any other entity if Detention Contracting's Board of Directors determines that such service or ownership would have a material adverse effect on Mr. Carr's ability to perform his duties under the employment agreement. This restriction does not, however, apply to Mr. Carr's service to and ownership of ISI*MCS, Ltd.

Mr. Carr receives an annual salary of not less than \$235,000.00, to be increased by Detention Contracting's Board of Directors annually by an amount of at least the amount of change in the Consumer Price Index. Mr. Carr is also eligible for benefits and bonuses in accordance with Detention Contracting's executive benefits and bonus plans and those of its parent company.

Mr. Carr agrees to a perpetual confidentiality provision and a non-competition and non-solicitation provision that lasts for two years from the date Mr. Carr's employment is terminated for any reason. If Mr. Carr breaches these restrictive covenants, then the agreement requires disgorgement of benefits derived from such breach and injunctive relief, as well as other rights and remedies available to the Company.

If Mr. Carr's employment is terminated without cause, then Mr. Carr is entitled to receive payment of his annual salary for one year following the date of termination. Immediately following the final payment of the one-year post-termination salary, Mr. Carr is released from the non-solicitation and non-competition covenants contained in the agreement, unless Detention Contracting elects to continue severance payments, including salary prorated over the extension period.

If Mr. Carr voluntarily resigns or is terminated for cause during the period of employment, then he is not entitled to receive any benefit or compensation following the date of termination.

Mark McDonald

Mr. McDonald's employment agreement with MCS-Detention, effective as of October 19, 2004, provides that Mr. McDonald will be employed as President of MCS-Detention for a period five years with an automatic renewal of one year unless either party gives notice to the contrary. During the employment period, Mr. McDonald is prohibited from serving as a consultant, employee, officer, manager, agent, or director of any other entity and from owning more than a 5% stake in any other entity if MCS-Detention's Board of Directors determines that such service or ownership would have a material adverse effect on Mr. McDonald's ability to perform his duties under the employment agreement.

Mr. McDonald receives an annual salary of not less than \$125,000.00, to be reviewed annually by MCS-Detention's Board of Directors. Mr. McDonald is also entitled to receive an annual bonus equal to 5% of the total gross margin of

MCS-Detention that exceeds a specified amount during the year prior. Mr. McDonald is also eligible for benefits in accordance with MCS-Detention's executive benefits plan, including full payment of all health/medical insurance coverage for Mr. McDonald and his dependents.

Mr. McDonald agrees to a perpetual confidentiality provision and a non-competition and non-solicitation provision that lasts for two years from the date Mr. McDonald's employment is terminated for any reason. If Mr. McDonald breaches these restrictive covenants, then the agreement requires disgorgement of benefits derived from such breach and injunctive relief, as well as other rights and remedies available to the Company.

If Mr. McDonald's employment is terminated without cause, then Mr. McDonald is entitled to receive payment of his annual salary for one year following the date of termination. Immediately following the final payment of the one-year post-termination salary, Mr. McDonald is released from the non-solicitation and non-competition covenants contained in the agreement, unless MCS-Detention elects to continue severance payments, including salary prorated over the extension period.

If Mr. McDonald voluntarily resigns or is terminated for cause during the period of employment, then he is not entitled to receive any benefit or compensation following the date of termination.

Tim Moxon

Mr. Moxon's employment agreement with MCS-Detention effective as of October 19, 2004, provides that Mr. Moxon will be employed as the Chief Financial Officer of MCS-Detention for a period five years with an automatic renewal of one year unless either party gives notice to the contrary. During the employment period, Mr. Moxon is prohibited from serving as a consultant, employee, officer, manager, agent, or director of any other entity and from owning more than a 5% stake in any other entity if MCS-Detention's Board of Directors determines that such service or ownership would have a material adverse effect on Mr. Moxon's ability to perform his duties under the employment agreement.

Mr. Moxon receives an annual salary of not less than \$105,000.00, to be reviewed annually by MCS-Detention's Board of Directors. Mr. Moxon is also entitled to receive an annual bonus equal to 15% of the 9% bonus pool derived from all entities of ISI. Mr. Moxon is also eligible for benefits in accordance with MCS-Detention's executive benefits plan including full payment of all health/medical insurance coverage for Mr. Moxon and his dependents. Mr. Moxon is also granted an option to purchase common stock in the parent company, such that upon full dilution, and the exercise of all options, Mr. Moxon may own 1.9% of the ownership interest in the parent company.

Mr. Moxon agrees to a perpetual confidentiality provision and a non-competition and non-solicitation provision that lasts for two years from the date Mr. Moxon's employment is terminated for any reason. If Mr. Moxon breaches these restrictive covenants, then the agreement requires disgorgement of benefits derived from such breach and injunctive relief, as well as other rights and remedies available to the Company.

If Mr. Moxon's employment is terminated without cause, then Mr. Moxon is entitled to receive payment of his annual salary for one year following the date of termination. Immediately following the final payment of the one-year post-termination salary, Mr. Moxon is released from the non-solicitation and non-competition covenants contained in the agreement, unless MCS-Detention elects to continue severance payments, including salary prorated over the extension period.

If Mr. Moxon voluntarily resigns or is terminated for cause during the period of employment, then he is not entitled to receive any benefit or compensation following the date of termination.

Post Merger Employment Agreements

There have been no employment agreements negotiated or drafted between Argyle and the executive officers of ISI, although it is anticipated that such agreements will be put in place after the closing of the ISI transaction.

It is anticipated that the Argyle Board of Directors will form a compensation committee promptly after the ISI transaction is closed. It is currently contemplated that at least a majority of the members of the Compensation Committee will be comprised of independent directors. Employment agreements for the executive officers of ISI will be negotiated with the independent members of this committee.

Argyle Executive Officers and Stockholders. No compensation of any kind, including finders and consulting fees, has been or will be paid to any Argyle stockholder who acquired common stock prior to its initial public offering, or any of their respective affiliates, for services rendered prior to or in connection with a business combination. However, those Argyle stockholders have been and will continue to be reimbursed for any out-of-pocket expenses incurred in connection with activities on Argyle's behalf, such as identifying potential target businesses and performing due diligence on suitable business combinations. There is no limit on the amount of these out-of-pocket expenses, and there will be no review of the reasonableness of the expenses by anyone other than Argyle's directors, or a court of competent jurisdiction if such reimbursement is challenged.

Since Argyle does not currently have an operating business, its officers do not receive any compensation for their service to Argyle; and, since it has no other employees, Argyle does not have any compensation policies, procedures, objectives or programs in place. Argyle will adopt appropriate compensation policies, procedures, objectives or programs after a merger with a target business is consummated and Argyle's management team has had the opportunity to fully understand the operations of the business. However, it is anticipated that, after closing, the compensation for senior executives of Argyle will be comprised of four elements: a base salary, an annual performance bonus, equity and benefits.

In developing salary ranges, potential bonus payouts, equity awards and benefit plans, it is anticipated that the Compensation Committee will take into account: 1) competitive compensation among comparable companies and for similar positions in the market, 2) relevant ways to incentivize and reward senior management for improving shareholder value while building Argyle into a successful company, 3) individual performance, 4) how best to retain key executives, 5) the overall performance of the Company and its various key component entities, 6) the Company's ability to pay and 7) other factors deemed to be relevant at the time.

Argyle and ISI senior management have discussed Argyle's above mentioned planned process for executive compensation after the merger is complete and the four compensation components. Specific compensation plans for ISI's key executives will be negotiated and established by the Compensation Committee after closing. This will include, but may not be limited to, the four ISI executives who currently have employment contracts (which will be modified, if necessary, to reflect any additions to or changes in compensation).

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**Argyle**

On June 23, 2005, Argyle issued an aggregate of 937,500 shares of Argyle's common stock to the individuals and entities set forth below for \$25,000 in cash, at a purchase price of \$0.027 per share, as follows:

Name	Number of Shares	Relationship to Argyle
Argyle Joint Venture	296,875	The general partner is an entity controlled by Bob Marbut, Argyle's Co-Chief Executive Officer, and Mr. Chaimovski, Argyle's other Co-Chief Executive Officer, owns interests in certain of its limited partners
Bob Marbut	296,875	These shares are owned by Argyle New Ventures, L.P., whose general partner is owned by Mr. Marbut, Argyle's Chairman and Co-Chief Executive Officer
Ron Chaimovski	296,875	Vice Chairman and Co-Chief Executive Officer
John J. Smith	46,875	Director

On July 13, 2005, Argyle issued the aforementioned stockholders options to purchase such additional number of shares as would be necessary to maintain their percentage ownership in Argyle after the offering in the event the underwriters exercise the over-allotment option. Such options were exercisable at \$0.027 per share only if and only to the extent that the over-allotment option was exercised. On September 23, 2005, Messrs. Marbut and Chaimovski, along with their affiliated entities, transferred an aggregate of 70,313 of their shares and a pro rata portion of their over-allotment options to Wesley Clark in connection with his appointment to Argyle's Board of Directors. On January 30, 2006, the underwriters exercised a portion of their over-allotment option and on February 1, 2006, the stockholders exercised their option for an aggregate of 18,761 shares of Argyle's common stock and Argyle received \$506.55 in connection with such exercise.

The holders of the majority of these shares will be entitled to make up to two demands that Argyle register these shares pursuant to an agreement January 24, 2006. The holders of the majority of these shares may elect to exercise these registration rights at any time after the date on which these shares of common stock are released from escrow, which, except in limited circumstances, is not before three years from the date of this prospectus. In addition, these stockholders have certain "piggy-back" registration rights on registration statements filed subsequent to the date on which these shares of common stock are released from escrow. Argyle will bear the expenses incurred in connection with the filing of any such registration statements.

On June 23 and July 6, 2005, Mr. Chaimovski and Argyle New Ventures, L.P., an entity controlled by Mr. Marbut, advanced a total of \$125,000 to Argyle to cover expenses related to Argyle's initial public offering. Such were payable

with 4% annual interest on the earlier of June 30, 2006 or the consummation of Argyle's initial public offering. In November 2005, these stockholders loaned Argyle an additional \$30,000 pursuant to 4% promissory notes due the earlier of November 15, 2006 or the consummation of Argyle's initial public offering. These loans were repaid on January 30, 2006 with the proceeds of Argyle's initial public offering.

Bob Marbut, Ron Chaimovski, Argyle New Ventures L.P. and Argyle Joint Venture purchased an aggregate of 125,000 units from Argyle at a purchase price of \$8.00 per unit in a private placement that occurred immediately prior to the effectiveness of Argyle's registration statement relating to its initial public offering on January 24, 2006. Argyle has granted the holders of such units demand and "piggy-back" registration rights with respect to the 125,000 shares, the 125,000 warrants and the 125,000 shares underlying the warrants at any time commencing on the date Argyle announces that it has entered into a letter of intent with respect to a proposed business combination. The demand registration may be exercised by the holders of a majority of such units. Argyle will bear the expenses incurred in connection with the filing of any such registration statements.

Argyle reimburses its officers and directors for any reasonable out-of-pocket business expenses incurred by them in connection with certain activities on Argyle's behalf such as identifying and investigating possible target businesses and business combinations. There is no limit on the amount of accountable out-of-pocket expenses reimbursable by Argyle, which will be reviewed only by Argyle's Board of Directors or a court of competent jurisdiction if such reimbursement is challenged.

Argyle's Board of Directors does not have any policies or procedures that it follows in connection to transactions it undertakes with related parties. The determination of any policies or procedures will be made after Argyle consummates a business combination. Other than the repayment of expenses, Argyle has had no transactions with related parties since its initial public offering.

ISI

MCS has entered into a global permanent exclusive license agreement for certain software with Mark McDonald, currently ISI's President of MCS-Detention. There are no ongoing payment obligations under this agreement.

In September 2004, Sam Youngblood and Don Carr created ISI*MCS, Ltd., a Texas limited partnership, for ISI*MCS to facilitate ISI's ability to perform contracts that require performance and payment bonds after ISI's bonding company indicated that it would not provide bonding to ISI after the William Blair Mezzanine Capital Fund III, L.P. refinancing and distributions to the ISI stockholders in connection with the Blair transaction, due to the deficit in equity at ISI after those transactions. ISI*MCS was formed to function as the contracting entity for all of ISI's bonded projects. In October 2004, all existing ISI bonded projects were transferred to ISI*MCS, and all future bonded projects were bid and contracted by ISI*MCS with the owner or general contractor. After the closing of the merger between ISI and Argyle, ISI*MCS will have no further arrangement, contract or agreement with ISI or Argyle.

Currently, ISI*MCS enters into contracts and provides the performance and payment bonds. ISI*MCS then subcontracts the work required by the bonded contracts to ISI-Detention, MCS-Detention or MCS-Commercial. ISI*MCS retains 2% of the amount of the contract for providing the bonds and assuming all risk under the bonds. ISI, through its three divisions, performs the work required by the bonded contracts in consideration for 98% of the original contract amount.

ISI*MCS does not compete with ISI. ISI*MCS only enters into contracts that require bonds, which ISI could not enter into, since ISI had no bonding capacity. After the merger, ISI and Argyle will provide ISI with any required bonding capacity, and ISI*MCS will no longer enter into contracts and subcontract them to ISI. After the completion of the ISI/Argyle merger, ISI*MCS will terminate all relationships with ISI. It is not anticipated that there will be an entity similar to ISI*MCS, after the merger is closed. ISI*MCS will not be dissolved after the merger because ISI*MCS will remain liable on the contracts entered into prior to the merger, and will remain in existence until all such liability has ended.

ISI-Detention, MCS-Detention and MCS-Commercial each entered into a master subcontract with ISI*MCS, whereby each of the entities agreed to fully and completely perform the work required by the bonded contracts that ISI*MCS subcontracted to such entities. There have been no defaults in performance of the work required by these contracts, or in payments between ISI*MCS and ISI.

As of September 30, 2006, ISI was obligated to pay ISI*MCS \$1,497,766.25 pursuant to its funding agreements and fees of \$488,289.89. Pursuant to the merger agreement, ISI*MCS is to be paid up to \$2,000,000 in full payment of all obligations of ISI.

On October 20, 2004, ISI*MCS and all of its limited partners granted to ISI the option to acquire 200 Units of Class A Limited Units in ISI*MCS (33% of the limited partnership interest) in ISI*MCS. The only limited partners in ISI*MCS at the time were Sam Youngblood and Don Carr (Chief Executive Officer and President of ISI, respectively). The General Partner of ISI*MCS was, and remains, ISI*MCS GP, Inc. a Texas corporation, of which Sam Youngblood and Don Carr are the only shareholders, officers and directors. ISI paid \$300,000 to ISI*MCS for this option. The exercise price per unit is \$1.00, and the option becomes exercisable upon (i) termination of the ISI*MCS partnership agreement or (ii) dissolution of ISI*MCS, and cannot be exercised after distribution of all or substantially all of the assets of ISI*MCS. ISI retains a put right to require the limited partners to purchase the option from ISI, which can be exercised upon (i) the seventh anniversary of the grant of the option or (ii) the dissolution of ISI*MCS. The put price is 33% of the Class A Preference Return to be paid to the partners of ISI*MCS upon dissolution of ISI*MCS. Payment of the put price is non-recourse to the partners, other than the funds made available to the Partners upon dissolution of ISI*MCS.

D. Hull Youngblood, Jr., brother to Sam Youngblood, the Chief Executive Officer of ISI, and the law firm of Hughes Luce, LLP, in which Mr. D. Hull Youngblood is a partner, provide legal services to ISI and its subsidiaries.

As of September 30, 2006 ISI held accounts receivable from Sam Youngblood and Don Carr in the amounts of \$174,617.89 and \$18,502.45, respectively. Effective November 30, 2006, Sam Youngblood and Don Carr had repaid these amounts in full.

Sam Youngblood and Don Carr are the principals in Green Wing Management, LP, the owner and lessor of the San Antonio office and warehouse facilities utilized by ISI and its subsidiaries. ISI currently pays Green Wing Management, LP \$23,667 per month in connection with such leases.

On November 1, 2005, Sam Youngblood, ISI's Chief Executive Officer loaned ISI \$65,922.00 and received a promissory note in that principal amount in exchange. The note matures on October 22, 2011 and until maturity interest at the rate of 12.00% per annum is payable quarterly. ISI is current in its obligations under this promissory note. Pursuant to the merger agreement, this promissory note will be paid off prior to or at the closing of the acquisition of ISI by Argyle.

On November 1, 2005, Don Carr, ISI's President loaned ISI \$32,469.00 and received a promissory note in that principal amount in exchange. The note matures on October 22, 2011 and until maturity interest at the rate of 12.00% per annum is payable quarterly. ISI is current in its obligations under this promissory note. Pursuant to the merger agreement, this promissory note will be paid off prior to or at the closing of the acquisition of ISI by Argyle.

Interests of Named Experts and Counsel

Loeb & Loeb LLP, Argyle's counsel, is issuing an opinion as to the validity of the shares of Argyle's common stock that will be issued pursuant to this prospectus/proxy statement. Loeb & Loeb LLP has waived its ability to sue the trust account in the event that the merger is not consummated, and, therefore, will not be paid for its services rendered in connection with the merger and this proxy statement/prospectus to the extent that the costs for such services (and those of all of our other vendors) exceed the amounts held outside of our trust account.

BENEFICIAL OWNERSHIP OF SECURITIES

The following table sets forth, as of _____, 2007, certain information regarding beneficial ownership of Argyle's common stock by each person who is known by Argyle to beneficially own more than 5% of Argyle's common stock. The table also identifies the stock ownership of each of Argyle's directors, each of Argyle's officers, and all directors and officers as a group. Except as otherwise indicated, the stockholders listed in the table have sole voting and investment powers with respect to the shares indicated.

Shares of common stock which an individual or group has a right to acquire within 60 days pursuant to the exercise or conversion of options, warrants or other similar convertible or derivative securities are deemed to be outstanding for the purpose of computing the percentage ownership of such individual or group, but are not deemed to be outstanding for the purpose of computing the percentage ownership of any other person shown in the table.

Name and Address of Beneficial Owner(1)	Amount and Nature of Beneficial Ownership	Approximate Percentage of Outstanding Common Stock
Bob Marbut	651,569(2)	13.6%
Argyle Joint Venture(3) 200 Concord Plaza, Suite 700 San Antonio, Texas 78216	278,910	5.8%
Ron Chaimovski	310,159	6.5%
Wesley Clark	71,720	1.50%
John J. Smith	47,813	1.00%
Sapling, LLC (4) Fir Tree Recovery Master Fund, L.P. 535 Fifth Avenue 31 st Floor New York, New York 10017	273,476	5.72%
Jack Silver (5) STAR Capital LLC 660 Madison Avenue New York, New York 10021	250,000	5.23%
Jonathan M. Glaser Daniel Albert David Roger Richter Pacific Assets Management, LLC Pacific Capital Management, Inc. JMG Triton Offshore Fund, Ltd.	247,751	5.2%
All directors and executive officers as a group	1,081,261	22.61%

(4 individuals)

(1) The business address of each of officers and directors of Argyle is 200 Concord Plaza, Suite 700, San Antonio, Texas 78216.

(2) Consists of 372,659 shares of Argyle common stock held by Argyle New Ventures, LP, which is controlled by Mr. Marbut, and 278,910 shares by Argyle Joint Venture, over which Mr. Marbut has voting and dispositive power.

(3) Mr. Marbut has voting and dispositive power over the shares held by Argyle Joint Venture.

(4) The information relating to Sapling and Fir Tree Master Recovery Fund is derived from a Schedule 13G dated January 30, 2006 filed by such entities with the Securities and Exchange Commission. Each person has shared voting and dispositive power with respect to each share of Argyle's common stock owned. Sapling may direct the voting and disposition of 186,610 shares of Argyle's common stock and Fir Tree Master Recovery Fund may direct the voting and disposition of 86,866 shares of Argyle's common stock. The sole member of both Sapling and Fir Tree Master Recovery Fund is Fir Tree Value Master Fund, LP and their investment manager is Fir Tree, Inc. Jeffrey Tannenbaum is the President of Sapling, LLC and Fir Tree Recovery Master Fund, L.P.

(5) The information relating to Jack Silver is derived from a Schedule 13G dated January 25, 2006 filed by Mr. Silver with the Securities and Exchange Commission.

(6) The information relating to the indicated stockholders is derived from a Schedule 13G, dated December 8, 2006, filed by such persons with the Securities and Exchange Commission. The principal business address of Jonathan M. Glaser is 11601 Wilshire Boulevard, Suite 2180, Los Angeles, CA 90025. The principal business address of Daniel Albert David, Pacific Assets Management, LLC and Pacific Capital Management, Inc. is 100 Drakes Landing, Suite 207, Greenbrae, CA 94904. The principal business address of Roger Richter is One Sansome Street, 39th Floor, San Francisco, CA 94104. The principal business address of JMG Triton Offshore Fund, Ltd. is Citco Building, Wickhams Cay, P.O. Box 662, Road Town, Tortola, BVI. Each person has shared voting and dispositive power with respect to each share of Argyle's common stock owned. Pacific Assets Management, LLC is the investment adviser to JMG Triton Offshore Fund, Ltd. and Pacific Capital Management, Inc. is a member of Pacific Assets Management, LLC. Mr. Glaser, Mr. David and Mr. Richter are control persons of Pacific Capital Management, Inc. and Pacific Assets Management, LLC.

105

Security Ownership of Officers and Directors of the Combined Company after the Acquisition

The following table sets forth information with respect to the beneficial ownership of the combined company's common stock immediately after the consummation of the acquisition by each person who is known by Argyle to beneficially own more than 5% of Argyle's common stock of Argyle's common stock, each officer, each director and all officers and directors as a group.

Shares of common stock which an individual or group has a right to acquire within 60 days pursuant to the exercise or conversion of options, warrants or other similar convertible or derivative securities are deemed to be outstanding for the purpose of computing the percentage ownership of such individual or group, but are not deemed to be outstanding for the purpose of computing the percentage ownership of any other person shown in the table.

Name and Address of Beneficial Owner(1)	Amount and Nature of Beneficial Ownership	Approximate Percentage of Outstanding Common Stock
Bob Marbut	651,569(2)	10.9%
Ron Chaimovski	310,159	5.2%
Wesley Clark	71,720	1.2%
John J. Smith	47,813	0.8%
Sam Youngblood	395,048	6.6%
Don Carr	194,576	3.3%
Mark McDonald	106,644	1.8%
William Blair Mezzanine Capital Fund III, L.P. (3)	440,288	7.4%
All directors and executive officers as a group (7 individuals)	1,777,529	29.8%

(1) The business address of each of officers and directors of Argyle is 200 Concord Plaza, Suite 700, San Antonio, Texas 78216.

(2) Consists of 372,659 shares of Argyle common stock held by Argyle New Ventures, LP, which is controlled by Mr. Marbut, and 278,910 shares by Argyle Joint Venture, over which Mr. Marbut has voting and dispositive power.

(3) David Jones has voting and dispositive power over the shares held by William Blair Mezzanine Capital Fund III, L.P.

SHARES ELIGIBLE FOR FUTURE SALE

After the acquisition of ISI, there will be 5,961,307 shares of Argyle common stock outstanding, of which all but 2,261,261 (1,081,261 shares owned by our current officers and directors and their respective affiliates and 1,180,000 shares to be issued to the current security holders of ISI.) shares will be registered and freely tradable without securities law restriction. The shares of common stock being issued in connection with the acquisition of ISI, by virtue of registration hereunder, will be freely tradable. In addition, there are outstanding warrants to purchase 3,825,046 shares of Argyle's common stock, each to purchase one share of common stock, 3,700,046 of which are freely tradable. The common stock issuable upon exercise of the warrants will also be freely tradable, provided that there is a registration statement in effect at the time of their exercise. Argyle intends to use its best efforts to cause such a registration statement to be in effect at such time as the warrants become exercisable. In addition, in connection with Argyle's initial public offering, Argyle issued a unit purchase option to the representative of the underwriters which is exercisable for 187,500 units, consisting of one share of common stock and one warrant to purchase one share of common stock at \$5.50 per share, at an exercise price of \$8.80 per unit. The securities underlying the representative's unit purchase option and underlying securities have registration rights and may be sold pursuant to Rule 144. Therefore, there are an aggregate of 4,200,046 shares of common stock that may be issued in the future upon exercise of outstanding warrants and options.

The 1,081,261 shares of Argyle's common stock owned by its officers and directors and their respective affiliates are being held in escrow, and, subject to certain limited exceptions, such as transfers to family members and trusts for estate planning purposes and upon death, these shares will not be transferable during the escrow period and will not be released from escrow until January 24, 2009, unless we were to consummate a transaction after the consummation of the initial business combination which results in all of the stockholders of the combined entity having the right to exchange their shares of common stock for cash, securities or other property.

At the closing of the merger, each of the security holders of ISI will enter into a lock-up agreement with Argyle with respect to the shares that they acquire pursuant to the merger so that they will not be able to sell the shares (except to family members or affiliates) until the specified times expire. William Blair Mezzanine Capital Fund III, L.P. will acquire 440,288 shares in connection with the merger and will not be able to sell such shares until the earlier of six months after the closing of the acquisition or November 1, 2007, whichever is earlier. The remaining 739,712 shares issued to Sam Youngblood, Don Carr, Mark McDonald and The Youngblood Trust will not be able to sell their shares until January 24, 2009.

In general, under Rule 144, a person who has owned restricted shares beneficially for at least one year is entitled to sell, within any three-month period, a number of shares that does not exceed the greater of the then-average preceding four weeks' average weekly trading volume or one percent of the total number of shares outstanding. Sales under Rule 144 are also subject to manner of sale provisions, notice requirements and the availability of current public information about the company. A person who has not been an affiliate of the company for at least the three months immediately preceding the sale and who has beneficially owned shares for at least two years is entitled to sell the shares under Rule 144 without regard to the limitations described above.

No prediction can be made about the effect that market sales of Argyle common stock or the availability for sale of Argyle common stock will have on its market price. Sales of substantial amounts of common stock in the public market could adversely affect the market price for Argyle's securities and could impair Argyle's future ability to raise capital through the sale of common stock or securities linked to it.

ARGYLE'S SECURITIES

General

Argyle is authorized to issue 89,000,000 shares of common stock, par value \$.0001, and 1,000,000 shares of preferred stock, par value \$.0001. As of the date of this proxy statement/prospectus, 4,781,307 shares of common stock are outstanding, held by six holders of record. No shares of preferred stock are currently outstanding.

107

Common Stock

Holders of the combined company's common stock will be to one vote for each share on all matters submitted to a vote of stockholders and do not have cumulative voting rights. Subject to the preferences and rights, if any, applicable to preferred stock, holders of common stock of the combined company are entitled to receive dividends if and when declared by the Board of Directors. Subject to the prior rights of the holders, if any, of preferred shares, holders of common stock are entitled to share ratably in any distribution of the assets of the combined company upon liquidation, dissolution or winding-up, after satisfaction of all debts and other liabilities.

Preferred Stock

Shares of preferred stock may be issued from time to time in one or more series. The Board of Directors of the combined company, without approval of the stockholders, will be authorized to designate series of preferred stock and to fix the rights, privileges, restrictions and conditions to be attached to each such series. The issuance of preferred stock, while providing flexibility in connection with possible acquisitions and other corporate purposes, could, among other things, adversely affect the voting power of the common stock.

As of the date of this document, there are no outstanding shares of preferred stock of any series.

Warrants

Argyle has 3,825,046 warrants currently outstanding, entitling the registered holder to purchase one share of common stock at \$5.50 per share. Argyle also has one unit purchase option outstanding, entitling the holder to purchase 187,500 units, consisting of one share of common stock and one warrant to purchase one share of common stock at \$5.50 per share, at an exercise price of \$8.80 per unit. The warrants are each subject to adjustment as discussed below, and are exercisable at any time commencing on the completion of the acquisition. The warrants will expire at 5:00 p.m., New York City time on January 24, 2011.

Argyle may call the warrants for redemption in whole and not in part, at a price of \$.01 per warrant, at any time after they become exercisable, upon not less than 30 days' prior written notice of redemption to each warrant holder; and if, and only if, the reported last sale price of the common stock equals or exceeds \$11.50 per share for any 20 trading days within a 30 trading day period ending on the third business day prior to the notice of redemption to warrant holders.

The warrants have been issued in registered form under a warrant agreement between American Stock Transfer & Trust Company, as warrant agent, and Argyle.

The exercise price and number of shares of common stock issuable on exercise of the warrants may be adjusted in certain circumstances including in the event of a stock dividend, or recapitalization, reorganization, merger or consolidation. However, the warrants will not be adjusted for issuances of common stock at a price below their respective exercise prices.

The warrants may be exercised upon surrender of the warrant certificate on or prior to the expiration date at the offices of the warrant agent, with the exercise form on the reverse side of the warrant certificate completed and executed as indicated, accompanied by full payment of the exercise price, by certified check payable to Argyle, for the number of warrants being exercised. Warrant holders do not have the rights or privileges of holders of common stock, or any voting rights, until they exercise their warrants and receive common stock. After the issuance of common stock upon exercise of the warrants, each holder will be entitled to one vote for each common share held of record on all matters to be voted on by stockholders.

The warrants may be deprived of any value and the market for the warrants may be limited if the prospectus relating to the common stock issuable upon their exercise of the warrants is not current or if the common stock is not qualified or exempt from qualification in the jurisdictions in which the holders of the warrants reside. No fractional shares will be issued upon exercise of the warrants. However, if a warrant holder exercises all warrants then owned of record by him, Argyle will pay to the warrant holder, in lieu of the issuance of any fractional share which is otherwise issuable, an amount for such fractional share in cash based on the market value of the common stock on the last trading day prior to the exercise date.

Change of Control Provisions

A number of provisions in Argyle's charter and bylaws and under Delaware law may make it more difficult to acquire control of Argyle. These provisions may have the effect of delaying, deferring, discouraging, preventing or rendering more difficult a future takeover attempt which is not approved by Argyle's Board, but which individual stockholders may deem to be in their best interests or in which they may receive a substantial premium over then-current market prices. As a result, stockholders who might desire to participate in such a transaction may not have an opportunity to do so. These provisions may also adversely affect the prevailing market price of the common stock. These provisions, which are described below, are intended to:

- Enhance the likelihood of continuity and stability in the Board of Directors;
- Discourage some types of transactions that may involve an actual or threatened change in control;
 - Discourage certain tactics that may be used in proxy fights;
- Ensure that the Board of Directors will have sufficient time to act in what it believes to be in the best interests of the company and its stockholders; and
- Encourage persons seeking to acquire control to consult first with the Board to negotiate the terms of any proposed business combination or offer.

Unissued Shares of Capital Stock

Common Stock. After the acquisition, Argyle will have approximately 5,961,307 shares of common stock outstanding, assuming that no stockholders elect to exercise their redemption rights. The remaining authorized and unissued common stock will be available for future issuance without additional stockholder approval. While the additional shares are not designed to deter or prevent a change of control, under some circumstances Argyle could use them to create voting impediments or to frustrate persons seeking to effect a takeover or otherwise gain control, by, for example, issuing shares in private placements to purchasers who might side with the Board of Directors in opposing a hostile takeover bid.

Preferred Stock. Argyle's Second Amended and Restated Certificate of Incorporation grants the Board of Directors the authority, without any further vote or action by stockholders, to issue preferred stock in one or more series, fix the number of shares constituting the series and establish the preferences, limitations and relative rights, including dividend rights, dividend rate, voting rights, terms of redemption, redemption price or prices, redemption rights and liquidation preferences of the shares of the series. The existence of authorized but unissued preferred stock could reduce the company's attractiveness as a target for an unsolicited takeover bid, since the company could, for example, issue preferred stock to parties who might oppose such a takeover bid, or issue shares with terms the potential acquirer may find unattractive. This may have the effect of delaying or preventing a change in control, discourage bids for the common stock at a premium over the market price, and adversely affect the market price, and voting and other rights of holders of common stock.

Comparison of Certain Charter and Bylaw Provisions of Argyle and ISI.

This section describes material differences between the rights of holders of Argyle common stock and the rights of holders of ISI capital stock. This summary is not intended to be a complete discussion of Argyle's Second Amended and Restated Certificate of Incorporation and bylaws and the certificate of incorporation and bylaws of ISI and is

qualified in its entirety by reference to the applicable document and applicable Delaware law.

109

Argyle and ISI are both organized under the laws of the State of Delaware. Therefore, any differences in the rights of holders of Argyle's capital stock and ISI capital stock arise primarily from differences in their respective certificates of incorporation and bylaws. Upon completion of the merger, holders of ISI capital stock will become holders of Argyle's capital stock, and their rights will be governed by Delaware law and Argyle's Second Amended and Restated Certificate of Incorporation and the bylaws of Argyle. The following discussion summarizes material differences between the rights of Argyle stockholders and ISI stockholders under the respective certificates of incorporation and bylaws of Argyle and of ISI. Copies of the governing corporate instruments are available without charge, to any person, including any beneficial owner to whom this document is delivered, by following the instructions listed under "*Where You Can Find More Information.*"

	Argyle	ISI
GENERAL MATTERS		
Registered office	615 South DuPont Highway, Dover, Delaware	1209 Orange Street Wilmington, Delaware
Transfer agent	American Stock Transfer and Trust Company	None
CAPITAL STRUCTURE		
Authorized capital stock	89,000,000 shares Common Stock, par value of \$.0001 per share 1,000,000 shares Preferred Stock, par value of \$.0001 per share	3,000 shares common stock, \$1.00 par value per share (ISI's certificate of incorporation will be amended immediately prior to the consummation of the acquisition to create a class of preferred stock that will be issued to William Blair Mezzanine Capital Fund III, L.P. in payment for a portion of outstanding debt).
Preferred (Preference) Shares	The Board of Directors is expressly granted authority to issue shares of the preferred stock, in one or more series, and to fix for each such series such voting powers, full or limited, and such designations, preferences and relative, participating, optional or other special rights and such qualifications, limitations or restrictions as shall be stated and expressed in the resolution or resolutions adopted by the Board of Directors providing for the	No class of preferred stock is currently authorized in ISI's certificate of incorporation. (ISI's certificate of incorporation will be amended immediately prior to the consummation of the acquisition to create a class of preferred stock that will be issued to William Blair Mezzanine Capital Fund III, L.P. in payment for a portion of outstanding debt).

issue of such series.

STOCKHOLDERS

Annual meetings

The Board of Directors sets the date and time for the annual meeting. To be properly brought before the annual meeting, business must be either (i) specified in the notice of annual meeting (or any supplement or amendment thereto) given by or at the direction of the Board of Directors, (ii) otherwise brought before the annual meeting by or at the direction of the Board of Directors, or (iii) otherwise properly brought before the annual meeting by a stockholder. In addition to any other applicable requirements for business to be properly brought before an annual meeting by a stockholder, the stockholder must have given timely notice thereof in writing to the Secretary of Argyle. To be timely, a stockholder's notice must be delivered to or mailed and received at the principal executive offices of Argyle not less than sixty days nor more than ninety days prior to the meeting; provided, however, that in the event that less than seventy days notice or prior public disclosure of the date of the annual meeting is given or made to stockholders, notice by a stockholder, to be timely, must be received no later than the close of business on the tenth day following the day on which such notice of the date of the annual meeting was mailed or such

The annual meeting is held at 11:00 a.m. on the last Tuesday of March in each year, unless that date is a legal holiday, in which case the meeting will be held on the next full business day.

public disclosure was made,
whichever first occurs.

Special meetings	Argyle Special meetings are not permitted to be called by Argyle's stockholders.	ISI Special meetings could be called by the Chairman of the Board, the President, the Board of Directors or by the holders of not less than one-tenth of all shares entitled to vote at the special meeting.
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BOARD OF DIRECTORS

Nominations	Nominations of persons for election to the Board of Directors at a meeting of stockholders may be made at such meeting by or at the direction of the Board of Directors, by any committee or persons appointed by the Board of Directors or by any stockholder entitled to vote for the election of directors. Such nominations by any stockholder are to be made pursuant to timely notice (as specified in the bylaws) in writing to the Secretary of Argyle.	Nominations may only be made by the Board of Directors or a committee of the Board of Directors.
Classes of directors; term	The Argyle Board of Directors is divided into three classes, with each class serving a staggered three-year term. Currently, Argyle's currently authorized number of directors is four, including one Class I director, one Class II director, and two Class III directors. The Argyle bylaws provide that its Board of Directors will consist of a number of directors to be fixed from time to time by a resolution duly adopted by the Argyle Board of Directors.	ISI's certificate of incorporation does not provide for classes of directors.

Vacancies	Argyle Newly created directorships and vacancies on the Board of Directors of Argyle resulting from death, resignation, disqualification, removal or other causes may be filled by a majority of the directors then in office, although less than a quorum, or by a sole remaining director.	ISI Vacancies on the Board of Directors may be filled by a majority of the directors then in office, although less than a quorum. Newly created directorships must be filled at an annual or special meeting of stockholders.
Removal	Argyle's bylaws provide that the entire Board of Directors or any individual director may be removed from office with or without cause by a majority vote of the holders of the outstanding shares then entitled to vote at an election of directors.	A director may only be removed at a special meeting of stockholders called for that purpose, with or without cause, by a vote of the holders of a majority of shares then entitled to vote at an election of directors.

ORGANIC CHANGES

Amendment of charter and bylaws	Argyle's certificate of incorporation may be amended in accordance with the general provisions of Delaware law; provided, however, that Article Sixth of Argyle's certificate of incorporation may not be amended prior to the consummation of a business combination (such as the one described in this proxy statement/prospectus).	ISI's certificate of incorporation may be amended in accordance with the general provisions of Delaware law.
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Classified Board of Directors, Vacancies and Removal of Directors

Argyle's Second Amended and Restated Certificate of Incorporation and bylaws provide that the Board of Directors will be divided into three classes of even number or nearly even number, with each class elected for staggered three-year terms expiring in successive years. Any effort to obtain control of the Board of Directors by causing the election of a majority of the Board of Directors may require more time than would be required without a staggered election structure. Under normal circumstances, stockholders may remove directors with or without cause. Vacancies in Argyle's Board of Directors, including a vacancy created by increasing the size of the Board of Directors, may only be filled by a majority of the directors. Any director elected to fill a vacancy, including a vacancy created by increasing the size of the Board of Directors, will hold office for the remainder of the full term of the class of directors in which the vacancy occurred and until such director's successor shall have been duly elected and qualified. No decrease in the number of directors will shorten the term of any incumbent director. The certificate of incorporation

and bylaws also provide that the number of directors will be fixed and increased or decreased from time to time by resolution of the Board of Directors. These provisions may have the effect of slowing or impeding a third-party from initiating a proxy contest, making a tender offer or otherwise attempting a change in the membership of Argyle's Board of Directors that would effect a change of control.

Business Combinations Under Delaware Law

As a Delaware corporation, Argyle is subject to Section 203 of the Delaware General Corporation Law, unless it elects in its charter not to be governed by that Section, which it has not done. Subject to specified exceptions, Section 203 prohibits a publicly held Delaware corporation from engaging in a “business combination” with an “interested stockholder” for a period of three years following the date the person became an interested stockholder, unless:

- Before that date, the Board of Directors approved either the business combination or the transaction in which the stockholder became an interested stockholder;
- Upon consummation of the transaction that resulted in the stockholder’s becoming an interested stockholder, the interested stockholder owned at least 85% of the voting stock outstanding at the time the transaction commenced, other than statutorily excluded shares; or
- On or after that date, the business combination is approved by the Board of Directors and authorized at an annual or special meeting of stockholders, and not by written consent, by the holders of at least two-thirds of the outstanding voting stock not owned by the interested stockholder.

A “business combination” includes a merger, asset or stock sale, or other transaction resulting in a financial benefit to the interested stockholder. Please note this is entirely different from the “business combination” provisions of Argyle’s certificate of incorporation that exist because Argyle is a “blank check” company. Except as otherwise described in the Delaware General Corporation Law, an “interested stockholder” is any person owning 15% or more of the outstanding voting stock of the corporation, or who is an affiliate or associate of the corporation and was the owner of 15% or more of the outstanding voting stock at any time within three years immediately before the date of determination, and the affiliates and associates of that person.

Limitation of Liability of Directors and Officers

Argyle’s Second Amended and Restated Certificate of Incorporation provides that no director will be personally liable to Argyle or its stockholders for monetary damages for breach of fiduciary duty as a director, except to the extent this limitation or exemption is not permitted by the Delaware General Corporation Law. As currently enacted, the Delaware General Corporation Law permits a corporation to provide in its certificate of incorporation that a director will not be personally liable to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, except for liability for: (i) any breach of the director’s duty of loyalty; (ii) acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) payments of unlawful dividends or unlawful stock repurchases or redemptions or (iv) any transaction from which the director derived an improper personal benefit.

The principal effect of this provision is that a stockholder will be unable to recover monetary damages against a director for breach of fiduciary duty unless the stockholder can demonstrate that one of the exceptions listed above applies. This provision, however, will not eliminate or limit liability arising under federal securities laws. The combined company’s charter will not eliminate its directors’ fiduciary duties. The inclusion of this provision in the charter may, however, discourage or deter stockholders or management from bringing a lawsuit against directors for a breach of their fiduciary duties, even though such an action, if successful, might otherwise have benefited the combined company and its stockholders. This provision should not affect the availability of equitable remedies such as injunction or rescission based upon a director’s breach of his or her fiduciary duties.

The Delaware General Corporation Law provides that a corporation may indemnify its directors and officers as well as its other employees and agents against judgments, fines, amounts paid in settlement and expenses, including attorneys' fees, in connection with various proceedings, other than an action brought by or in the right of the corporation, if such person acted in good faith and in a manner he or she reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, if he or she had no reasonable cause to believe his or her conduct was unlawful. A similar standard is applicable in the case of an action brought by or in the right of the corporation (commonly known as "derivative suits"), except that indemnification in such a case may only extend to expenses, including attorneys' fees, incurred in connection with the defense or settlement of such actions, and the statute requires court approval before there can be any indemnification where the person seeking indemnification has been found liable to the corporation. The combined company's charter and, with regard to its officers, its bylaws provide that the combined company will indemnify its directors and officers to the fullest extent permitted by Delaware law. Under these provisions and subject to the Delaware General Corporation Law, the combined company will be required to indemnify its directors and officers for all judgments, fines, settlements, legal fees and other expenses incurred in connection with pending or threatened legal proceedings because of the director's or officer's position with the combined company or another entity that the director or officer serves as a director, officer, employee or agent at the combined company's request, subject to various conditions, and to advance funds to the combined company's directors and officers before final disposition of such proceedings to enable them to defend against such proceedings. To receive indemnification, the director or officer must have been successful in the legal proceeding or have acted in good faith and in what was reasonably believed to be a lawful manner in the best interest of the combined company. The bylaws also specifically authorize the combined company to maintain insurance on behalf of any person who is or was or has agreed to become a director, officer, employee or agent of the combined company, or is or was serving at the combined company's request as a director, officer, employee or agent of another entity, against certain liabilities.

Transfer Agent and Registrar

The Transfer Agent and Registrar for the shares of Argyle common stock, warrants and units is American Stock Transfer & Trust Company, 59 Maiden Lane, Plaza Level, New York, NY 10038, (212) 936-5100.

STOCKHOLDER PROPOSALS

If the acquisition is consummated, the Argyle 2007 annual meeting of stockholders will be held on or about _____, 2007 unless the date is changed by the Board of Directors. If you are a stockholder and you want to include a proposal in the proxy statement for that annual meeting, you need to provide it to Argyle by no later than _____, 2007. You should direct any proposals to Argyle's secretary at Argyle's principal office.

LEGAL MATTERS

Loeb & Loeb LLP, New York, New York, will pass upon the validity of the Argyle common stock to be issued in the acquisition as set forth in this proxy statement/prospectus. A copy of their opinion is filed as an annex to the Registration Statement of which this proxy statement/prospectus forms a part.

EXPERTS

The financial statements of ISI included in this proxy statement/prospectus, have been audited by Padgett, Stratemann & Co., L.L.P., an independent registered public accounting firm, as stated in their report appearing herein, and have been so included in reliance upon the report of such firm, given upon their authority as experts in accounting and auditing.

The financial statements for the year ended December 31, 2005 for Argyle included in this document have been audited by Goldstein Golub Kessler LLP, independent registered public accounting firm, as stated in their report appearing herein, and have been so included in reliance upon their report, given upon their authority as experts in accounting and auditing.

DELIVERY OF DOCUMENTS TO STOCKHOLDERS

Pursuant to the rules of the Securities and Exchange Commission, Argyle and services that it employs to deliver communications to its stockholders are permitted to deliver to two or more stockholders sharing the same address a single copy of each of Argyle's annual report to stockholders and proxy statement. Upon written or oral request, Argyle will deliver a separate copy of the annual report to stockholders and/or proxy statement to any stockholder at a shared address who wishes to receive separate copies of such documents in the future. Stockholders receiving multiple copies of such documents may likewise request that Argyle deliver single copies of such documents in the future. Stockholders may notify Argyle of their requests by calling or writing Argyle at Argyle's principal executive offices at 200 Concord Plaza, Suite 700, San Antonio, TX 78216.

WHERE YOU CAN FIND MORE INFORMATION

Argyle files reports, proxy statements and other information with the Securities and Exchange Commission as required by the Securities Exchange Act of 1934, as amended.

You may read and copy reports, proxy statements and other information filed by Argyle with the SEC at its public reference room located at 100 F Street, N.E., Washington, D.C. 20549-1004.

You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. You may also obtain copies of the materials described above at prescribed rates by writing to the SEC, Public Reference Section, 100 F Street, N.E., Washington, D.C. 20549-1004.

Argyle files its reports, proxy statements and other information electronically with the SEC. You may access information on Argyle at the SEC web site containing reports, proxy statements and other information at <http://www.sec.gov>.

This proxy statement/prospectus describes the material elements of relevant contracts, exhibits and other information described in this proxy statement/prospectus. Information and statements contained in this proxy statement/prospectus are qualified in all respects by reference to the copy of the relevant contract or other document included as an annex to this document.

All information contained or incorporated by reference in this proxy statement/prospectus relating to Argyle has been supplied by Argyle, and all such information relating to ISI has been supplied by ISI. Information provided by either of us does not constitute any representation, estimate or projection of the other.

If you would like additional copies of this proxy statement/prospectus, or if you have questions about the acquisition, you should contact:

Bob Marbut
Chairman and Co-Chief Executive Officer
Argyle Security Acquisition Corporation
200 Concord Plaza, Suite 700
San Antonio, TX 78216
(210) 828-1700

INDEX TO FINANCIAL STATEMENTS

ISI Financial Statements F-2

Argyle Financial Statements F-30

**ISI DETENTION CONTRACTING GROUP, INC.
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

	PAGE
REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM	F-3
CONSOLIDATED BALANCE SHEETS	F-4
CONSOLIDATED STATEMENTS OF OPERATIONS	F-6
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT	F-7
CONSOLIDATED STATEMENTS OF CASH FLOWS	F-8 - F-9
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS	F-10 - F-29

F-2

Independent Auditors' Report

To the Board of Directors and Stockholders
ISI Detention Contracting Group, Inc.
and Subsidiaries
San Antonio, Texas

We have audited the accompanying consolidated balance sheets of ISI Detention Contracting Group, Inc. and Subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of operations, stockholders' deficit, and cash flows for the years ended December 31, 2005, 2004, and 2003. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in note 2, the consolidated financial statements as of December 31, 2005 and 2004 and for the years then ended have been restated to reflect additional interest expense.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ISI Detention Contracting Group, Inc. and Subsidiaries as of December 31, 2005 and 2004, and the results of their operations and their cash flows for the years ended December 31, 2005, 2004, and 2003, in conformity with accounting principles generally accepted in the United States of America.

/s/ Padgett, Stratemann & Co., L.L.P.
San Antonio, Texas
March 17, 2006, except for notes 2, 7, 9,
10, 14, 15, and 16, as to which the
date is December 1, 2006

F-3

ISI Detention Contracting Group, Inc. and Subsidiaries

Consolidated Balance Sheets

Assets

	December 31, 2005	December 31, 2004	September 30, 2006 (Unaudited)	September 30, 2005 (Unaudited)
Current Assets				
Cash and cash equivalents	\$ 415,764	\$ 1,308,344	\$ 254,483	\$ 149,707
Receivables:				
Contract - net of allowance for doubtful accounts of \$450,099 and \$113,328 at December 31, 2005 and 2004, respectively, and \$264,488 and \$284,220 at September 30, 2006 and 2005, respectively	10,229,418	6,678,633	16,694,584	11,150,997
Receivable - related party	2,327,846	3,493,640	4,160,046	1,416,142
Other	344,142	152,145	377,098	282,276
Inventory	355,493	1,726	324,464	1,725
Refundable income taxes	487,335	1,018,645	655,843	162,556
Deferred income taxes	-	17,736	-	17,736
Costs and estimated earnings in excess of billings on incomplete contracts	2,792,706	2,111,726	4,178,225	2,387,494
Total current assets	16,952,704	14,782,595	26,644,743	15,568,633
Property and Equipment				
Land and buildings	1,774,265	1,774,265	2,645,438	1,774,265
Furniture, fixtures, and equipment	2,368,561	2,060,771	2,506,579	2,157,966
Vehicles	1,670,024	1,561,207	1,767,351	1,611,417
	5,812,850	5,396,243	6,919,368	5,543,648
Less accumulated depreciation and amortization	2,694,422	2,063,407	3,195,984	2,510,109
Net property and equipment	3,118,428	3,332,836	3,723,384	3,033,539
Other Assets				
Goodwill	1,255,252	1,059,822	1,254,306	1,101,762
Loan origination fees - less accumulated amortization of \$387,731 and \$38,285 at December 31, 2005 and 2004, respectively, and \$649,815 and \$268,516 at September 30, 2006 and 2005, respectively	1,223,862	1,135,340	1,008,008	1,233,751

Deposits and other assets	35,458	26,071	171,355	34,269
Total other assets	2,514,572	2,221,233	2,433,669	2,369,782
	\$ 22,585,704	\$ 20,336,664	\$ 32,801,796	\$ 20,971,954

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

F-4

Liabilities and Stockholders' Deficit

	December 31, 2005	December 31, 2004	September 30, 2006 (Unaudited)	September 30, 2005 (Unaudited)
Current Liabilities				
Current maturities of long-term debt	\$ 60,788	\$ 131,836	\$ 80,814	\$ 61,444
Current portion of capitalized lease obligations	61,369	55,815	95,580	59,931
Accounts payable and accrued liabilities	5,973,993	4,034,804	11,175,091	5,256,680
Accounts Payable - related party	1,799,710	1,497,766	1,986,056	1,886,155
Billings in excess of costs and estimated earnings on incomplete contracts	3,533,968	3,831,885	6,912,067	3,487,879
Total current liabilities	11,429,828	9,552,106	20,249,608	10,752,089
Long-Term Liabilities				
Line of credit	4,450,850	4,429,335	4,662,850	4,281,850
Long-term debt - less current maturities	12,944,401	11,513,476	13,510,651	12,050,559
Long-term portion of capitalized lease obligations	1,422,001	1,483,370	2,011,705	1,433,519
Deferred income taxes	255,188	350,491	255,188	350,491
Warrants subject to redemption	4,412,948	4,153,896	4,819,615	4,380,258
Total long-term liabilities	23,485,388	21,930,568	25,260,009	22,496,677
Total liabilities	34,915,216	31,482,674	45,509,617	32,248,766
Stockholders' Deficit				
Common stock - \$1 par value; 3,000 shares authorized; 105 shares issued and outstanding	105	105	105	105
Additional paid-in capital	16,808	16,808	16,808	16,808
Accumulated deficit	(12,346,425)	(11,162,923)	(12,724,734)	(12,293,725)
Total stockholders' deficit	(12,329,512)	(11,146,010)	(12,707,821)	(12,276,812)
	\$ 22,585,704	\$ 20,336,664	\$ 32,801,796	\$ 20,971,954

ISI Detention Contracting Group, Inc. and Subsidiaries

Consolidated Statements of Operations

	Years Ended December 31,			Nine Months Ended September 30,	
	2005	2004	2003	2006 (Unaudited)	2005 (Unaudited)
Revenues:					
Contract revenues	\$ 20,905,409	\$ 34,871,115	\$ 31,823,804	\$ 22,729,085	\$ 16,021,017
Contract revenues - related party	14,475,895	2,872,324	-	13,586,044	9,970,445
Service revenues	3,771,050	2,420,096	2,522,983	4,881,879	2,409,492
Other revenues	82,133	11,451	378,808	36,798	29,126
	39,234,487	40,174,986	34,725,595	41,233,806	28,430,080
Cost of revenues:					
Contract costs	28,213,117	28,299,615	22,916,750	29,018,321	20,944,829
Other costs	2,652,272	2,271,716	2,165,342	3,554,670	1,772,683
	30,865,389	30,571,331	25,082,092	32,572,991	22,717,512
Gross profit	8,369,098	9,603,655	9,643,503	8,660,815	5,712,568
Management special bonuses	-	5,150,539	-	-	-
General and administrative expenses	6,908,440	6,495,638	6,341,568	6,249,385	4,846,606
	1,460,658	(2,042,522)	3,301,935	2,411,430	865,962
Interest expense	(3,177,891)	(812,777)	-	(2,779,773)	(2,459,407)
Investment and other income (loss) - net	7,915	(85,343)	(55,418)	346	(573)
Income (loss) before income taxes	(1,709,318)	(2,940,642)	3,246,517	(367,997)	(1,594,018)
Income tax expense (benefit):					
Current	(448,249)	(969,232)	1,745,613	10,312	(463,216)
Deferred	(77,567)	75,643	(580,844)	-	-
	(525,816)	(893,589)	1,164,769	10,312	(463,216)
Net income (loss)	\$ (1,183,502)	\$ (2,047,053)	\$ 2,081,748	\$ (378,309)	\$ (1,130,802)
Weighted-average number of shares outstanding:					

Basic and diluted	104.91	104.91	100.00	104.91	104.91
Income (loss) per share:					
Basic and diluted	\$ (11,281.12)	\$ (19,512.47)	\$ 20,817.48	\$ (3,606.03)	\$ (10,778.78)

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

F-6

ISI Detention Contracting Group, Inc. and Subsidiaries

Consolidated Statements of Stockholders' Deficit

Years Ended December 31, 2005, 2004, and 2003

	Common Stock	Additional Paid-In Capital	Retained Earnings (Deficit)	Total
Balance at December 31, 2002	\$ 100	\$ 900	\$ 5,737,722	\$ 5,738,722
Net income - year ended December 31, 2003	-	-	2,081,748	2,081,748
Balance at December 31, 2003	100	900	7,819,470	7,820,470
Stockholder distributions	-	-	(16,935,340)	(16,935,340)
Common stock issued	5	15,908	-	15,913
Net loss - year ended December 31, 2004 - as restated	-	-	(2,047,053)	(2,047,053)
Balance at December 31, 2004 - as restated	105	16,808	(11,162,923)	(11,146,010)
Net loss - year ended December 31, 2005 - as restated	-	-	(1,183,502)	(1,183,502)
Balance at December 31, 2005 - as restated	105	16,808	(12,346,425)	(12,329,512)
Net loss - nine months ended September 30, 2006 - unaudited	-	-	(378,309)	(378,309)
Balance at September 30, 2006 - unaudited	\$ 105	\$ 16,808	\$ (12,724,734)	\$ (12,707,821)

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

ISI Detention Contracting Group, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

Increase (Decrease) in Cash and Cash Equivalents

	Years Ended December 31,			Nine Months Ended September 30,	
	2005	2004	2003	2006 (Unaudited)	2005 (Unaudited)
Cash Flows From Operating Activities					
Net income (loss)	\$ (1,183,502)	\$ (2,047,053)	\$ 2,081,748	\$ (378,309)	\$ (1,130,802)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:					
Interest accretion and fair value adjustment of stock warrants	919,868	299,136	-	902,279	721,974
Depreciation and amortization of property and equipment	1,003,569	670,338	491,577	497,748	466,034
Loss on disposal of assets	-	37,129	20,827	-	-
Deferred income taxes	(77,567)	75,643	(585,351)	-	(17,735)
Changes in:					
Net decrease in marketable securities	-	-	784,231	-	-
Receivables:					
Contract	(3,650,791)	1,744,604	(43,613)	(6,498,122)	(4,602,495)
Contract - related party	1,165,794	(3,493,640)	-	(1,832,200)	2,077,498
Note receivable	-	177,386	-	-	-
Other	(191,997)	606,591	(446,194)	-	-
Prepared income taxes	-	-	189,667	-	-
Inventory	(453,767)	-	-	31,029	-
Refundable income taxes	531,310	(1,017,172)	-	(168,508)	873,825
Costs and estimated earnings in excess of billings on incomplete contracts	(680,980)	456,219	(1,705,399)	(1,385,519)	(275,768)
Prepaid expenses and other assets	-	900	32,647	-	-
Deposits and other assets	(9,387)	(3,712)	-	-	-
Accounts payable and accrued liabilities	1,939,195	718,875	(306,984)	5,201,098	1,221,876
Accounts payable - related party	301,944	1,497,766	-	186,346	388,389
Billings in excess of costs and estimated	(297,917)	1,576,040	(319,942)	3,378,099	(344,006)

earnings on incomplete contracts					
Income taxes payable	-	(1,071,291)	1,071,291	-	-
Net cash provided by (used in) operating activities	(684,228)	257,759	1,264,505	(66,059)	(621,210)

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

F-8

ISI Detention Contracting Group, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(Continued)

Increase (Decrease) in Cash and Cash Equivalents

	Years Ended December 31,			Nine Months Ended September 30,	
	2005	2004	2003	2006 (Unaudited)	2005 (Unaudited)
Cash Flows From Investing Activities					
Purchases of property and equipment	\$ (298,056)	\$ (620,071)	\$ (452,040)	\$ (426,516)	\$ (231,128)
Proceeds from sale of property and equipment	-	4,000	-	-	-
Loan origination fees and other assets	(468,811)	(1,676,131)	49,858	80,903	(148,549)
Net cash used in investing activities	(766,867)	(2,292,202)	(402,182)	(345,613)	(379,677)
Cash Flows From Financing Activities					
Line of credit borrowings - net	21,515	4,429,335	-	212,000	(147,485)
Short-term borrowings - net	-	-	(565,000)	-	-
Long-term borrowings	715,000	15,300,000	714,465	-	-
Payments on long-term borrowings and capitalized lease obligations	(178,000)	(318,985)	(861,799)	38,513	-
Stockholder distributions	-	(16,935,340)	-	-	-
Net cash provided by (used in) financing activities	558,515	2,475,010	(712,334)	250,513	(147,485)
Net increase (decrease) in cash and cash equivalents	(892,580)	440,567	149,989	(161,159)	(1,148,372)
Cash and cash equivalents at beginning of period	1,308,344	867,777	717,788	415,642	1,298,079
Cash and cash equivalents at end of period	\$ 415,764	\$ 1,308,344	\$ 867,777	\$ 254,483	\$ 149,707
Supplemental Disclosures of Cash Flow Information					
Cash paid for interest	\$ 2,258,023	\$ 513,641	\$ 72,565	\$ 1,877,494	\$ 1,737,733



Cash paid for income taxes - net										
of refunds	\$	-	\$	-	\$	450,000	\$	-	\$	-

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

F-9

1. Nature of Business and Significant Accounting Policies

ISI Detention Contracting Group, Inc. and Subsidiaries (the “Company”) are detention equipment contractors that specialize in turnkey installations, including design, engineering, supply, and installation of various detention equipment for correctional facilities and institutions. The work is performed under fixed-price contracts. The projects are located in various cities in the United States. The length of the contracts varies but is typically less than two years.

Metroplex Control Systems (“MCS”), a subsidiary of the Company, is a multi-faceted company responsible for turnkey installations covering the full spectrum of electronic security and low voltage systems, including fire alarm, access control, closed circuit television, intercom, sound/paging, and other custom designed systems.

Cash balances are maintained by the Company at several banks. Accounts at each institution are insured by the Federal Deposit Insurance Corporation up to \$100,000.

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

A summary of the significant accounting policies followed by the Company in preparation of the accompanying consolidated financial statements is set forth below:

Basis of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries and partnerships. Intercompany transactions and balances have been eliminated in consolidation.

Consolidated subsidiaries include ISI Detention Contracting Group, Inc.; ISI Detention Systems, Inc.; ISI Systems, Ltd.; Detention Contracting Group, Ltd.; ISI Controls, Ltd.; Metroplex Commercial Fire and Security Alarms, Inc.; MCFSA, Ltd.; and Metroplex Control Systems, Inc.

1. Nature of Business and Significant Accounting Policies (continued)

Recently Issued Accounting Pronouncements

In November 2005, the Financial Accounting Standards Board (“FASB”) issued Staff Position No. FAS 115-1, *The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments* (“FSP 115-1”). FSP 115-1 provides accounting guidance for determining and measuring other-than-temporary impairments of debt and equity securities, and confirms the disclosure requirements for investments in unrealized loss positions as outlined in EITF issue 03-01, *The Meaning of Other-Than-Temporary Impairments and its Application to Certain Investments*. The accounting requirements of FSP 115-1 are not expected to have a material impact on the Company’s consolidated financial position, results of operations, or cash flows.

In June 2005, FASB issued Statement on Financial Accounting Standards (“SFAS”) No. 154, *Accounting Changes and Error Corrections* (“SFAS No. 154”) - a replacement of APB No. 20 and FAS No. 3. SFAS No. 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. It establishes, unless impracticable, retrospective application as the required method for reporting a change in accounting principle in the absence of explicit transition requirements specific to the newly adopted accounting principle. SFAS No. 154 also provides guidance for determining whether retrospective application of a change in accounting principle is impracticable and for reporting a change when retrospective application is impracticable. The correction of an error in previously issued financial statements is not an accounting change. However, the reporting of an error correction involves adjustments to previously issued financial statements similar to those generally applicable to reporting an accounting change retrospectively. Therefore, the reporting of a correction of an error by restating previously issued financial statements is also addressed by SFAS No. 154. SFAS No. 154 is required to be adopted in fiscal years beginning after December 15, 2005. The Company does not believe its adoption will have a material impact on its financial position, results of operations, or cash flows.

1. Nature of Business and Significant Accounting Policies (continued)

Recently Issued Accounting Pronouncements (continued)

In December 2004, FASB revised and reissued SFAS No. 123-R, *Share-Based Payment* (“SFAS No. 123-R”), which supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*. The revised statement addresses the accounting for share-based payment transactions with employees and other third parties, eliminates the ability to account for share-based payment transactions using APB No. 25, and requires that the compensation costs relating to such transactions be recognized in the consolidated statement of operations. In March 2005, the Securities and Exchange Commission (“SEC”) released Staff Accounting Bulletin (“SAB”) No. 107, *Share-Based Payment* (“SAB No. 107”), to provide public companies additional guidance in applying the provisions of SFAS No. 123-R. Among other things, the SAB describes the staff’s expectations in determining the assumptions that underlie the fair value estimates and discusses the interaction of SFAS No. 123-R with certain existing staff guidance. SAB No. 107 should be applied upon the adoption of SFAS No. 123-R. In April 2005, the SEC amended Regulation S-X to provide a six-month adoption deferral period for public companies. The Company does not believe its adoption will have a material impact on its financial position, results of operations, or cash flows.

On December 16, 2004, FASB issued SFAS No. 153, *Exchanges of Nonmonetary Assets*(an amendment of APB Opinion No. 129) (“SFAS No. 153”). SFAS No. 153 addresses the measurement of exchanges of nonmonetary assets and redefines the scope of transactions that should be measured based on the fair value of the assets exchanged. SFAS No. 153 is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The Company does not believe the adoption of SFAS No. 153 will have a material effect on its results of operations, financial position, or cash flows.

In November 2004, FASB issued SFAS No. 151, *Inventory Costs* (“SFAS No. 151”), which amends part of Accounting Research Bulletin (“ARB”) No. 43, *Inventory Pricing* (“ARB No. 43”), concerning the treatment of certain types of inventory costs. The provisions of ARB No. 43 provided that certain inventory-related costs, such as double freight and re-handling might be “so abnormal” that they should be charged against current earnings rather than be included in the cost of inventory. As amended by SFAS No. 151, the “so-abnormal” criterion has been eliminated. Thus, all such (abnormal) costs are required to be treated as current period charges under all circumstances. In addition, fixed production overhead should be allocated based on the normal capacity of the production facilities, with unallocated overhead charged to expense when incurred. SFAS No. 151 is required to be adopted for fiscal years beginning after June 15, 2005. The Company does not believe the adoption of SFAS No. 153 will have a material effect on its results of operations, financial position, or cash flows.

1. Nature of Business and Significant Accounting Policies (continued)

Recently Issued Accounting Pronouncements (continued)

In June 2006, FASB issued Interpretation Number FIN 48, *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109* ("FIN 48"). FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, and provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The Company is evaluating the impact of the interpretation on its consolidated financial statements and will adopt the provisions of this interpretation in fiscal year 2007.

In September 2006, the SEC issued SAB 108. SAB 108 addresses the process and diversity in practice of quantifying financial statement misstatements resulting in the potential build up of improper amounts on the balance sheet. The Company will be required to adopt the provisions of SAB 108 effective during the fourth quarter of 2006. The Company does not believe the adoption of SAB 108 will have a material impact on its consolidated financial statements.

In September 2006, FASB issued FAS 157, *Fair Value Measurements* ("FAS 157"). FAS 157 establishes a framework for measuring fair value and expands disclosures about fair value measurements. The changes to current practice resulting from the application of this standard relate to the definition of fair value, the methods used to measure fair value, and the expanded disclosures about fair value measurements. FAS 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company does not believe the adoption of the provisions of FAS 157 will materially impact its financial position and consolidated results of operations.

Cash and Cash Equivalents

Cash equivalents for purposes of the consolidated statements of cash flows are all highly liquid debt instruments with original maturities of three months or less.

Accounts Receivable

Accounts receivable are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts is established as losses are estimated to have occurred through a provision for bad debts charged to earnings. Losses are charged against the allowance when management believes the uncollectibility of a receivable is confirmed. Subsequent recoveries, if any, are credited to the allowance. The allowance for doubtful accounts is evaluated on a regular basis by management and is based on historical experience and specifically identified questionable receivables. The evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

1. Nature of Business and Significant Accounting Policies (continued)

Accounts Receivable

Accounts receivable are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts is established as losses are estimated to have occurred through a provision for bad debts charged to earnings. Losses are charged against the allowance when management believes the uncollectibility of a receivable is confirmed. Subsequent recoveries, if any, are credited to the allowance. The allowance for doubtful accounts is evaluated on a regular basis by management and is based on historical experience and specifically identified questionable receivables. The evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

Fair Value of Financial Instruments

The recorded values of financial instruments, including accounts receivable, other assets, and accounts payable, approximate fair value due to their short maturity. The carrying value of the revolving line of credit approximates fair value due to its variable interest rate. The recorded value of the long-term debt approximates fair value based on borrowing rates currently available to the Company for financing arrangements with similar terms and average maturities. The warrants are recorded at fair value based on independent appraisals obtained by the Company.

Revenue Recognition

The Company recognizes revenue when services are performed except when work is being performed under a construction contract. Such contracts generally provide that the customers accept completion of progress to date and compensate the Company for services rendered measured in terms of units installed, hours expended, or some other measure of progress. Revenues from construction contracts are recognized on the percentage-of-completion method in accordance with the American Institute of Certified Public Accountants' Statement of Position 81-1, "*Accounting for Performance of Construction-Type and Certain Production-Type Contracts.*" The Company recognizes revenue on signed contracts and change orders. The Company generally recognizes revenue on unsigned change orders where it has written notices to proceed from the customer and where collection is deemed probable. Percentage-of-completion for construction contracts is measured principally by the percentage of costs incurred and accrued to date for each contract to the estimated total costs for each contract at completion. The Company generally considers contracts to be substantially complete upon departure from the work site and acceptance by the customer. Contract costs include all direct material, labor, subcontract, equipment costs, related payroll taxes and insurance costs, and any other indirect costs related to contract performance. Changes in job performance, job conditions, estimated contract costs, and profitability, and final contract settlements may result in revisions to costs and income and the effects of these revisions are recognized in the period in which the revisions are determined. Provisions for total estimated losses on incomplete contracts are made in the period in which such losses are determined.

Costs incurred prior to award of contracts are expensed as incurred.

The balances billed but not paid by customers pursuant to retainage provisions in construction contracts will be due upon completion of the contracts and acceptance by the customer. Based on the Company's experience with similar contracts in recent years, the retention balance at each balance sheet date will be collected within the subsequent fiscal year.

The current asset "Costs and estimated earnings in excess of billings on incomplete contracts" represents revenues recognized in excess of amounts billed which management believes will be billed and collected within the subsequent year. The current liability "Billings in excess of costs and estimated earnings on incomplete contracts" represents

billings in excess of revenues recognized.

Property and Equipment

Property and equipment are stated at cost. Depreciation and amortization are calculated on the straight-line method based on the following estimated useful lives: buildings - 10 to 40 years; furniture, fixtures, and equipment - 3 to 10 years; and vehicles - 3 to 7 years.

F-14

1. Nature of Business and Significant Accounting Policies (continued)

Property and Equipment (continued)

The Company reviews the carrying value of property and equipment for impairment whenever events and circumstances indicate the carrying value of the asset may not be recoverable from the estimated future cash flows expected to result from its use and eventual disposition. In cases where undiscounted expected future cash flows are less than the carrying value, an impairment loss is recognized equal to an amount by which the carrying value exceeds the fair value of assets. The factors considered by management in performing this assessment include current operating results, trends and prospects, and the effects of obsolescence, demand, competition, and other economic factors. Based on this assessment, there was no impairment at December 31, 2005 and 2004.

Assets Held Under Capital Leases

Assets held under capital leases are recorded at the lower of the net present value of the minimum lease payments or the fair value of the asset at the inception of the lease. Amortization expense is computed using the straight-line method over the shorter of the estimated useful life of the asset or the lease term.

Income Taxes

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets, including tax loss and credit carryforwards, and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred income tax expense represents the change during the period in the deferred tax assets and deferred tax liabilities. The components of the deferred tax assets and liabilities are individually classified as current and noncurrent based on their characteristics. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

1. Nature of Business and Significant Accounting Policies (continued)

Goodwill

As required by SFAS No. 142, *Goodwill and Other Intangible Assets*, the Company reviews goodwill annually for impairment at the end of each fiscal year, or if events or circumstances indicate potential impairment. The Company must recognize an impairment loss if, and to the extent that, goodwill exceeds fair value. Based on the reviews, the Company has determined that no goodwill impairment exists at December 31, 2005, 2004, and 2003.

Loan Origination Fees

Loan origination fees and costs related to the line of credit and the long-term note agreement (notes 7 and 8) are being amortized over the term of each respective note (three years for the line of credit and seven years for the long-term note agreement). Additional loan fees totaling approximately \$438,000 were added during 2005 relating to transactions occurring during 2005 and 2004. These amounts are being amortized over the original terms.

Contingencies

Certain conditions may exist as of the date the consolidated financial statements are issued, which may result in a loss to the Company but which will only be resolved when one or more future events occur or fail to occur. The Company's management and its legal counsel assess such contingent liabilities, and such assessment inherently involves an exercise of judgment. In assessing loss contingencies related to legal proceedings that are pending against the Company or unasserted claims that may result in such proceedings, the Company's legal counsel evaluates the perceived merits of any legal proceedings or unasserted claims, as well as the perceived merits of the amount of relief sought or expected to be sought therein.

If the assessment of a contingency indicates that it is probable that a material loss has been incurred and the amount of the liability can be estimated, then the estimated liability would be accrued in the Company's consolidated financial statements. If the assessment indicates that a potentially material loss contingency is not probable but is reasonably possible, or is probable but cannot be estimated, then the nature of the contingent liability, together with an estimate of the range of possible loss if determinable and material, would be disclosed.

Loss contingencies considered remote are generally not disclosed unless they involve guarantees, in which case the guarantees would be disclosed.

1. Nature of Business and Significant Accounting Policies (continued)***Basic and Diluted Net Income (Loss) Per Share***

Basic net income (loss) per common share is computed by dividing net income (loss) applicable to common stockholders by the weighted-average number of common shares outstanding during the period. Diluted net income (loss) per common share is determined using the weighted-average number of common shares outstanding during the period, adjusted for the dilutive effect of common stock equivalents, consisting of shares that might be issued upon exercise of common stock warrants and stock appreciation rights. In periods where losses are reported, the weighted-average number of common shares outstanding excludes common stock equivalents, because their inclusion would be anti-dilutive.

A reconciliation of basic and dilutive common stock shares is as follows:

	Years Ended December 31,			Nine Months Ended September 30,	
	2005	2004	2003	2006 (Unaudited)	2005 (Unaudited)
Weighted-average number of shares:					
Basic shares outstanding	104.91	104.91	100.00	104.91	104.91
Potential dilutive shares outstanding:					
Employee stock appreciation rights	19.65	17.48	-	22.89	19.65
Common stock warrants	52.45	52.45	-	52.46	52.45
Total potential dilutive common shares	72.10	69.93	-	75.35	72.10
Total basic and potential dilutive shares	177.01	174.84	100.00	180.26	177.01

Reclassification

Certain amounts have been reclassified from prior presentations to conform to current classifications. There is no effect on previously reported net income (loss) or accumulated deficit.

2. Restatements

Subsequent to the issuance of the consolidated financial statements of the Company as of December 31, 2005 and 2004, and for the years then ended, interest expense was adjusted to reflect an adjustment to the fair value of the warrants issued in connection with long-term debt issued in 2004. Accordingly, the consolidated financial statements as of December 31, 2005 and 2004, and for the years then ended, have been restated to reflect additional interest expense of \$884,868 and \$299,136, respectively, related to the stock warrants described in note 7. The warrants have been reclassified from stockholders' equity to long-term liabilities.

2. Restatements (continued)

The cumulative effect of the matters described above on the accompanying consolidated financial statements as of December 31, 2005 and 2004, and for the years then ended, was as follows:

	2005		2004	
	As Previously Reported	As Restated	As Previously Reported	As Restated
Interest expense	\$ 2,293,023	\$ 3,177,891	\$ 513,641	\$ 812,777
Loss before income taxes	(824,450)	(1,709,318)	(2,641,506)	(2,940,642)
Income tax benefit	313,039	525,816	856,143	893,589
Net loss	(511,411)	(1,183,502)	(1,785,363)	(2,047,053)
Basic and diluted earnings per share	(4,874.76)	(11,281.12)	(17,018.04)	(19,512.47)

Selected balance sheet accounts as of December 31, 2005 and 2004 are as follows:

	2005		2004	
	As Previously Reported	As Restated	As Previously Reported	As Restated
Long-term debt - less current maturities	\$ 16,163,345	\$ 12,944,401	\$ 15,158,236	\$ 11,513,476
Warrants subject to redemption	-	4,412,948	-	4,153,896
Stockholders' deficit	(11,185,731)	(12,329,512)	(10,674,320)	(11,146,010)

3. Contract Receivables

Contract receivables consist of the following:

	December 31,	
	2005	2004
Completed contracts and and contracts in progress	\$ 10,140,046	\$ 8,070,923
Retainage	2,417,218	2,101,350
	\$ 12,557,264	\$ 10,172,273

4. Related Party Transactions

Other receivables included \$164,266 and \$57,194 at December 31, 2005 and 2004, respectively, due from stockholders of the Company. The remainder of the other receivables include amounts due from employees and miscellaneous sales.

The Company had notes payable to the stockholders at December 31, 2005. The terms are included in note 7.

In conjunction with the major refinancing of the Company in 2004, the majority stockholders formed a new company in 2004 which is used as the contracting entity on all future bonded contracts. The Company transferred certain existing bonded contracts at their remaining contract values, and no gain or loss was recognized on the transfers to the new company (ISI*MCS, Ltd.) at the time of its formation. All contracts of ISI*MCS, Ltd. will be subcontracted to ISI Detention Contracting Group, Inc. for the full contract amount, less a 2% fee. The Company records contract revenue based on the ISI*MCS, Ltd.'s contract amount, net of the 2% fee. Contract revenue from ISI*MCS, Ltd. totaled \$14,475,895 for the year ended December 31, 2005 (\$2,872,324 in 2004). Contract receivables from ISI*MCS, Ltd. at December 31, 2005 totaled \$2,327,846 (\$3,493,640 in 2004).

Amounts payable to ISI*MCS, Ltd. at December 31, 2005 totaled \$1,799,710 (\$1,497,766 in 2004).

5. Costs and Estimated Earnings on Incomplete Contracts and Backlog

Costs and estimated earnings on incomplete contracts and backlog information are as follows:

	December 31,	
	2005	2004
Amended contract amount	\$ 86,733,666	\$ 66,911,055
Revenue recognized to date	41,294,221	41,069,747
Unearned contract amount - backlog	\$ 45,439,445	\$ 25,841,308
Cost to date	\$ 33,140,765	\$ 34,559,481
Estimated cost to complete	40,488,728	19,999,573
Estimated total cost	\$ 73,629,493	\$ 54,559,054
Billings to date	\$ 42,035,483	\$ 42,789,906
Costs and estimated earnings in excess of billings on incomplete contracts	\$ 2,792,706	\$ 2,111,726
Billings in excess of costs and estimated earnings on incomplete contracts	\$ 3,533,968	\$ 3,831,885

The Company recognizes as backlog only those contracts on which it has received signed contracts or executed letters of intent to award a contract from its customers. The Company also verifies funding is in place on the contracts prior to inclusion in backlog. Backlog is the contract amount less revenue recognized using percentage-of-completion accounting as described in note 1 of these consolidated financial statements.

The various subsidiary companies often function as subcontractors to other subsidiary companies. The above schedule is computed on a consolidated basis. Intercompany contract amounts and billings have been eliminated, and costs and estimated earnings in excess of billings and billings in excess of costs and estimated earnings have been recomputed based on actual combined costs of the companies.

6. Goodwill

The following analysis details the changes in goodwill for each reportable segment during the years ended December 31, 2005 and 2004:

	MCS Detention	MCS Commercial	Total
Balance at December 31, 2003	\$ 496,233	\$ 45,170	\$ 541,403
Acquisitions	-	138,744	138,744
Purchase accounting adjustments	379,675	-	379,675
Balance at December 31, 2004	875,908	183,914	1,059,822
Acquisitions	-	195,430	195,430
Balance at December 31, 2005	\$ 875,908	\$ 379,344	\$ 1,255,252

The acquisition of goodwill in 2005 resulted from the acquisition of the net assets of a company in a related line of business for approximately \$550,000. The allocation of the purchase price included approximately \$150,000 of goodwill acquired.

The acquisition of goodwill in 2004 resulted from the acquisition of the net assets of a company in a related line of business for approximately \$250,000. The allocation of the purchase price included approximately \$125,000 of goodwill acquired.

Purchase accounting adjustments in 2004 relate to a contingent payment of approximately \$380,000 related to the purchase of MCS Detention in 2001. The purchase agreement provided for a contingent payment in the event of a sale of MCS Detention. The Company and the seller agreed to the refinancing which occurred in 2004 as an event that triggered the payment of the contingent amount.

7. Long-Term Debt

Long-term debt consists of the following:

Collateral	Monthly Installment	Interest Rate	Payable Through	December 31,	
				2005	2004
Vehicles	\$473 to \$1,008	0.00% to 1.90%	2006	\$ 21,605	\$ 130,284
Vehicles	\$430 to \$579	Prime plus 0.50% to 1.00%	2009	38,112	-
Equipment	\$1,277	Prime plus 0.50%	2008	38,992	-
Unsecured (A)	(B)	11.58%	2011	12,757,665	11,445,240
Phone system	\$2,220	9.00%	2006	50,424	69,788
Stockholders - unsecured (A)	(B)	12.00%	2011	98,391	-
				13,005,189	11,645,312
Less current maturities				60,788	131,836
Long-term debt - less current maturities				\$ 12,944,401	\$ 11,513,476

(A) The notes are unsecured and subordinated to the line of credit (note 8). The note agreements contain prepayment options with prepayment penalties. There are both financial and restrictive covenants associated with the note agreements.

Proceeds received from the lender during 2004 totaled \$15,300,000 and were allocated \$11,335,104 to debt and \$3,964,896 to a common stock warrant based on an assessment of fair values. Total debt of \$15,300,000 is due and payable in one single payment in October 2011. The note payable discount of \$3,964,896 will be accreted as interest expense on the effective interest rate method through that date. Total accretion for 2005 was \$660,816 (\$110,136 in 2004).

7. Long-Term Debt (continued)

The lender warrant was for 52.4532 shares of common stock, which equated to giving the warrant holder 30% of the Company's shares after exercise of the warrant. Subsequent issuances of stockholder appreciation rights to key employees have caused the percentage to be diluted to 29.1%. The warrant has an exercise price of \$1.00 per share and is exercisable in whole or in part at any time through October 2014. The warrant contains put privileges, effective October 2011 or prior to that date upon the occurrence of certain events, which could cause settlement in cash versus Company shares; therefore, the warrants have been recorded as a liability. The put price is determined as the greater of five times earnings before income tax, depreciation, and amortization plus cash positions of the Company or market value of the Company.

Additional funds totaling \$651,609 were advanced from the lender during 2005 for the purchase of a company in a similar line of business. In connection with the acquisition, the stockholders loaned the Company funds in the amount of \$98,391. The 2005 advances have terms similar to the original terms and are unsecured and subordinated to the line of credit.

(B) Interest only through October 22, 2011, payable quarterly.

Aggregate maturities required on long-term debt at December 31, 2005 are as follows:

Year ending December 31,		
2006	\$	60,788
2007		54,661
2008		122,452
2009		111,232
2010		-
Later years		12,656,056
	\$	13,005,189

Interest expense includes the accretion of interest on the common stock warrant and mark-to-market adjustments for the fair value of the warrants. Increase in fair value of the warrants was estimated at \$259,052 and \$189,000 for the years ended December 31, 2005 and 2004, respectively.

8. Line of Credit

During 2004, the Company secured a new three-year line of credit agreement for \$6,000,000. The line of credit is secured by all tangible and intangible assets of the Company excluding vehicles. The line calls for all accounts receivable collections to be deposited directly to a lockbox. The note matures and is payable October 21, 2007. Interest is payable quarterly and is calculated at the lender's base rate (greater of prime or federal funds rate) plus 0.5% or 350 basis points in excess of LIBOR for the applicable period. The outstanding balance on the line at December 31, 2005 and 2004 was \$4,450,850 and \$4,429,335, respectively. The agreement contains both financial and restrictive covenants.

9. Capitalization of Leases

The Company sold its owner-occupied real estate to a partnership owned by the Company's stockholders during 2004 and entered into a lease back of the properties with the partnership. The lease is a triple net lease, expiring in 2018, at a monthly rental of \$16,667. The lease is required to be classified as a capital lease under accounting principles generally accepted in the United States or America. The Company had previously recorded and reported the asset and liability based on estimated incremental borrowing rates of the Company. The asset and liability have been adjusted and reported in these consolidated financial statements at their historical net carrying value at the date of sale, due to the related party nature of the sale. The effect of the changes in these carrying values did not result in any change in previously reported net income or stockholders' deficit.

The following is a summary of the leased property, included in property and equipment in the accompanying consolidated financial statements:

	December 31,	
	2005	2004
Land, buildings, and improvements	\$ 1,598,487	\$ 1,598,487
Less accumulated amortization	206,546	98,783
	\$ 1,391,941	\$ 1,499,704

Amortization of assets held under capital leases is included with depreciation expense.

9. Capitalization of Leases (continued)

The following is a schedule by years of future minimum lease payments under capital leases together with the present value of net minimum lease payments at December 31, 2005:

Year ending December 31,		
2006	\$	200,000
2007		200,000
2008		200,000
2009		200,000
2010		200,000
Later years		1,583,334
Future minimum lease payments		2,583,334
Less amount of net minimum lease payments attributable to interest		1,099,964
Present value of net minimum lease payments	\$	1,483,370
Current portion of capitalized lease obligations	\$	61,369
Long-term portion of capitalized lease obligations		1,422,001
	\$	1,483,370

September 30, 2006 (Unaudited)

The Company entered into a new lease in 2006. The lease expires in 2018 and has a monthly rental payment of \$7,000. The lease is required to be classified as a capital lease under accounting principles generally accepted in the United States of America.

The following is a summary of the additional property leased in 2006, which is included in property and equipment in the accompanying consolidated financial statements as of September 30, 2006:

Land and buildings	\$	680,000
Less accumulated amortization		27,200
	\$	652,800

10. Income Taxes

Income tax expense (benefit) differs from the amount which would be provided by applying the statutory federal income tax rates as follows:

	Years Ended December 31,		
	2005	2004	2003
Computed at the expected statutory rate	\$ (581,168)	\$ (999,818)	\$ 1,104,253
Permanent differences	100,535	96,120	4,757
State income tax - net of federal tax benefit	-	3,307	2,315
Change in beginning temporary differences	30,933	-	3,914
Change in valuation allowance	(21,855)	-	18,704
Long-term contract adjustments	(25,390)	-	-
Other	(28,871)	6,802	30,826
Tax expense (benefit)	\$ (525,816)	\$ (893,589)	\$ 1,164,769

The following temporary differences gave rise to the deferred tax liability at December 31:

	December 31,	
	2005	2004
Excess of tax over financial accounting depreciation	\$ (1,006,801)	\$ (921,204)
Capital lease	82,292	-
Reserve for bad debts	350,099	113,327
Section 267 disallowed loss	64,279	-
Long-term contracts less than 10% complete	(200,970)	(69,408)
Charitable contribution carryover	24,827	8,246
Realized capital losses	260,247	260,247
	(426,027)	(608,792)
Tax rate	34%	34%
Net deferred tax liability	(144,849)	(206,989)
Valuation allowance	(110,339)	(125,766)
	\$ (255,188)	\$ (332,755)
Deferred tax assets	\$ 265,793	\$ 106,220
Less valuation allowance	110,339	88,484
	155,454	17,736
Total deferred tax liability	410,642	350,491
Net deferred tax liability	\$ (255,188)	\$ (332,755)

10. Income Taxes (continued)

Change in the valuation allowance for the year ended December 31, 2005 was \$21,855 (\$32,865 for the year ended December 31, 2004). The allowance is related to capital losses incurred by the Company which can only be used to offset future capital gains.

11. Commitments

The Company leases office equipment under operating leases expiring through 2009. Rental expense was \$154,996, \$170,108, and \$160,650 for the years ended December 31, 2005, 2004, and 2003, respectively.

Minimum rental commitments as of December 31, 2005 are as follows:

Year ending December 31,		
2006	\$	150,018
2007		151,518
2008		121,692
2009		30,000
	\$	453,228

12. Noncash Investing and Financing Activities

The consolidated statements of cash flows do not reflect the following noncash investing and financing activities:

- Direct financing of \$118,551 was used for the purchase of equipment and vehicles during the year ended December 31, 2005 (\$136,099 in 2004).
- Debt totaling \$1,544,095 was assumed by a partnership owned by the Company's stockholders during the year ended December 31, 2004.
- Goodwill of \$15,913 was funded by the issuance of 2.2 shares of common stock during the year ended December 31, 2004.

12. Noncash Investing and Financing Activities (continued)

- Direct financing of \$220,335 was used for the purchase of vehicles during the year ended December 31, 2003.
- Direct financing of \$624,950 was used for the addition of the new facilities during the year ended December 31, 2003.

13. Self Insurance

The Company is self-insured to certain limits under its group health and dental plans. Stop-loss coverage is provided for claims above \$65,000 per employee. Operations are charged with the cost of claims reported and an estimate of claims incurred but not reported based on prior experience. The determination of such claims and expenses and the appropriateness of the related liability are continually reviewed and updated. Total claims payable and claims incurred but not reported were \$126,111 and \$147,840 at December 31, 2005 and 2004, respectively. These amounts are included in accrued liabilities.

14. Stock Appreciation Rights

The Company made verbal agreements with certain key employees to provide incentive compensation for enhancement of Company and stockholder value and to share in the future economic success of the Company. Under these agreements, the Company has committed to issue common stock shares to the key employees if the Company is sold, the employees are employed by the Company at time of sale, and sale price of the Company exceeds \$6,000,000.

In accordance with EITF No. 96-5, *Recognition of Liabilities for Contractual Termination Benefits or Changing Benefit Plan Assumptions in Anticipation of a Business Combination*, compensation cost will be recognized when a business combination has not been consummated.

Common shares committed to the employees are as follows:

	December 31,	
	2005	2004
Number of common stock shares	19.65	17.48
Estimated fair value	\$ 435,785	\$ 415,295

15. Segment Reporting

The Company's operations are classified into three principal reportable segments that provide different products and services. Separate management of each segment is required because each business unit is subject to different marketing, production, and technology strategies.

Operating Segments	Revenue	Inter-segment Revenue	Operating Income (Loss)	Depreciation/ Amortization	Total Assets	Capital Expenditures
ISI						
December 31, 2005	\$ 10,995,182	\$ 3,312,691	\$ (562,750)	\$ 561,992	\$ 17,627,240	\$ 130,620
December 31, 2004	\$ 14,756,861	\$ 7,046,554	\$ (4,162,230)	\$ 237,792	\$ 15,604,775	\$ 202,498
December 31, 2003	\$ 13,163,247	\$ 5,663,144	\$ 1,508,498	\$ 133,787	\$ 12,634,439	\$ 17,917
September 30, 2006*	\$ 14,714,767	\$ 6,571,221	\$ 480,406	\$ 76,994	\$ 25,273,735	\$ 93,159
September 30, 2005*	\$ 8,109,530	\$ 2,025,675	\$ (89,800)	\$ 104,757	\$ 15,376,843	\$ 142,195
MCS Detention						
December 31, 2005	\$ 10,891,378	\$ -	\$ 1,803,595	\$ 181,936	\$ 1,704,762	\$ 130,627
December 31, 2004	\$ 11,031,267	\$ -	\$ 2,284,252	\$ 176,858	\$ 1,836,695	\$ 250,528
December 31, 2003	\$ 8,021,813	\$ -	\$ 1,370,311	\$ 111,791	\$ 1,803,344	\$ 43,465
September 30, 2006*	\$ 9,919,561	\$ -	\$ 1,294,702	\$ 152,585	\$ 2,614,884	\$ 295,932
September 30, 2005*	\$ 7,275,493	\$ -	\$ 914,198	\$ 129,672	\$ 2,839,082	\$ 68,107
MCS Commercial						
December 31, 2005	\$ 17,347,927	\$ -	\$ 219,813	\$ 259,641	\$ 3,253,702	\$ 36,809
December 31, 2004	\$ 14,386,858	\$ -	\$ (164,544)	\$ 255,688	\$ 2,895,194	\$ 167,045
December 31, 2003	\$ 13,540,535	\$ -	\$ 423,126	\$ 245,999	\$ 1,435,514	\$ 390,658
September 30, 2006*	\$ 16,599,478	\$ -	\$ 636,322	\$ 268,169	\$ 4,913,177	\$ 37,425
September 30, 2005*	\$ 13,045,057	\$ -	\$ 41,564	\$ 231,605	\$ 2,756,029	\$ 20,826
Eliminations						
December 31, 2005	\$ -	\$ (3,312,691)	\$ -	\$ -	\$ -	\$ -
December 31, 2004	\$ -	\$ (7,046,554)	\$ -	\$ -	\$ -	\$ -
December 31, 2003	\$ -	\$ (5,663,144)	\$ -	\$ -	\$ -	\$ -
September 30, 2006*	\$ -	\$ (6,571,221)	\$ -	\$ -	\$ -	\$ -
September 30, 2005*	\$ -	\$ (2,025,675)	\$ -	\$ -	\$ -	\$ -
Total Company						
December 31, 2005	\$ 39,234,487	\$ -	\$ 1,460,658	\$ 1,003,569	\$ 22,585,704	\$ 298,056
December 31, 2004	\$ 40,174,986	\$ -	\$ (2,042,522)	\$ 670,338	\$ 20,336,664	\$ 620,071
December 31, 2003	\$ 34,725,595	\$ -	\$ 3,301,935	\$ 491,577	\$ 15,873,297	\$ 452,040
September 30, 2006*	\$ 41,233,806	\$ -	\$ 2,411,430	\$ 497,748	\$ 32,801,796	\$ 426,516
September 30, 2005*	\$ 28,430,080	\$ -	\$ 865,962	\$ 466,034	\$ 20,971,954	\$ 231,128

*Unaudited

16. Subsequent Event

Subsequent to September 30, 2006, the Company entered into a stock purchase agreement with Argyle Security Acquisition Corporation to sell all of its outstanding stock.

F-29

**ARGYLE SECURITY ACQUISITION CORPORATION
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

	<u>PAGE</u>
SEPTEMBER 30, 2006 FINANCIAL STATEMENTS:	
BALANCE SHEETS	F-31
STATEMENTS OF OPERATIONS	F-32
STATEMENTS OF STOCKHOLDERS' EQUITY	F-33
STATEMENTS OF CASH FLOWS	F-34
NOTES TO THE FINANCIAL STATEMENTS	F-35 - F-39
DECEMBER 31, 2005 FINANCIAL STATEMENTS:	
REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM	F-40
BALANCE SHEET	F-41
STATEMENT OF OPERATIONS	F-42
STATEMENT OF STOCKHOLDERS' EQUITY	F-43
STATEMENT OF CASH FLOWS	F-44
NOTES TO THE FINANCIAL STATEMENTS	F-44 - F-50

Argyle Security Acquisition Corporation
(a development stage company)

Balance Sheet

	September 30, 2006 (unaudited)	December 31, 2005
ASSETS		
Current assets:		
Cash	\$ 920,429	\$ 9,608
Cash and cash equivalents, held in trust	29,073,971	-
Prepaid expenses	29,333	-
Other assets, deferred offering costs	-	294,745
Total current assets	30,023,733	304,353
Deferred income taxes	34,442	-
Property and equipment, net of accumulated depreciation of \$1,075	5,445	-
Total assets	\$ 30,063,620	\$ 304,353
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accrued expenses	\$ 166,141	\$ 132,096
Notes payable - stockholders	-	155,000
Deferred underwriting costs	1,422,740	-
Accrued income taxes	71,926	-
Total liabilities	1,660,807	287,096
Common stock, subject to possible redemption - 764,627 shares at \$7.14 per share	5,459,435	-
Deferred interest attributable to common stock subject to possible redemption (net of taxes of \$37,484)	152,941	-
Stockholders' Equity:		
Preferred stock — \$.0001 par value; 1,000,000 shares authorized; 0 shares issued and outstanding	-	-
Common stock—\$.0001 par value; 89,000,000 shares authorized; issued and outstanding: 4,781,307 at September 30, 2006 (including 764,627 shares of common stock subject to possible redemption) and 937,500 at December 31, 2005	478	94
Additional paid-in capital	22,726,636	24,906
Retained earnings/(deficit accumulated) during the development stage	63,323	(7,743)
Total stockholders' equity	22,790,437	17,257
Total liabilities and stockholders' equity	\$ 30,063,620	\$ 304,353
See notes to unaudited financial statements		

Argyle Security Acquisition Corporation
(a development stage company)

Unaudited Statements of Operations

	Three months ended September 30, 2006	Three months ended September 30, 2005	Nine months ended September 30, 2006	Inception through September 30, 2005	Inception through September 30, 2006
Operating expenses	\$ 229,829	\$ 3,157	\$ 809,278	\$ 3,246	814,310
Other income and expense					
Bank interest income	5,173	-	11,409	-	11,409
Interest on cash and cash equivalents held in trust	382,549	-	952,609	-	952,609
Interest expense	(18,362)	(1,292)	(46,190)	(1,292)	(48,901)
Total other income and expense	369,360	(1,292)	917,828	(1,292)	915,117
Income/(Loss) before provision for income taxes	139,531	(4,449)	108,550	(4,538)	100,807
Provision for income taxes	37,484	-	37,484	-	37,484
Net income/(loss)	102,047	(4,449)	71,066	(4,538)	63,323
Deferred interest (net of taxes), attributable to common stock subject to possible redemption	38,987	-	152,941	-	152,941
Net income/(loss) allocable to holders of non-redeemable common stock	\$ 63,060	\$ (4,449)	\$ (81,875)	\$ (4,538)	\$ (89,618)
Net income/(loss) per share — basic and diluted	\$ 0.02	\$ (0.00)	\$ 0.02	\$ (0.00)	\$ 0.02
Weighted average number of shares outstanding — basic and diluted	4,781,307	937,500	4,375,600	937,500	2,951,666
Net income/(loss) per share exclusive of shares and related interest subject to possible redemption - - basic and diluted	\$ 0.02	\$ (0.00)	\$ (0.02)	\$ (0.00)	\$ (0.04)
Weighted average number of shares outstanding exclusive of shares subject to possible redemption — basic and diluted	4,016,680	937,500	3,692,197	937,500	2,551,303

See notes to unaudited financial statements

Argyle Security Acquisition Corporation
(a development stage company)

Unaudited Statements of Stockholders' Equity

	Common Stock Shares	Stock Amount	Paid-in Capital in Excess of Par	Retained Earnings/ (Deficit Accumulated) During the Development Stage	Total Stockholders' Equity
Stock issuance on June 23, 2005 at \$.027	937,500	\$ 94	\$ 24,906	\$	25,000
Net loss				\$ (7,743)	(7,743)
Balances, at December 31, 2005	937,500	\$ 94	\$ 24,906	\$ (7,743)	\$ 17,257
Stock issuance on January 24, 2006 at \$8	125,000	12	999,988	-	1,000,000
Stock issuance on January 30, 2006 at \$8	3,625,000	362	28,999,638	-	29,000,000
Stock issuance on January 30, 2006 at \$8	75,046	8	600,360	-	600,368
Proceeds from issuance of option to underwriters	-	-	100	-	100
Expenses of offerings	-	-	(2,417,117)	-	(2,417,117)
Less: Proceeds subject to possible redemption of 764,627 shares and associated deferred interest	-	-	(5,612,376)	-	(5,612,376)
Stock based compensation	-	-	130,632	-	130,632
Officer and director option exercise	18,761	2	505	-	507
Net income	-	-	-	71,066	71,066
Balances at September 30, 2006	4,781,307	\$ 478	\$ 22,726,636	\$ 63,323	\$ 22,790,437

See notes to unaudited financial statements

Argyle Security Acquisition Corporation
(a development stage company)

Unaudited Statement of Cash Flows

	Nine months ended September 30, 2006	Inception through September 30, 2005	Inception through September 30, 2006
Cash flows from operating activities			
Net income/(loss)	\$ 71,066	\$ (4,538)	\$ 63,323
Adjustment to reconcile net loss to net cash provided by operating activities:			
Stock based compensation	130,632	-	130,632
Depreciation expense	1,075	-	1,075
Increase in prepaid expenses	(29,333)	-	(29,333)
Increase in accrued expenses	162,045	2,677	166,140
Interest earned on cash and cash equivalents, held in trust	(952,609)	-	(952,609)
Accrued interest on deferred underwriting costs	45,725	-	45,725
Increase in deferred income tax asset	(34,442)	-	(34,442)
Increase in accrued income taxes	71,926	-	71,926
Interest income released from the trust	600,000	-	600,000
Net cash provided by (used in) operating activities	66,085	(1,861)	62,437
Cash flows from investing activities:			
Purchases of investments held in trust	(249,269,030)	-	(249,269,030)
Maturity of investments held in trust	220,547,667	-	220,547,667
Purchase of property and equipment	(6,520)	-	(6,520)
Net cash used in investing activities	(28,727,883)	-	(28,727,883)
Cash flows from financing activities			
Gross proceeds from public offering and private placement	30,600,368	-	30,600,368
Offering costs	(873,356)	(143,815)	(1,040,100)
Proceeds from issuance and exercises of options	607	-	607
Repayment of notes payable, stockholders	(155,000)	-	(155,000)
Proceeds from notes payable, stockholders	-	125,000	155,000
Proceeds from sale of common stock to founding stockholders	-	25,000	25,000
Net cash provided by financing activities	29,572,619	6,185	29,585,875
Net increase in cash	910,821	4,324	920,429
Cash, beginning of period	9,608	-	-
Cash, end of period	\$ 920,429	\$ 4,324	\$ 920,429
Supplemental disclosure of cash flow information			
Cash paid for interest	\$ 3,177	\$ -	\$ 3,177
Supplemental schedule of non-cash financing activities:			

Accrual of deferred underwriting costs	\$	1,377,017	\$	-	\$	1,377,017
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See notes to unaudited financial statements

F-34

Argyle Security Acquisition Corporation
(a development stage company)

Notes to Unaudited Financial Statements
September 30, 2006

Note 1 - Basis of Presentation

The financial statements of Argyle Security Acquisition Corporation (the "Company") as of September 30, 2006, for the three and nine months ended September 30, 2006, for the three months ended September 30, 2005, for the period from June 22, 2005 (inception) to September 30, 2006 (cumulative) and for the period from inception to September 30, 2005, are unaudited. In the opinion of management, all normal recurring adjustments considered necessary for a fair presentation have been included. Operating results for the interim periods presented are not necessarily indicative of the results to be expected for the year ending December 31, 2006. The audited balance sheet for the year ended December 31, 2005 does not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statement presentation.

The statements and related notes have been prepared pursuant to the rules and regulations of the U.S. Securities and Exchange Commission. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been omitted pursuant to such rules and regulations. These financial statements should be read in conjunction with the financial statements that were included in the Company's Annual Report on Form 10-K for the year ended December 31, 2005, as filed with the U.S. Securities and Exchange Commission.

Note 2 - Organization, business operations and summary of significant accounting policies

The Company was incorporated in Delaware on June 22, 2005 as a blank check company formed to acquire, through merger, capital stock exchange, asset acquisition or other similar business combination, a business in the security industry.

As of September 30, 2006, the Company had not completed an acquisition and was still in the development stage. All activity through September 30, 2006 relates to the Company's formation, its initial public offering and the initiation of its search for a target business.

The Company completed a private placement (the "Private Placement") on January 24, 2006 and received net proceeds of approximately \$900,000. Also on January 24, 2006, the registration statement for the Company's initial public offering (the "Public Offering") was declared effective. The Company consummated the Public Offering on January 30, 2006 and received net proceeds of approximately \$27.3 million. The Company's management has broad discretion with respect to the specific application of the net proceeds of the Private Placement and the Public Offering (collectively the "Offerings"), although substantially all of the net proceeds of the Offerings are intended to be generally applied toward consummating a business combination with a target company. As used herein, a "target business" shall include an operating business in the security industry and a "business combination" shall mean the acquisition by the Company of a target business.

Of the proceeds from the Offerings, approximately \$28.7 million was deposited into a trust account ("Trust Account") until the earlier of (i) the consummation of the first business combination or (ii) the distribution of the Trust Account as described below. The amount in the Trust Account includes approximately \$1.3 million of contingent underwriting compensation and \$45,000 of contingent private placement fees which will be paid to the underwriters if a business combination is consummated, but which will be forfeited if public stockholders elect to have their shares redeemed for cash if a business combination is not consummated. The remaining proceeds may be used to pay for business, legal

and accounting due diligence on prospective acquisitions and continuing general and administrative expenses.

F-35

The Company, after signing a definitive agreement for the acquisition of a target business, will submit such transaction for stockholder approval. The Company will proceed with a business combination only if a majority of the shares of common stock voted by the public stockholders are voted in favor of the business combination and public stockholders owning less than 20% of the aggregate shares sold in this offering and the private placement exercise their redemption rights. The officers and directors of the Company (“Initial Stockholders”), have agreed to vote their 937,500 founding shares of common stock in accordance with the vote of the majority in interest of all other stockholders of the Company with respect to any business combination and to vote the 125,000 shares of common stock included in the units they purchased in the Private Placement and any shares they acquire in the aftermarket in favor of the business combination. After consummation of the Company’s first business combination, these voting agreements will no longer be applicable.

With respect to the first business combination which is approved and consummated, any holder of shares sold in the Public Offering, other than the Initial Stockholders and their nominees (the “Public Stockholders”) who voted against the business combination may demand that the Company redeem his or her shares. The per share redemption price will equal \$7.14 per share plus interest earned thereon in the Trust Account, net of taxes payable and \$600,000 of interest income which was released from the Trust Account in September, 2006 to fund our working capital. Public Stockholders holding 19.99% of the aggregate number of shares sold in this offering and the private placement may seek redemption of their shares in the event of a business combination. Accordingly, an amount classified as common stock subject to possible redemption and the associated deferred interest has been reflected in the accompanying balance sheet.

The Company’s Certificate of Incorporation provides for liquidation of the Company in the event that the Company does not consummate a business combination within 18 months from the date of consummation of the Public Offering, or 24 months from the consummation of the Public Offering if certain extension criteria have been satisfied. The Initial Stockholders have waived their right to liquidation distributions with respect to the shares of common stock owned by them prior to the Public Offering. Accordingly, in the event of such a liquidation, the amount in the Trust Account will be distributed to the holders of the shares sold in the Public Offering.

Cash and cash equivalents

The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents.

Income taxes

Deferred income taxes are recorded based on enacted statutory rates to reflect the tax consequences in future years of the differences between the tax bases of assets and liabilities and their financial reporting amounts. Deferred tax assets, such as net operating loss carryforwards, which will generate future tax benefits are recognized to the extent that realization of such benefits through future taxable earnings or alternative tax strategies in the foreseeable short term future is more likely than not.

Recently issued accounting pronouncements

In December 2004, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 123 (revised 2004), “Share based payment” (“SFAS 123(R)”). SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values. The Company adopted SFAS 123(R) on January 1, 2006.

In June, 2006, the FASB issued FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes” (FIN 48), an interpretation of Statement of Financial Accounting Standards No. 109, “Accounting for Income Taxes” (FAS 109).

FIN 48 clarifies the accounting for uncertainty in income taxes by prescribing a recognition threshold for tax positions taken or expected to be taken in a tax return. FIN 48 is effective for fiscal years beginning after December 15, 2006. We are currently evaluating the impact FIN 48 will have on our financial position or results of operations.

F-36

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates.

Note 3 - Offerings

Public Offering

On January 30, 2006, the Company sold 3,700,046 units (which includes 75,046 units sold by the underwriters pursuant to a partial exercise of their over-allotment option) to the public at a price of \$8.00 per unit. Each unit consists of one share of the Company's common stock, \$0.0001 par value, and one redeemable common stock purchase warrant ("warrant"). Each warrant entitles the holder to purchase from the Company one share of common stock at an exercise price of \$5.50 commencing the later of the completion of a business combination with a target business or January 24, 2007 and expiring January 24, 2011. The warrants are redeemable by the Company at a price of \$.01 per warrant upon 30 days notice after the warrants become exercisable, only in the event that the last sale price of the common stock is at least \$11.50 per share for any 20 trading days within a 30 trading day period ending three business days before a notice of redemption is delivered.

Private Placement

On January 24, 2006, the Company sold to certain of its officers and directors an aggregate of 125,000 units identical to the units sold in the Public Offering at a price of \$8.00 per unit.

Note 4 - Notes Payable to Stockholders

In 2005, the Company issued unsecured promissory notes to the officers of the Company totaling \$155,000. The Notes had an interest rate of 4% per annum and were paid in full with proceeds from the Public Offering, including aggregate interest of \$3,177.

Note 5 - Stockholders' Equity

On July 13, 2005 the Company granted to its officers, directors and their respective affiliates certain options, which were exercisable only in the event the underwriters exercised the over allotment option, to purchase that number of shares enabling them to maintain their 20% ownership interest in the company (without taking into account the units they purchased in the private placement). The measurement date was deemed to be January 30, 2006, the date the over allotment was exercised because the number of options to be issued was not known until that date.

On January 30, 2006 the underwriters exercised the over allotment option in the amount of 75,046 units. On February 1, 2006 the officers and directors exercised their options and purchased 18,761 units for an aggregate cost of \$507. The compensation cost resulting from these share-based payments was \$130,632 at January 30, 2006 using the Black-Scholes pricing model. This model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. The fair value of the options was estimated at the measurement date using the following assumptions:

- Weighted average volatility factor of 0.10;
- No expected dividend payments;
- Weighted average risk-free interest rate of 5%;
- A weighted average expected life of 0.13 years.

The fair value of each option was \$6.99 per share. The exercise price of each option was \$0.027 per share. All options vested immediately at the measurement date and no further options may be exercised. Compensation expense was recognized immediately and recorded as an operating expense.

As of September 30, 2006, no officer or director of the Company holds options to purchase the Company's securities.

The Company's officers and their respective affiliates purchased an aggregate of 125,000 units in the Private Placement, but have waived their right to liquidation distributions with respect to the shares of common stock included in such units. Accordingly, in the event of such a liquidation, the amount in the Trust Account will be distributed to the holders of the shares sold in the Public Offering.

The Company sold to the underwriters for \$100, options to purchase up to an aggregate of 187,500 units. The units issuable upon exercise of these options are identical to those sold on January 24, 2006. These options will be exercisable at \$8.80 per unit commencing on the later of the consummation of a business combination or one year from January 24, 2006, and expiring January 24, 2011. The options to purchase the 187,500 units and the Securities underlying such units have been deemed compensation by the National Association of Securities Dealers ("NASD") and are therefore subject to a 180-day lock-up pursuant to Rule 2710(g) (1) of the NASD Conduct Rules. Additionally, these options may not be sold, transferred, assigned, pledged or hypothecated for a one-year period (including the foregoing 180-day period) following January 24, 2006. However, these options may be transferred to any underwriter and selected dealer participating in the offering and their bona fide officers or partners.

The Company accounted for these purchase options as a cost of raising capital and included the instrument as equity in its financial statements. Accordingly, there is no net impact on the Company's financial position or results of operations, except for the recording of the \$100 proceeds from the sale. The Company has estimated, based upon a Black Scholes model, that the fair value of the purchase options on the date of sale was approximately \$3.40 per unit, (a total value of approximately \$637,500) using an expected life of five years, volatility of 44%, and a risk-free rate of 5%. However, because the Company's units do not have a trading history, the volatility assumption was based on information currently available to management. The volatility estimate was derived using historical data of public companies in the proposed industry. The Company believes the volatility estimate calculated from these companies was a reasonable benchmark to use in estimating the expected volatility of our units; however, the use of an index to estimate volatility may not necessarily be representative of the volatility of the underlying securities. Although an expected life of five years was used in the calculation, if the Company does not consummate a business combination within the prescribed time period and it liquidates, the options will become worthless.

The Company has engaged Rodman & Renshaw, LLC (the "Representative"), on a non-exclusive basis, as its agent for the solicitation of the exercise of the warrants. To the extent not inconsistent with the guidelines of the NASD and the rules and regulations of the Securities and Exchange Commission, the Company has agreed to pay the Representative for bona fide services rendered a commission equal to 5% of the exercise price, if the exercise was solicited by the Representative. In addition to soliciting, either orally or in writing, the exercise of the warrants, the Representative's services may also include disseminating information, either orally or in writing, to warrant holders about the Company or the market for the Company's securities, and assisting in the processing of the exercise of the warrants. No compensation will be paid to the Representative upon the exercise of the warrants if:

- the market price of the underlying shares of common stock is lower than the exercise price;
- the holder of the warrants has not confirmed in writing that the representative solicited the exercise;
- the warrants are held in a discretionary account;
- the warrants are exercised in an unsolicited transaction; or
- the arrangements to pay the commission is not disclosed to warrant holders at the time of exercise.

Note 6 - Common stock reserved for issuance

As of September 30, 2006, 3,825,046 shares of common stock were reserved for issuance upon exercise of redeemable warrants and 375,000 shares of common stock were reserved for issuance pursuant to the underwriters' unit purchase option described above.

Note 7 - Preferred Stock

The Company is authorized to issue 1,000,000 shares of preferred stock with such designations, voting and other rights and preferences, as may be determined from time to time by the Board of Directors. No shares of preferred stock are currently issued or outstanding.

Note 8 - Income Taxes

The provision for income taxes for the period from January 1, 2006 through September 30, 2006 is as follows:

	January 1, 2006 Through September 30, 2006
Current tax expense	\$ 71,926
Deferred tax (benefit)	(34,442)
	\$ 37,484

The company recorded a \$71,926 provision on its current taxable income and a deferred tax benefit of \$34,442 in its provision for income taxes. In addition, the Company recorded deferred interest expense attributable to possible common stock redemptions net of a tax benefit of \$37,484. A valuation allowance against additional net deferred tax assets in the amount of \$27,261 is the result of an evaluation of the uncertainty associated with the realization of the benefit of these tax assets.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders
Argyle Security Acquisition Corporation

We have audited the accompanying balance sheet of Argyle Security Acquisition Corporation (a corporation in the development stage) as of December 31, 2005, and the related statements of operations, stockholders' equity and cash flows for the period from June 22, 2005 (inception) to December 31, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Argyle Security Acquisition Corporation as of December 31, 2005, and the results of its operations and its cash flows for the period from June 22, 2005 (inception) to December 31, 2005 in conformity with United States generally accepted accounting principles.

/s/ Goldstein Golub Kessler LLP
GOLDSTEIN GOLUB KESSLER LLP
New York, New York

February 3, 2006

F-40

ARGYLE SECURITY ACQUISITION CORPORATION
(a corporation in the development stage)

BALANCE SHEET

	December 31, 2005
Assets	
Current assets - cash	\$ 9,608
Other assets, deferred offering costs	294,745
Total assets	\$ 304,353
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current liabilities	
Accrued expenses	\$ 132,096
Notes payable, stockholders	155,000
Total liabilities	287,096
Stockholders' equity	
Preferred stock, \$.0001 par value, authorized 1,000,000 shares; none issued	—
Common stock, \$.0001 par value, authorized 89,000,000 shares; issued and outstanding 937,500	94
Paid-in capital in excess of par	24,906
Deficit accumulated during the development stage	(7,743)
Total stockholders' equity	17,257
Total liabilities and stockholders' equity	\$ 304,353

See accompanying notes to the financial statements.

ARGYLE SECURITY ACQUISITION CORPORATION
(a corporation in the development stage)

STATEMENT OF OPERATIONS

**For
the period From June
22, 2005 (inception)
to December
31, 2005**

Formation and operating costs	\$ 7,743
Net loss	(7,743)
Weighted-average shares outstanding (basic and diluted)	937,500
Net loss per share (basic and diluted)	\$ (0.01)

See accompanying notes to financial statements.

F-42

ARGYLE SECURITY ACQUISITION CORPORATION

(a corporation in the development stage)

STATEMENT OF STOCKHOLDERS' EQUITY

For the period from June 22, 2005

(inception) to December 31, 2005

	Common Stock		Paid-in Capital in Excess of Par		Deficit Accumulated During the Development Stage	Total Stockholders' Equity
	Shares	Amount				
Stock issuance on June 23, 2005 at \$.027	937,500	\$ 94	\$ 24,906			\$ 25,000
Net loss					\$ (7,743)	(7,743)
Balances, at December 31, 2005	937,500	\$ 94	\$ 24,906		\$ (7,743)	\$ 17,257

See accompanying notes to financial statements.

ARGYLE SECURITY ACQUISITION CORPORATION
(a corporation in the development stage)

STATEMENT OF CASH FLOWS

For the period
from June 22,
2005 (inception)
to December 31,
2005

Cash flows from operating activities

Net loss	\$	(7,743)
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**Adjustment to reconcile net loss to net cash
provided by operating activities:**

Increase in accrued expenses		4,096
Net cash used in operating activities		(3,647)

Cash flows from financing activities

Proceeds from notes payable, stockholders		155,000
Proceeds from sale of common stock		25,000
Payments made for deferred offering costs		(166,745)

Net cash provided by financing activities		13,255
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Net increase in cash		9,608
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Cash, beginning of period		0
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Cash, end of period	\$	9,608
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Supplemental schedule of non-cash financing activities:

Accrual of costs of public offering	\$	128,000
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See accompanying notes to financial statements.

ARGYLE SECURITY ACQUISITION CORPORATION
(a corporation in the development stage)
NOTES TO FINANCIAL STATEMENTS

Note 1 - Organization, business operations and summary of significant accounting policies

Argyle Security Acquisition Corporation (the "Company") was incorporated in Delaware on June 22, 2005 as a blank check company to acquire, through merger, capital stock exchange, asset acquisition or other similar business combination, a business in the security industry.

At December 31, 2005, the Company had not yet commenced any operations. All activity through December 31, 2005 relates to the Company's formation, a private placement and initial public offering described below. The Company has selected December 31 as its fiscal year-end.

The Company, after signing a definitive agreement for the acquisition of a target business, will submit such transaction for stockholder approval. The officers and directors of the Company ("Initial Stockholders"), have agreed to vote their 937,500 founding shares of common stock in accordance with the vote of the majority in interest of all other stockholders of the Company with respect to any business combination and to vote the 125,000 shares of common stock included in the units they purchased in the Private Placement (as defined in Note 6) and any shares they acquire in the aftermarket in favor of the business combination. After consummation of the Company's first business combination, all of these voting safeguards will no longer be applicable.

With respect to the first business combination which is approved and consummated, any holder of shares sold in the Public Offering (as defined in Note 6), other than the Initial Stockholders and their nominees (the "Public Stockholders") who voted against the business combination may demand that the Company redeem his or her shares. The per share redemption price will equal \$7.14 per share plus interest earned thereon (less taxes payable and up to \$600,000 of the interest earned on the trust account that may be released to the Company) in the Trust Account (as defined in Note 6). Accordingly, Public Stockholders holding 19.99% of the aggregate number of shares sold in this offering and the private placement may seek redemption of their shares in the event of a business combination.

The Company's Certificate of Incorporation provides for mandatory liquidation of the Company, without stockholder approval, in the event that the Company does not consummate a business combination within 18 months from the date of consummation of the Public Offering, or 24 months from the consummation of the Public Offering if certain extension criteria have been satisfied. The Initial Stockholders purchased an aggregate of 125,000 units in the Private Placement, but have waived their right to liquidation distributions with respect to the shares of common stock included in such units. Accordingly, in the event of such a liquidation, the amount in the Trust Account will be distributed to the holders of the shares sold in the Public Offering.

ARGYLE SECURITY ACQUISITION CORPORATION
(a corporation in the development stage)
NOTES TO FINANCIAL STATEMENTS

Cash and cash equivalents

The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents.

Income Taxes

The Company recorded a deferred income tax asset of approximately \$2,600 for the tax effect of net operating loss carryforwards and temporary differences, aggregating \$7,743. In recognition of the uncertainty regarding the ultimate amount of income tax benefits to be derived, the Company has recorded a full valuation allowance at December 31, 2005.

The effective tax rate differs from the statutory rate of 34% due to the increase in the valuation allowance.

Recently issued accounting pronouncements

Management does not believe that any recently issued, but not yet effective, accounting standards if currently adopted would have a material effect on the accompanying financial statements.

Loss per common share

Loss per share is computed by dividing net loss by the weighted-average number of shares of common stock outstanding during the period. Shares of common stock issuable upon exercise of options are excluded from the computation since their effect, for the periods presented, are anti-dilutive.

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of expenses during the reporting period. Actual results could differ from those estimates.

ARGYLE SECURITY ACQUISITION CORPORATION
(a corporation in the development stage)
NOTES TO FINANCIAL STATEMENTS

Note 2 - Notes Payable to Stockholders

The Company issued unsecured promissory notes to the Officers of the Company totaling \$155,000, from June 23, 2005 to November 22, 2005. The Notes had an interest rate of 4% per annum, were outstanding at December 31, 2005 and were paid in full with proceeds from the Public Offering, including interest of \$3,177. The fair value of the notes payable approximates the carrying amount due to their short-term nature.

Note 3 - Preferred Stock

The Company is authorized to issue 1,000,000 shares of preferred stock with such designations, voting and other rights and preferences, as may be determined from time to time by the Board of Directors.

Note 4 - Stock split

On November 23, 2005, the Company effected a three-for-ten reverse split of its shares of common stock. All references in the accompanying financial statements to the number of shares of common stock and loss per share have been retroactively restated to reflect this transaction.

Note 5 - Subsequent Events

On January 24, 2006, the Company sold 3,700,046 units to the public at a price of \$8.00 per unit. Each unit consists of one share of the Company's common stock, \$0.0001 par value, and one redeemable common stock purchase warrant ("warrant"). Each warrant entitles the holder to purchase from the Company one share of common stock at an exercise price of \$5.50 commencing the later of the completion of a business combination with a target business or January 24, 2007 and expiring January 24, 2011. The underwriters were granted an option to purchase an additional 543,750 units within 45 days of the effective date of the registration statement to cover any over-allotments. The underwriters exercised the option with respect to 75,046 units on January 27, 2006 and were issued such units on January 30, 2006. The warrants are redeemable at a price of \$.01 per warrant upon 30 days notice after the warrants become exercisable, only in the event that the last sale price of the common stock is at least \$11.50 per share for any 20 trading days within a 30 trading day period ending three business days before we send the notice of redemption.

The registration statement for the Company's initial public offering (the "Public Offering") was declared effective on January 24, 2006. The Company completed a private placement (the "Private Placement") of an aggregate of 125,000 units, identical to the units sold in the Public Offering, on such date and received net proceeds of \$892,500. The Company consummated the Public Offering on January 30, 2006 and received net proceeds of \$27,320,262. The Company's management has broad discretion with respect to the specific application of the net proceeds of the Private Placement and the Public Offering (collectively the "Offerings"), although substantially all of the net proceeds of the Offerings are intended to be generally applied toward consummating a business combination with a target company. As used herein, a "target business" shall include an operating business in the security industry and a "business combination" shall mean the acquisition by the Company of a target business.

ARGYLE SECURITY ACQUISITION CORPORATION

(a corporation in the development stage)

NOTES TO FINANCIAL STATEMENTS

Of the proceeds of the Offerings, \$28,721,363 is being held in a trust account (“Trust Account”) and invested until the earlier of (i) the consummation of the first business combination or (ii) the distribution of the Trust Account as described below. The amount in the Trust Account includes \$1,332,017 of contingent underwriting compensation and \$45,000 of contingent private placement fees (collectively the “Discount”) which will be paid to the underwriters if a business combination is consummated, but which will be forfeited if a business combination is not consummated. The remaining proceeds not held in the trust account may be used to pay for business, legal and accounting due diligence on prospective acquisitions and continuing general and administrative expenses.

The following represents the condensed balance sheet information derived from the company’s January 30, 2006 financial statements which were filed on February 7, 2006 in the Company’s Current Report on Form 8-K/A. Such balance sheet includes the effects of the consummation of the Company’s public offering and private placement.

CONDENSED BALANCE SHEET

Assets:	JANUARY 30, 2006	
Cash	\$	777,880
Cash held in the trust account		28,721,363
Prepaid expenses		100,000
Total assets	\$	29,599,243
Liabilities and stockholders’ equity:		
Total liabilities - deferred underwriting fees	\$	1,377,017
Common stock subject to redemption		5,459,435
Stockholders’ equity		22,762,791
Total liabilities and stockholders’ equity	\$	29,599,243

F-48

On July 13, 2005 the Company granted to its officers, directors and their respective affiliates certain options, which are exercisable only in the event the underwriters exercise the over-allotment option, to purchase that number of shares enabling them to maintain their 20% ownership interest without regard to the units they purchased in the private placement. The measurement date was deemed to be January 30, 2006, the date the over-allotment was exercised because the number of options to be issued was not known until that date.

On January 27, 2006 the underwriters exercised the over-allotment option in the amount of 75,046 units. On February 1, 2006 the officers and directors exercised their options and purchased 18,761 units for an aggregate cost of \$507. The compensation cost resulting from these share-based payments was \$130,632 at January 30, 2006 using the Black-Scholes pricing model. This model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. The fair value of the options was estimated at the measurement date using the following assumptions:

- Weighted average volatility factor of 0.10;
- No expected dividend payments;
- Weighted average risk-free interest rate of 5%;
- A weighted average expected life of 0.13 years.

The fair value of each option is \$6.99 per share. The options have no intrinsic value. The exercise price of each option is \$0.027 per share. All options vest immediately at the measurement date and expire three days thereafter. Compensation expense was recognized in January 2006.

The following summarizes information about stock options outstanding at January 30, 2006:

Exercise Price	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted-average Remaining Contractual Life	Weighted-average Exercise Price	Number Exercisable	Weighted-average Exercise Price
\$0.027	135,938	48 days	\$0.027	18,761	\$0.027

The Company's officers and their respective affiliates purchased an aggregate of 125,000 units in the Private Placement, but have waived their right to liquidation distributions with respect to the shares of common stock included in such units. Accordingly, in the event of such a liquidation, the amount in the Trust Account will be distributed to the holders of the shares sold in the Public Offering.

ARGYLE SECURITY ACQUISITION CORPORATION

(a corporation in the development stage)

NOTES TO FINANCIAL STATEMENTS

In January 2006, the Company sold to the co-managers for \$100, options to purchase up to an aggregate of 187,500 units. The units issuable upon exercise of these options are identical to those sold on January 24, 2006. These options will be exercisable at \$8.80 per unit commencing on the later of the consummation of a business combination or one year from January 24, 2006, and expire January 24, 2011. The options and the 187,500 units, the 187,500 shares of common stock and the 187,500 warrants underlying such units, and the 187,500 shares of common stock underlying such warrants, have been deemed compensation by the National Association of Securities Dealers (“NASD”) and are therefore subject to a 180-day lock-up pursuant to Rule 2710(g) (1) of the NASD Conduct Rules. Additionally, these options may not be sold, transferred, assigned, pledged or hypothecated for a one-year period (including the foregoing 180-day period) following January 24, 2006. However, these options may be transferred to any underwriter and selected dealer participating in the offering and their bona fide officers or partners.

The Company accounted for these purchase options in January 2006 as a cost of raising capital and included the instrument as equity in its financial statements. Accordingly, there is no net impact on the Company’s financial position or results of operations, except for the recording of the \$100 proceeds from the sale. The Company has estimated, based upon a Black Scholes model, that the fair value of the purchase options on the date of sale is approximately \$3.40 per unit, (a total value of approximately \$637,500) using an expected life of five years, volatility of 44%, and a risk-free rate of 5%. However, because the Company’s units do not have a trading history, the volatility assumption is based on information currently available to management. The volatility estimate is derived using historical data of public companies in the proposed industry. The Company believes the volatility estimate calculated from these companies is a reasonable benchmark to use in estimating the expected volatility of our units; however, the use of an index to estimate volatility may not necessarily be representative of the volatility of the underlying securities. Although an expected life of five years was used in the calculation, if the Company does not consummate a business combination within the prescribed time period and it liquidates, the options will become worthless.

The Company has engaged Rodman & Renshaw, LLC (the “Representative”), on a non-exclusive basis, as its agent for the solicitation of the exercise of the warrants. To the extent not inconsistent with the guidelines of the NASD and the rules and regulations of the Securities and Exchange Commission, the Company has agreed to pay the Representative for bona fide services rendered a commission equal to 5% of the exercise price for each warrant exercised more than one year after January 24, 2006, if the exercise was solicited by the Representative. In addition to soliciting, either orally or in writing, the exercise of the warrants, the Representative’s services may also include disseminating information, either orally or in writing, to warrant holders about the Company or the market for the Company’s securities, and assisting in the processing of the exercise of the warrants. No compensation will be paid to the Representative upon the exercise of the warrants if:

- the market price of the underlying shares of common stock is lower than the exercise price;
- the holder of the warrants has not confirmed in writing that the representative solicited the exercise;
 - the warrants are held in a discretionary account;
 - the warrants are exercised in an unsolicited transaction; or
- the arrangements to pay the commission is not disclosed to warrant holders at the time of exercise.

At January 30, 2006, 4,200,046 shares of common stock were reserved for issuance upon exercise of redeemable warrants.

F-50

ANNEXES

	Page
A - Fairness Opinion of Giuliani Capital Advisors	A-2
B - 2007 Omnibus Security and Incentive Plan	A-5
C - Amended and Restated Certificate of Incorporation for Argyle	A-26
D - Merger Agreement	A-28

A-1

Annex A

December 8, 2006

The Board of Directors for
Argyle Security Acquisition Corporation
Argyle Security Acquisition Corporation
156 West 56th Street, Suite 1605
New York, NY 10019

Ladies and Gentlemen:

The Board of Directors (the “Board” or “you”) of Argyle Security Acquisition Corporation (“Argyle”) has requested our opinion as to the fairness from a financial point of view (the “Opinion”) to Argyle of the consideration regarding the transaction proposed pursuant to the draft merger agreement, dated as of December 7, 2006 (the “Merger Agreement”), by and between Argyle and ISI Detention Contracting Group, Inc. (“ISI”) (the “Transaction”). The Merger Agreement provides for, among other things, the merger of ISI with Argyle, through ISI Security Group, Inc. (the acquisition corporation), for total Transaction consideration paid of a maximum \$18.2 million in cash and 1,180,000 Argyle shares in addition to the assumption of certain indebtedness associated with the William Blair Mezzanine Capital Fund III, L.P. New Note (as defined), senior bank debt and capital leases, collectively aggregating to \$12.5 million, subject to certain assumptions as stipulated in the Merger Agreement which for the purpose of this Opinion are assumed to be accurate (the “Consideration”).

Giuliani Capital Advisors LLC (“GCA”), as part of its investment banking business, is continually engaged in providing fairness opinions in connection with mergers and acquisitions, leveraged buyouts and recapitalizations, and private placement transactions. We are registered with the Securities and Exchange Commission as a Broker-Dealer and we are a member of the National Association of Securities Dealers.

In connection with our review of the proposed Transaction and the preparation of our Opinion herein, we have, among other things:

- I. Reviewed a draft of the Merger Agreement circulated on December 7, 2006 which, for the purposes of this Opinion we have assumed, with your permission, to be identical in all material respects to the agreement to be executed;

A-2

The Board of Directors for
Argyle Security Acquisition Corporation

December 8, 2006
Page 2

- II. Reviewed certain publicly available information about ISI;
- III. Reviewed information furnished to us by ISI's management, including certain audited financial statements and unaudited financial analyses, projections, budgets, reports and other information;
- IV. Held discussions with various members of senior management of ISI concerning historical and current operations, financial condition and prospects, including recent financial performance;
- V. Reviewed the valuation of ISI based on the terms of the Merger Agreement;
- VI. Reviewed the valuations of publicly traded companies that we deemed comparable in certain respects to ISI;
- VII. Reviewed the financial terms of selected acquisition transactions involving companies in lines of business that we deemed comparable in certain material respects to the business of ISI;
- VIII. Prepared a discounted cash flow analysis of ISI on a stand-alone basis;
- IX. Assisted in negotiations and discussions related to the merger between ISI and Argyle;
- X. In addition, we have conducted such other quantitative reviews, analyses and inquiries relating to ISI as considered appropriate in rendering this Opinion; and
- XI. These analyses were prepared primarily based on information that was obtained from publicly available sources, as well as on information that was provided by, or on behalf of, ISI.

In preparing our Opinion, we have relied on and assumed the accuracy and completeness of all financial and other information supplied or otherwise made available to GCA by ISI or Argyle. We have not assumed any responsibility for independent verification of such information or any independent appraisal of ISI's assets or liabilities (contingent or otherwise). With respect to the audited financials, unaudited financial analyses, financial forecasts, estimates, projections or other information furnished to us by ISI or Argyle, we have assumed, without any further independent investigation and analysis, that they have been reasonably prepared in good faith and reflect the best currently available estimates and judgment of the respective management team as to the expected future financial performance of ISI and/or Argyle, and we express no opinion with respect to such forecasts and projections or the assumptions on which they are based. We have also relied upon Argyle and ISI to advise us promptly if any information previously provided became inaccurate or was required to be updated during the period of our review.

In our analyses, we have made numerous assumptions with respect to industry performance, business and economic conditions, and other matters, many of which are beyond the control of ISI. Any assumptions made in our analyses are not necessarily indicative of future results or value, which may differ significantly from those assumptions. Estimates of values of companies do not purport to be appraisals or to necessarily reflect the prices at which companies or their securities actually may be sold. No company or transaction utilized in our analyses was identical to ISI or the Transaction. Accordingly, such analyses are not based solely on arithmetic calculations; rather, they involve complex considerations and judgments concerning differences in financial and operating characteristics of the relevant companies, the timing of the relevant transactions and prospective buyer interests, as well as other factors that could affect the public trading markets of companies to which ISI is being compared. Our comparisons included companies with similar products/services, similar operating or financial characteristics or servicing similar markets or markets displaying certain key similarities to ISI.

A-3

The Board of Directors for
Argyle Security Acquisition Corporation

December 8, 2006
Page 3

In arriving at our Opinion, we were not authorized to solicit, and did not solicit, interest from any party with respect to a potential acquisition of ISI's shares or its assets.

It should be noted that this Opinion is based on economic and market conditions and other circumstances existing on, and information made available prior to, or as of, the date hereof. GCA has undertaken no, and hereby disclaims any, obligation to update the Opinion after the date hereof to reflect any new developments which might affect any matters or opinions set forth herein. In addition, the Opinion is, in any event, limited to the fairness to Argyle, from a financial point of view as of the date of such Opinion, of the consideration being paid by Argyle pursuant to the Merger Agreement, and does not address ISI's underlying business decision to effect the Transaction, the structure or tax consequences of the Merger Agreement, other terms of the Merger Agreement, or the availability or advisability of any alternatives to the Transaction.

GCA has been engaged to render this Opinion to the Board in connection with the proposed Transaction and will receive a fee following the delivery of the Opinion, regardless of its content. In addition, Argyle has agreed to indemnify us against certain liabilities arising out of our engagement. Neither GCA nor its affiliates currently hold any shares of Argyle or ISI. Further, GCA has been engaged by Argyle as its financial advisor and will receive fees for such, including a fee contingent upon the successful consummation of the Transaction.

The Opinion is directed solely to the Board for its use in deliberating about the Transaction and does not constitute a recommendation to the Board or any shareholders of Argyle regarding the proposed Transaction. Furthermore, this Opinion should not be construed as creating any fiduciary duty on the part of GCA to any such party and is information to be used only by the Board. The Opinion is not to be quoted or referred to, in whole or in part, without our prior written consent.

On the basis of, and subject to, the foregoing, we are of the opinion that, as of the date hereof, the Consideration, subject to certain assumptions as stipulated in the Merger Agreement which for the purpose of this Opinion are assumed to be accurate, is fair, from a financial point of view to Argyle.

Respectfully submitted,

GIULIANI CAPITAL ADVISORS LLC

A-4

Annex B

ARGYLE SECURITY ACQUISITION CORPORATION

2007 OMNIBUS SECURITIES AND INCENTIVE PLAN

A-5

Table Of Contents

	Page
ARTICLE I PURPOSE	1
ARTICLE II DEFINITIONS	1
ARTICLE III EFFECTIVE DATE OF PLAN	5
ARTICLE IV ADMINISTRATION	5
Section 4.1	5
Section 4.2	5
Section 4.3	6
Section 4.4	6
ARTICLE V STOCK SUBJECT TO PLAN AND LIMITATIONS THEREON	6
Section 5.1	6
Section 5.2	7
ARTICLE VI ELIGIBILITY FOR AWARDS; TERMINATION OF EMPLOYMENT, DIRECTOR STATUS OR CONSULTANT STATUS	7
Section 6.1	7
Section 6.2	7
Section 6.3	8
Section 6.4	9
Section 6.5	9
Section 6.6	9
ARTICLE VII OPTIONS	10
Section 7.1	10
Section 7.2	10
Section 7.3	10
Section 7.4	10
Section 7.5	11
Section 7.6	11
Section 7.7	11
ARTICLE VIII RESTRICTED STOCK AWARDS	11
Section 8.1	11
Section 8.2	12
Section 8.3	12
Section 8.4	12
ARTICLE IX UNRESTRICTED STOCK AWARDS	12
ARTICLE X PERFORMANCE UNIT AWARDS	13
Section 10.1	13
Section 10.2	13
Section 10.3	13

ARTICLE XI PERFORMANCE SHARE AWARDS		13
Section 11.1	Terms and Conditions	13
Section 11.2	Shareholder Rights and Privileges	13
Section 11.3	Special Committee Discretion	13
ARTICLE XII DISTRIBUTION EQUIVALENT RIGHTS		14
Section 12.1	Terms and Conditions	14
Section 12.2	Interest Equivalents	14
ARTICLE XIII STOCK APPRECIATION RIGHTS		14
Section 13.1	Terms and Conditions	14
Section 13.2	Tandem Stock Appreciation Rights	14
ARTICLE XIV RECAPITALIZATION OR REORGANIZATION		15
Section 14.1	Adjustments to Common Stock	15
Section 14.2	Recapitalization	15
Section 14.3	Other Events	16
Section 14.4	Powers Not Affected	16
Section 14.5	No Adjustment for Certain Awards	16
ARTICLE XV AMENDMENT AND TERMINATION OF PLAN		16
ARTICLE XVI MISCELLANEOUS		17
Section 16.1	No Right to Award	17
Section 16.2	No Rights Conferred	17
Section 16.3	Other Laws; Withholding	17
Section 16.4	No Restriction on Corporate Action	17
Section 16.5	Restrictions on Transfer	18
Section 16.6	Beneficiary Designations	18
Section 16.7	Rule 16b-3	18
Section 16.8	Section 162(m)	18
Section 16.9	Other Plans	19
Section 16.10	Limits of Liability	19
Section 16.11	Governing Law	19
Section 16.12	Severability of Provisions	19
Section 16.13	No Funding	19
Section 16.14	Headings	19

ARGYLE SECURITY ACQUISITION CORPORATION

2007 OMNIBUS SECURITIES AND INCENTIVE PLAN

**ARTICLE I
PURPOSE**

The purpose of this Argyle Security Acquisition Corporation 2007 Omnibus Securities and Incentive Plan (the “Plan”) is to benefit the shareholders of Argyle Security Acquisition Corporation, a Delaware corporation (the “Company”), by assisting the Company to attract, retain and provide incentives to key management employees and nonemployee directors of, and non-employee consultants to, the Company and its Affiliates, and to align the interests of such employees, nonemployee directors and nonemployee consultants with those of the Company’s shareholders. Accordingly, the Plan provides for the granting of Distribution Equivalent Rights, Incentive Stock Options, Non-Qualified Stock Options, Performance Share Awards, Performance Unit Awards, Restricted Stock Awards, Stock Appreciation Rights, Tandem Stock Appreciation Rights, Unrestricted Stock Awards, or any combination of the foregoing, as may be best suited to the circumstances of the particular Employee, Director or Consultant, as provided herein.

**ARTICLE II
DEFINITIONS**

The following definitions shall be applicable throughout the Plan unless the context otherwise requires:

“Affiliate” shall mean any person or entity which, at the time of reference, directly, or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with, the Company.

“Award” shall mean, individually or collectively, any Distribution Equivalent Right, Option, Performance Share Award, Performance Unit Award, Restricted Stock Award, Stock Appreciation Right, Tandem Stock Appreciation Right or Unrestricted Stock Award.

“Award Agreement” shall mean a written agreement between the Company and the Holder with respect to an Award, each of which shall constitute a part of the Plan.

“Board” shall mean the Board of Directors of the Company.

“Cause” shall mean (i) for a Holder who is a party to an employment or consulting agreement with the Company or an Affiliate which agreement provides for a definition of “Cause” therein, “Cause” shall have the same meaning as provided for in such agreement, or (ii) for a Holder who is not a party to such an agreement, “Cause” shall mean repeated failure to properly perform assigned duties (after written notice of at least one such failure had previously been communicated to the Holder by the Company or Affiliate), gross negligence, commission of a felony or any act materially injurious to the Company or an Affiliate involving dishonesty or breach of any duty of confidentiality or loyalty.

“Code” shall mean the Internal Revenue Code of 1986, as amended. Reference in the Plan to any section of the Code shall be deemed to include any amendments or successor provisions to any section and any regulation under such section.

“Committee” shall mean the Compensation Committee of the Board, which Committee shall administer the Plan and shall be comprised of such individuals, all as pursuant to the requirements of Article IV.

“Common Stock” shall mean the common stock, par value \$.0001 per share, of the Company.

“Company” shall mean Argyle Security Acquisition Corporation, a Delaware corporation, and any successor thereto.

“Consultant” shall mean any non-Employee advisor to the Company or an Affiliate who has contracted directly with the Company or an Affiliate to render bona fide perform consulting or advisory services thereto.

“Director” shall mean a member of the Board or a member of the board of directors of an Affiliate, in either case, who is not an Employee.

“Distribution Equivalent Right” shall mean an Award granted under Article XII of the Plan which entitles the Holder to receive bookkeeping credits, cash payments and/or Common Stock distributions equal in amount to the distributions that would have been made to the Holder had the Holder held a specified number of shares of Common Stock during the period the Holder held the Distribution Equivalent Right.

“Distribution Equivalent Right Award Agreement” shall mean a written agreement between the Company and a Holder with respect to a Distribution Equivalent Right Award.

“Effective Date” shall mean the date of the consummation of the merger between a wholly-owned subsidiary of the Company and ISI-Detention Contracting Group, Inc., pursuant to which ISI-Detention Contracting Group, Inc., shall become a wholly-owned subsidiary of the Company.

“Employee” shall mean any person employed by the Company or an Affiliate.

“Exchange Act” shall mean the Securities Exchange Act of 1934, as amended.

“Fair Market Value” shall mean, as of any specified date, the mean of the reported high and low sales prices of the Common Stock on the NASDAQ Stock Market or a domestic or foreign national securities exchange (including London’s Alternative Investment Market) on which the Common Stock may be listed for that date, or if no prices are reported for that date, for the last preceding date for which such prices of the Common Stock are so reported. If the Common Stock is not listed on the NASDAQ Stock Market or on a domestic or foreign national securities exchange, but is quoted on the OTC Bulletin Board or by the National Quotation Bureau at the time a determination of its Fair Market Value is required to be made hereunder, its Fair Market Value shall be deemed to be equal to the mean of the reported high and low sales prices or closing bid and asked prices of the Common Stock on the most recent date on which such prices of the Common Stock was so quoted. In the event the Common Stock is not listed or quoted as set forth above at the time a determination of its Fair Market Value is required to be made hereunder, the determination of its Fair Market Value shall be made by the Committee in such manner as it deems appropriate.

“Family Member” shall mean any child, stepchild, grandchild, parent, spouse, former spouse, sibling, niece, nephew, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law or sister-in-law, including adoptive relationships, any person sharing the Holder’s household (other than a tenant of the Holder), a trust in which such persons have more than fifty percent (50%) of the beneficial interest, a foundation in which such persons (or the Holder) control the management of assets, and any other entity in which such persons (or the Holder) own more than fifty percent (50%) of the voting interests.

“Holder” shall mean an Employee, Director or Consultant who has been granted an Award, or any such individual’s beneficiary, estate or representative, to the extent applicable.

“Incentive Stock Option” shall mean an Option which is an “incentive stock option” within the meaning of Section 422 of the Code.

“Non-Qualified Stock Option” shall mean an Option which is not an Incentive Stock Option.

“Option” shall mean an Award granted under Article VII of the Plan of an option to purchase shares of Common Stock, and includes both Incentive Stock Options and Non-Qualified Stock Options.

“Option Agreement” shall mean a written agreement between the Company and a Holder with respect to an Option.

“Performance Share Award” shall mean an Award granted under Article XI of the Plan under which, upon the satisfaction of predetermined individual and/or Company (and/or Affiliate) performance goals and/or objectives, shares of Common Stock (and/or cash) are paid to the Holder.

“Performance Share Award Agreement” shall mean a written agreement between the Company and a Holder with respect to a Performance Share Award.

“Performance Unit” shall mean a Unit awarded to a Holder pursuant to a Performance Unit Award.

“Performance Unit Award” shall mean an Award granted under Article X of the Plan under which, upon the satisfaction of predetermined individual and/or Company (and/or Affiliate) performance goals and/or objectives, a cash payment (and/or shares of Common Stock) shall be provided to the Holder, based on the number of Units awarded to the Holder.

“Performance Unit Award Agreement” shall mean a written agreement between the Company and a Holder with respect to a Performance Unit Award.

“Plan” shall mean this Argyle Security Acquisition Corporation 2007 Omnibus Securities and Incentive Plan, as amended from time to time, together with each of the Award Agreements utilized hereunder.

“Restricted Stock Award” shall mean an Award granted under Article VIII of the Plan of shares of Common Stock, which shares shall be subject to Transfer Restrictions.

“Restricted Stock Award Agreement” shall mean a written agreement between the Company and a Holder with respect to a Restricted Stock Award.

“Restriction Period” shall mean the period of time for which shares of Common Stock subject to a Restricted Stock Award shall be subject to Restrictions, as set forth in the applicable Restricted Stock Award Agreement.

“Restrictions” shall mean forfeiture, transfer and/or other restrictions applicable to shares of Common Stock awarded to an Employee, Director or Consultant under the Plan pursuant to a Restricted Stock Award and set forth in a Restricted Stock Award Agreement.

“Rule 16b-3” shall mean Rule 16b-3 promulgated by the Securities and Exchange Commission under the Exchange Act, as such may be amended from time to time, and any successor rule, regulation or statute fulfilling the same or a substantially similar function.

“Stock Appreciation Right” shall mean an Award granted under Article XIII of the Plan of a right, granted alone or in connection with a related Option, to receive a payment on the date of exercise.

“Stock Appreciation Right Award Agreement” shall mean a written agreement between the Company and a Holder with respect to a Stock Appreciation Right.

“Tandem Stock Appreciation Right” shall mean a Stock Appreciation Right granted in connection with a related Option, the exercise of which shall result in forfeiture of the otherwise entitlement to purchase some or all of the shares of Common Stock under the related Option.

“Ten Percent Shareholder” shall mean an Employee who, at the time an Option is granted to him or her, owns more than ten percent (10%) of the total combined voting power of all classes of stock of the Company or of any parent corporation or subsidiary corporation thereof (both as defined in Section 424 of the Code), within the meaning of Section 422(b)(6) of the Code.

“Total and Permanent Disability” shall mean the inability to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than twelve (12) months, all as described in Section 22(e)(3) of the Code.

“Units” shall mean bookkeeping units, each of which represents such monetary amount as shall be designated by the Committee in a Performance Unit Award Agreement.

“Unrestricted Stock Award” shall mean an Award granted under Article IX of the Plan of shares of Common Stock which are not subject to Restrictions.

“Unrestricted Stock Award Agreement” shall mean a written agreement between the Company and a Holder with respect to an Unrestricted Stock Award.

ARTICLE III EFFECTIVE DATE OF PLAN

The Plan shall be effective as of the Effective Date, provided that the Plan is approved by the shareholders of the Company within twelve (12) months of such date.

ARTICLE IV ADMINISTRATION

Section 4.1 Composition of Committee. The Plan shall be administered by the Committee, which shall be appointed by the Board. Notwithstanding the foregoing, however, at any time that the Common Stock is registered under Section 12 of the Exchange Act, the Committee shall consist solely of two (2) or more Directors who are each (i) “outside directors” within the meaning of Section 162(m) of the Code (“Outside Directors”), and (ii) “non-employee directors” within the meaning of Rule 16b - 3 (“Non-Employee Directors”); provided, however, that the Board or the Committee may delegate to a committee of one or more members of the Board who are not (x) Outside Directors, the authority to grant Awards to eligible persons who are not (A) then “covered employees” within the meaning of Section 162(m) of the Code and are not expected to be “covered employees” at the time of recognition of income resulting from such Award, or (B) persons with respect to whom the Company wishes to comply with the requirements of Section 162(m) of the Code, and/or (y) Non-Employee Directors, the authority to grant Awards to eligible persons who are not then subject to the requirements of Section 16 of the Exchange Act. If a member of the Committee shall be eligible to receive an Award under the Plan, such Committee member shall have no authority hereunder with respect to his or her own Award.

Section 4.2 Powers. Subject to the provisions of the Plan, the Committee shall have the sole authority, in its discretion, to determine which individuals shall receive an Award, the time or times when such Award shall be made, what type of Award shall be granted and the number of shares of Common Stock which may be issued under such Award, as applicable; notwithstanding the foregoing, the Board shall have the authority in its sole discretion to itself make any such determination or determinations under this Section 4.2 with respect to any Award, in lieu of the Committee. In making such determinations the Committee or the Board, as applicable, may take into account the nature of the services rendered by the respective individuals, their present and potential contribution to the Company’s (or the Affiliate’s) success and such other factors as the Committee in its discretion shall deem relevant.

Section 4.3 Additional Powers. The Committee shall have such additional powers as are delegated to it under the other provisions of the Plan. Subject to the express provisions of the Plan, the Committee is authorized to construe the Plan and the respective Award Agreements executed hereunder, to prescribe such rules and regulations relating to the Plan as it may deem advisable to carry out the intent of the Plan, and to determine the terms, restrictions and provisions of each Award, including such terms, restrictions and provisions as shall be requisite in the judgment of the Committee to cause designated Options to qualify as Incentive Stock Options, and to make all other determinations necessary or advisable for administering the Plan. The Committee may correct any defect or supply any omission or reconcile any inconsistency in any Award Agreement in the manner and to the extent it shall deem expedient to carry it into effect. The determinations of the Committee on the matters referred to in this Article IV shall be conclusive.

Section 4.4 Committee Action. In the absence of specific rules to the contrary, action by the Committee shall require the consent of a majority of the members of the Committee, expressed either orally at a meeting of the Committee or in writing in the absence of a meeting.

ARTICLE V STOCK SUBJECT TO PLAN AND LIMITATIONS THEREON

Section 5.1 Stock Grant and Award Limits. The Committee may from time to time grant Awards to one or more Employees, Directors and/or Consultants determined by it to be eligible for participation in the Plan in accordance with the provisions of Article VI. Subject to Article XIV, the aggregate number of shares of Common Stock that may be issued under the Plan shall not exceed One Million (1,000,000) shares. Shares shall be deemed to have been issued under the Plan solely to the extent actually issued and delivered pursuant to an Award. To the extent that an Award lapses or the rights of its Holder terminate, any shares of Common Stock subject to such Award shall again be available for the grant of a new Award. Notwithstanding any provision in the Plan to the contrary, the maximum number of shares of Common Stock that may be subject to Awards of Options under Article VII and/or Stock Appreciation Rights under Article XIII, in either or both cases granted to any one Employee during any calendar year, shall be One Hundred Fifty Thousand (150,000) shares (subject to adjustment in the same manner as provided in Article XIV with respect to shares of Common Stock subject to Awards then outstanding). The limitation set forth in the preceding sentence shall be applied in a manner which shall permit compensation generated in connection with the exercise of Options to constitute “performance-based” compensation for purposes of Section 162(m) of the Code, including, but not limited to, counting against such maximum number of shares, to the extent required under Section 162(m) of the Code, any shares subject to Options that are canceled or repriced.

Section 5.2 Stock Offered. The stock to be offered pursuant to the grant of an Award may be authorized but unissued Common Stock, Common Stock purchased on the open market or Common Stock previously issued and outstanding and reacquired by the Company.

ARTICLE VI
ELIGIBILITY FOR AWARDS; TERMINATION OF
EMPLOYMENT, DIRECTOR STATUS OR CONSULTANT STATUS

Section 6.1 Eligibility. Awards made under the Plan may be granted solely to persons who, at the time of grant, are Employees, Directors or Consultants. An Award may be granted on more than one occasion to the same Employee, Director or Consultant, and, subject to the limitations set forth in the Plan, such Award may include a Distribution Equivalent Right Award, a Non-Qualified Stock Option Award, a Performance Share Award, a Restricted Stock Award, a Stock Appreciation Right Award, a Tandem Stock Appreciation Right Award, an Unrestricted Stock Award, any combination thereof or, solely for Employees, an Incentive Stock Option Award.

Section 6.2 Termination of Employment or Director Status. Except to the extent inconsistent with the terms of the applicable Award Agreement and/or the provisions of Section 6.4 or Section 6.5, the following terms and conditions shall apply with respect to the termination of a Holder's employment with, or status as a Director of, the Company or an Affiliate, as applicable, for any reason, including, without limitation, retirement upon or after attaining age sixty-five (65) with at least five (5) full years of service for the Company and/or an Affiliate, Total and Permanent Disability or death:

(a) The Holder's rights, if any, to exercise any then exercisable Non-Qualified Stock Options shall terminate:

(1) If such termination is for a reason other than the Holder's retirement upon or after attaining age sixty-five (65) with at least five (5) full years of service for the Company and/or an Affiliate, Total and Permanent Disability or death, not more than ninety (90) days after the date of such termination of employment or after the date of such termination of Director status;

(2) If such termination is on account of the Holder's retirement upon or after attaining age sixty-five (65) with at least five (5) full years of service for the Company and/or an Affiliate or on account of the Holder's Total and Permanent Disability, one (1) year after the date of such termination of employment or Director status; or

(3) If such termination is on account of the Holder's death, one (1) year after the date of the Holder's death.

Upon such applicable date the Holder (and such Holder's estate, designated beneficiary or other legal representative) shall forfeit any rights or interests in or with respect to any such Non-Qualified Stock Options.

(b) The Holder's rights, if any, to exercise any then exercisable Incentive Stock Option shall terminate:

(1) If such termination is for a reason other than the Holder's Total and Permanent Disability or death, not more than three (3) months after the date of such termination of employment;

(2) If such termination is on account of the Holder's Total and Permanent Disability, one (1) year after the date of such termination of employment; or

(3) If such termination is on account of the Holder's death, one (1) year after the date of the Holder's death.

Upon such applicable date the Holder (and such Holder's estate, designated beneficiary or other legal representative) shall forfeit any rights or interests in or with respect to any such Incentive Stock Options.

(c) If a Holder's employment with, or status as a Director of, the Company or an Affiliate, as applicable, terminates for any reason prior to full vesting of any Award which is not an Option, or the actual or deemed satisfaction and/or lapse of the restrictions, terms and conditions applicable to any Award which is not an Option, in either case the then nonvested portion of such Award, if any, shall immediately be canceled, and the Holder (and such Holder's estate, designated beneficiary or other legal representative) shall forfeit any then nonvested rights or interests in and with respect to any such Award. The immediately preceding sentence notwithstanding, the Committee, in its sole discretion, may determine, prior to or within thirty (30) days after the date of such termination of employment or Director status, that all or a portion of any such Holder's Award shall not be so canceled and forfeited.

Section 6.3 Termination of Consultant Status. Except to the extent inconsistent with the terms of the applicable Award Agreement and/or the provisions of Section 6.4 or Section 6.5, the following terms and conditions shall apply with respect to the termination of a Holder's status as a Consultant, for any reason:

(a) The Holder's rights, if any, to exercise any then exercisable Non-Qualified Stock Options shall terminate:

(1) If such termination is for a reason other than the Holder's death, not more than ninety (90) days after the date of such termination; or

(2) If such termination is on account of the Holder's death, one (1) year after the date of the Holder's death.

(b) If the status of a Holder as a Consultant terminates for any reason prior to full vesting of any Award which is not an Option, or the actual or deemed satisfaction and/or lapse of the restrictions, terms and conditions applicable to any Award which is not an Option, in either case the then nonvested portion of such Award, if any, shall immediately be canceled, and the Holder (and such Holder's estate, designated beneficiary or other legal representative) shall forfeit any then nonvested rights or interests in and with respect to any such Award. The immediately preceding sentence notwithstanding, the Committee, in its sole discretion, may determine, prior to or within thirty (30) days after the date of such termination of such a Holder's status as a Consultant, that all or a portion of any such Holder's Award shall not be so canceled and forfeited.

Section 6.4 Special Termination Rule. Except to the extent inconsistent with the terms of the applicable Award Agreement, and notwithstanding anything to the contrary contained in this Article VI, if a Holder's employment with, or status as a Director of, the Company or an Affiliate shall terminate, and if, within ninety (90) days of such termination, such Holder shall become a Consultant, such Holder's rights with respect to any Award or portion thereof granted thereto prior to the date of such termination may be preserved, if and to the extent determined by the Committee in its sole discretion, as if such Holder had been a Consultant for the entire period during which such Award or portion thereof had been outstanding. Should the Committee effect such determination with respect to such Holder, for all purposes of the Plan, such Holder shall not be treated as if his or her employment or Director status had terminated until such time as his or her Consultant status shall terminate, in which case his or her Award shall then be treated pursuant to the provisions of Section 6.3 and, to the extent applicable, Section 6.5. Should a Holder's status as a Consultant terminate, and if, within ninety (90) days of such termination, such Holder shall become an Employee or a Director, such Holder's rights with respect to any Award or portion thereof granted thereto prior to the date of such termination may be preserved, if and to the extent determined by the Committee in its sole discretion, as if such Holder had been an Employee or a Director, as applicable, for the entire period during which such Award or portion thereof had been outstanding, and, should the Committee effect such determination with respect to such Holder, for all purposes of the Plan, such Holder shall not be treated as if his or her Consultant status had terminated until such time as his or her employment with the Company or an Affiliate, or his or her Director status, as applicable, shall terminate, in which case his or her Award shall then be treated pursuant to the provisions of Section 6.2 and, to the extent applicable, Section 6.5.

Section 6.5 Termination for Cause. Notwithstanding anything in this Article VI or elsewhere in the Plan to the contrary, and unless a Holder's Award Agreement specifically provides otherwise, should a Holder's employment, Director status or engagement as a Consultant with or for the Company or an Affiliate be terminated by the Company or Affiliate for Cause, all of such Holder's then outstanding Awards shall expire immediately upon such termination and shall be immediately forfeited thereby.

Section 6.6 Special Committee Discretion. Notwithstanding anything to the contrary contained in this Article VI, the Committee shall have the authority and discretion to provide in any Award Agreement for post-termination of employment, Director status or Consultant status, as applicable, continuing vesting (including continuing opportunity for the satisfaction of applicable performance goals) and/or extension of any exercise period.

ARTICLE VII OPTIONS

Section 7.1 Option Period. The term of each Option shall be as specified in the Option Agreement.

Section 7.2 Limitations on Exercise of Option. An Option shall be exercisable in whole or in such installments and at such times as specified in the Option Agreement.

Section 7.3 Special Limitations on Incentive Stock Options. To the extent that the aggregate Fair Market Value (determined at the time the respective Incentive Stock Option is granted) of Common Stock with respect to which Incentive Stock Options are exercisable for the first time by an individual during any calendar year under all plans of the Company and any parent corporation or subsidiary corporation thereof (both as defined in Section 424 of the Code) which provide for the grant of Incentive Stock Options exceeds One Hundred Thousand Dollars (\$100,000) (or such other individual limit as may be in effect under the Code on the date of grant), such Incentive Stock Options shall be treated as Non-Qualified Stock Options. The Committee shall determine, in accordance with applicable provisions of the Code, Treasury Regulations and other administrative pronouncements, which of a Holder's Options which were intended by the Committee to be Incentive Stock Options when granted to the Holder, will not constitute Incentive Stock Options because of such limitation, and shall notify the Holder of such determination as soon as practicable after such determination. No Incentive Stock Option shall be granted to an Employee if, at the time the Option is granted, such Employee is a Ten Percent Shareholder, unless (i) at the time such Incentive Stock Option is granted the Option price is at least one hundred ten percent (110 %) of the Fair Market Value of the Common Stock subject to the Option on the date of grant, and (ii) such Incentive Stock Option by its terms is not exercisable after the expiration of five (5) years from the date of grant.

Section 7.4 Option Agreement. Each Option shall be evidenced by an Option Agreement in such form and containing such provisions not inconsistent with the provisions of the Plan as the Committee from time to time shall approve, including, but not limited to, provisions to qualify an Option as an Incentive Stock Option. An Option Agreement may provide for the payment of the Option price, in whole or in part, by the delivery of a number of shares of Common Stock (plus cash if necessary) having a Fair Market Value equal to such Option price. Each Option Agreement shall, solely to the extent inconsistent with the provisions of Sections 6.2, 6.3, 6.4 and 6.5, as applicable, specify the effect of termination of employment, Director status or Consultant status on the exercisability of the Option. Moreover, an Option Agreement may provide for a "cashless exercise" of the Option by establishing procedures whereby the Holder, by a properly-executed written notice, directs (i) an immediate market sale or margin loan respecting all or a part of the shares of Common Stock to which he is entitled upon exercise pursuant to an extension of credit by the Company to the Holder of the Option price, (ii) the delivery of the shares of Common Stock from the Company directly to a brokerage firm and (iii) the delivery of the Option price from sale or margin loan proceeds from the brokerage firm directly to the Company. An Option Agreement may also include provisions relating to (i) subject to the provisions hereof, accelerated vesting of Options, (ii) tax matters (including provisions covering any applicable Employee wage withholding requirements and requiring additional "gross-up" payments to Holders to meet any excise taxes or other additional income tax liability imposed as a result of a payment upon a "change of control" of the Company resulting from the operation of the Plan or of such Option Agreement) and (iii) any other matters not inconsistent with the terms and provisions of the Plan that the Committee shall in its sole discretion determine. The terms and conditions of the respective Option Agreements need not be identical. No Incentive Stock Option shall be granted more than ten (10) years from the date on which the Plan is approved by the Company's stockholders.

Section 7.5 Option Price and Payment. The price at which a share of Common Stock may be purchased upon exercise of an Option shall be determined by the Committee; provided, however, that such Option price (i) shall not be less than the Fair Market Value of a share of Common Stock on the date such Option is granted, and (ii) shall be subject to adjustment as provided in Article XIV. The Option or portion thereof may be exercised by delivery of an irrevocable notice of exercise to the Company. The Option price for the Option or portion thereof shall be paid in full in the manner prescribed by the Committee. Separate stock certificates shall be issued by the Company for those shares of Common Stock acquired pursuant to the exercise of an Incentive Stock Option and for those shares of Common Stock acquired pursuant to the exercise of a Non-Qualified Stock Option.

Section 7.6 Shareholder Rights and Privileges. The Holder of an Option shall be entitled to all the privileges and rights of a shareholder of the Company solely with respect to such shares of Common Stock as have been purchased under the Option and for which certificates of stock have been registered in the Holder's name.

Section 7.7 Options and Rights in Substitution for Stock Options Granted by Other Corporations. Options may be granted under the Plan from time to time in substitution for stock options held by individuals employed by entities who become Employees as a result of a merger or consolidation of the employing entity with the Company or any Affiliate, or the acquisition by the Company or an Affiliate of the assets of the employing entity, or the acquisition by the Company or an Affiliate of stock of the employing entity with the result that such employing entity becomes an Affiliate.

ARTICLE VIII RESTRICTED STOCK AWARDS

Section 8.1 Restriction Period to be Established by Committee. At the time a Restricted Stock Award is made, the Committee shall establish the Restriction Period applicable to such Award. Each Restricted Stock Award may have a different Restriction Period, in the discretion of the Committee. The Restriction Period applicable to a particular Restricted Stock Award shall not be changed except as permitted by Section 8.2.

Section 8.2 Other Terms and Conditions. Common Stock awarded pursuant to a Restricted Stock Award shall be represented by a stock certificate registered in the name of the Holder of such Restricted Stock Award. If provided for under the Restricted Stock Award Agreement, the Holder shall have the right to vote Common Stock subject thereto and to enjoy all other shareholder rights, except that (i) the Holder shall not be entitled to delivery of the stock certificate until the Restriction Period shall have expired, (ii) the Company shall retain custody of the stock certificate during the Restriction Period (with a stock power endorsed by the Holder in blank), (iii) the Holder may not sell, transfer, pledge, exchange, hypothecate or otherwise dispose of the Common Stock during the Restriction Period, (iv) the Holder shall be entitled to receive dividends on the Common Stock during the Restriction Period and (v) a breach of the terms and conditions established by the Committee pursuant to the Restricted Stock Award Agreement shall cause a forfeiture of the Restricted Stock Award. At the time of such Restricted Stock Award, the Committee may, in its sole discretion, prescribe additional terms and conditions or restrictions relating to Restricted Stock Awards, including, but not limited to, rules pertaining to the effect of termination of employment, Director status or Consultant status, prior to expiration of the applicable Restriction Period. Such additional terms, conditions or restrictions shall, to the extent inconsistent with the provisions of Sections 6.2, 6.3, 6.4 and 6.5, as applicable, be set forth in a Restricted Stock Award Agreement made in conjunction with the Restricted Stock Award. Such Restricted Stock Award Agreement may also include provisions relating to (i) subject to the provisions hereof, accelerated vesting of Restricted Stock Awards, including but not limited to accelerated vesting upon the occurrence of a “change of control” of the Company, (ii) tax matters (including provisions covering any applicable Employee wage withholding requirements and requiring additional “gross-up” payments to Holders to meet any excise taxes or other additional income tax liability imposed as a result of a payment made in connection with a “change of control” of the Company resulting from the operation of the Plan or of such Restricted Stock Award Agreement) and (iii) any other matters not inconsistent with the terms and provisions of the Plan that the Committee shall in its sole discretion determine. The terms and conditions of the respective Restricted Stock Agreements need not be identical.

Section 8.3 Payment for Restricted Stock. The Committee shall determine the amount and form of any payment for Common Stock received pursuant to a Restricted Stock Award, provided that in the absence of such a determination, a Holder shall not be required to make any payment for Common Stock received pursuant to a Restricted Stock Award, except to the extent otherwise required by law.

Section 8.4 Restricted Stock Award Agreements. At the time any Restricted Stock Award is made under this Article VIII, the Company and the Holder shall enter into a Restricted Stock Award Agreement setting forth each of the matters contemplated hereby and such other matters as the Committee may determine to be appropriate.

ARTICLE IX UNRESTRICTED STOCK AWARDS

Pursuant to the terms of the applicable Unrestricted Stock Award Agreement, a Holder may be awarded (or sold) shares of Common Stock which are not subject to Restrictions, in consideration for past services rendered thereby to the Company or an Affiliate or for other valid consideration.

ARTICLE X
PERFORMANCE UNIT AWARDS

Section 10.1 Terms and Conditions. The Committee shall set forth in the applicable Performance Unit Award Agreement the performance goals and objectives (and the period of time to which such goals and objectives shall apply) which the Holder and/or the Company would be required to satisfy before the Holder would become entitled to payment pursuant to Section 10.2, the number of Units awarded to the Holder and the dollar value assigned to each such Unit.

Section 10.2 Payments. The Holder of a Performance Unit shall be entitled to receive a cash payment, except as otherwise provided in Section 10.3, equal to the dollar value assigned to such Unit under the applicable Performance Unit Award Agreement if the Holder and/or the Company satisfy (or partially satisfy, if applicable under the applicable Performance Unit Award Agreement) the performance goals and objectives set forth in such Performance Unit Award Agreement.

Section 10.3 Special Committee Discretion. Notwithstanding anything to the contrary contained in this Article X, the Committee shall have the authority and discretion to provide in the applicable Performance Unit Award Agreement for the payment under a Performance Unit Award in the form of shares of Common Stock, cash or any combination thereof.

ARTICLE XI
PERFORMANCE SHARE AWARDS

Section 11.1 Terms and Conditions. The Committee shall set forth in the applicable Performance Share Award Agreement the performance goals and objectives (and the period of time to which such goals and objectives shall apply) which the Holder and/or the Company would be required to satisfy before the Holder would become entitled to the receipt of shares of Common Stock, except as otherwise provided in Section 11.3, pursuant to such Holder's Performance Share Award and the number of shares of Common Stock subject to such Performance Share Award.

Section 11.2 Shareholder Rights and Privileges. The Holder of a Performance Share Award shall have no rights as a shareholder of the Company until such time, if any, as the Holder actually receives shares of Common Stock pursuant to the Performance Share Award.

Section 11.3 Special Committee Discretion. Notwithstanding anything to the contrary contained in this Article XI, the Committee shall have the authority and discretion to provide in the applicable Performance Share Award Agreement for the payment under a Performance Share Award in the form of cash, shares of Common Stock or any combination thereof.

ARTICLE XII
DISTRIBUTION EQUIVALENT RIGHTS

Section 12.1 Terms and Conditions. The Committee shall set forth in the applicable Distribution Equivalent Rights Award Agreement the terms and conditions, if any, including whether the Holder is to receive credits currently in cash, is to have such credits reinvested (at Fair Market Value determined as of the date of reinvestment) in additional shares of Common Stock or is to be entitled to choose among such alternatives. Distribution Equivalent Rights Awards may be settled in cash or in shares of Common Stock, as set forth in the Applicable Distribution Equivalent Rights Award Agreement. A Distribution Equivalent Rights Award may, but need not be, awarded as a component of another Award, where, if so awarded, such Distribution Equivalent Rights Award shall expire or be forfeited by the Holder under the same conditions as under such other Award.

Section 12.2 Interest Equivalents. The Distribution Equivalent Rights Award Agreement for a Distribution Equivalent Rights Award may provide for the crediting of interest on a Distribution Rights Award to be settled in cash at a future date, at a rate set forth in the applicable Distribution Equivalent Rights Award Agreement or on the amount of cash payable thereunder.

ARTICLE XIII
STOCK APPRECIATION RIGHTS

Section 13.1 Terms and Conditions. The Committee shall set forth in the applicable Stock Appreciation Right Award Agreement the terms and conditions of the Stock Appreciation Right, including (i) the base value (the "Base Value") for the Stock Appreciation Right, which for purposes of a Stock Appreciation Right which is not a Tandem Stock Appreciation Right, shall be equal to the Fair Market Value of a share of the Common Stock on the date of grant of the Stock Appreciation Right, (ii) the number of shares of Common Stock subject to the Stock Appreciation Right, (iii) the period during which the Stock Appreciation Right may be exercised, and (iv) any other special rules and/or requirements which the Committee imposes upon the Stock Appreciation Right. Upon the exercise of some or all of the portion of a Stock Appreciation Right, the Holder shall receive a payment from the Company, in cash or in the form of shares of Common Stock having an equivalent Fair Market Value, or in a combination of both, as determined in the sole discretion of the Committee, equal to the product of:

- (a) The excess of (i) the Fair Market Value of a share of the Common Stock on the date of exercise, over (ii) the Base Value, multiplied by;
- (b) The number of shares of Common Stock with respect to which the Stock Appreciation Right is exercised.

Section 13.2 Tandem Stock Appreciation Rights. If the Committee grants a Stock Appreciation Right which is intended to be a Tandem Stock Appreciation Right, the Tandem Stock Appreciation Right must be granted at the same time as the related Option, and the following special rules shall apply:

- (a) The Base Value shall be equal to the Fair Market Value of a share of the Common Stock on the date of grant of the Tandem Stock Appreciation Right;

(b) The Tandem Stock Appreciation Right may be exercised for all or part of the shares of Common Stock which are subject to the related Option, but solely upon the surrender by the Holder of the Holder's right to exercise the equivalent portion of the related Option (and when a share of Common Stock is purchased under the related Option, an equivalent portion of the related Tandem Stock Appreciation Right shall be cancelled);

(c) The Tandem Stock Appreciation Right shall expire no later than the date of the expiration of the related Option;

(d) The value of the payment with respect to the Tandem Stock Appreciation Right may be no more than one hundred percent (100%) of the difference between the Fair Market Value of a share of the Common Stock on the date of grant of the Tandem Stock Appreciation Right and the Fair Market Value of the shares of Common Stock subject to the related Option at the time the Tandem Stock Appreciation Right is exercised; and

(e) The Tandem Stock Appreciation Right may be exercised solely when the Fair Market Value of the shares of Common Stock subject to the related Option exceeds the exercise price under the related Option.

ARTICLE XIV RECAPITALIZATION OR REORGANIZATION

Section 14.1 Adjustments to Common Stock. The shares with respect to which Awards may be granted under the Plan are shares of Common Stock as presently constituted; provided, however, that if, and whenever, prior to the expiration or distribution to the Holder of an Award theretofore granted, the Company shall effect a subdivision or consolidation of shares of Common Stock or the payment of a stock dividend on Common Stock without receipt of consideration by the Company, the number of shares of Common Stock with respect to which such Award may thereafter be exercised or satisfied, as applicable, (i) in the event of an increase in the number of outstanding shares, shall be proportionately increased, and the purchase price per share shall be proportionately reduced, and (ii) in the event of a reduction in the number of outstanding shares, shall be proportionately reduced, and the purchase price per share shall be proportionately increased. Notwithstanding the foregoing, any such adjustment made with respect to an Award which is an Incentive Stock Option shall comply with the requirements of Section 424(a) of the Code, and in no event shall any such adjustment be made which would render any Incentive Stock Option granted under the Plan to be other than an "incentive stock option" for purposes of Section 422 of the Code.

Section 14.2 Recapitalization. If the Company recapitalizes or otherwise changes its capital structure, thereafter upon any exercise or satisfaction, as applicable, of a previously granted Award, the Holder shall be entitled to receive (or entitled to purchase, if applicable) under such Award, in lieu of the number of shares of Common Stock then covered by such Award, the number and class of shares of stock and securities to which the Holder would have been entitled pursuant to the terms of the recapitalization if, immediately prior to such recapitalization, the Holder had been the holder of record of the number of shares of Common Stock then covered by such Award.

Section 14.3 Other Events. In the event of changes to the outstanding Common Stock by reason of recapitalization, reorganization, merger, consolidation, combination, exchange or other relevant change in capitalization occurring after the date of the grant of any Award and not otherwise provided for under this Article XIV, all outstanding Awards and Award Agreements evidencing such Awards shall be adjusted by the Board in its discretion as to the number and price of shares of Common Stock or other consideration subject to such Awards. In the event of any such change to the outstanding Common Stock, the aggregate number of shares available under the Plan shall be appropriately adjusted by the Board, the determination of which shall be conclusive.

Section 14.4 Powers Not Affected. The existence of the Plan and the Awards granted hereunder shall not affect in any way the right or power of the Board or of the shareholders of the Company to make or authorize any adjustment, recapitalization, reorganization or other change of the Company's capital structure or business, any merger or consolidation of the Company, any issue of debt or equity securities ahead of or affecting Common Stock or the rights thereof, the dissolution or liquidation of the Company or any sale, lease, exchange or other disposition of all or any part of its assets or business or any other corporate act or proceeding.

Section 14.5 No Adjustment for Certain Awards. Except as hereinabove expressly provided, the issuance by the Company of shares of stock of any class or securities convertible into shares of stock of any class, for cash, property, labor or services, upon direct sale, upon the exercise of rights or warrants to subscribe therefor or upon conversion of shares or obligations of the Company convertible into such shares or other securities, and in any case whether or not for fair value, shall not affect previously granted Awards, and no adjustment by reason thereof shall be made with respect to the number of shares of Common Stock subject to Awards theretofore granted or the purchase price per share, if applicable.

ARTICLE XV AMENDMENT AND TERMINATION OF PLAN

The Board in its discretion may terminate the Plan at any time with respect to any shares for which Awards have not theretofore been granted. The Board shall have the right to alter or amend the Plan or any part hereof from time to time; provided, however, that no change in any Award theretofore granted may be made which would materially and adversely impair the rights of the Holder without the consent of the Holder (unless such change is required in order to cause the benefits under the Plan to qualify as "performance-based" compensation within the meaning of Section 162(m) of the Code).

**ARTICLE XVI
MISCELLANEOUS**

Section 16.1 No Right to Award. Neither the adoption of the Plan by the Company nor any action of the Board or the Committee shall be deemed to give an Employee, Director or Consultant any right to an Award except as may be evidenced by an Award Agreement duly executed on behalf of the Company, and then solely to the extent and on the terms and conditions expressly set forth therein.

Section 16.2 No Rights Conferred. Nothing contained in the Plan shall (i) confer upon any Employee any right with respect to continuation of employment with the Company or any Affiliate, (ii) interfere in any way with the right of the Company or any Affiliate to terminate the employment of an Employee at any time, (iii) confer upon any Director any right with respect to continuation of such Director's membership on the Board, (iv) interfere in any way with the right of the Company or an Affiliate to terminate a Director's membership on the Board at any time, (v) confer upon any Consultant any right with respect to continuation of his or her consulting engagement with the Company or any Affiliate, or (vi) interfere in any way with the right of the Company or an Affiliate to terminate a Consultant's consulting engagement with the Company or an Affiliate at any time.

Section 16.3 Other Laws; Withholding. The Company shall not be obligated to issue any Common Stock pursuant to any Award granted under the Plan at any time when the shares covered by such Award have not been registered under the Securities Act of 1933 and under such other state and federal laws, rules or regulations as the Company or the Committee deems applicable and, in the opinion of legal counsel of the Company, if there is no exemption from the registration requirements of such laws, rules or regulations available for the issuance and sale of such shares. No fractional shares of Common Stock shall be delivered, nor shall any cash in lieu of fractional shares be paid. The Company shall have the right to deduct in cash (whether under this Plan or otherwise) in connection with all Awards any taxes required by law to be withheld and to require any payments required to enable it to satisfy its withholding obligations. In the case of any Award satisfied in the form of shares of Common Stock, no shares shall be issued unless and until arrangements satisfactory to the Company shall have been made to satisfy any tax withholding obligations applicable with respect to such Award. Subject to such terms and conditions as the Committee may impose, the Company shall have the right to retain, or the Committee may, subject to such terms and conditions as it may establish from time to time, permit Holders to elect to tender, Common Stock (including Common Stock issuable in respect of an Award) to satisfy, in whole or in part, the amount required to be withheld.

Section 16.4 No Restriction on Corporate Action. Nothing contained in the Plan shall be construed to prevent the Company or any Affiliate from taking any corporate action which is deemed by the Company or such Affiliate to be appropriate or in its best interest, whether or not such action would have an adverse effect on the Plan or any Award made under the Plan. No Employee, Director, Consultant, beneficiary or other person shall have any claim against the Company or any Affiliate as a result of any such action.

Section 16.5 Restrictions on Transfer. No Award under the Plan or any Award Agreement and no rights or interests herein or therein, shall or may be assigned, transferred, sold, exchanged, encumbered, pledged or otherwise hypothecated or disposed of by a Holder except (i) by will or by the laws of descent and distribution, or (ii) except for an Incentive Stock Option, by gift to any Family Member of the Holder. An Award may be exercisable during the lifetime of the Holder only by such Holder or by the Holder's guardian or legal representative unless it has been transferred by gift to a Family Member of the Holder, in which case it shall be exercisable solely by such transferee. Notwithstanding any such transfer, the Holder shall continue to be subject to the withholding requirements provided for under Section 16.3 hereof.

Section 16.6 Beneficiary Designations. Each Holder may, from time to time, name a beneficiary or beneficiaries (who may be contingent or successive beneficiaries) for purposes of receiving any amount which is payable in connection with an Award under the Plan upon or subsequent to the Holder's death. Each such beneficiary designation shall serve to revoke all prior beneficiary designations, be in a form prescribed by the Company and be effective solely when filed by the Holder in writing with the Company during the Holder's lifetime. In the absence of any such written beneficiary designation, for purposes of the Plan, a Holder's beneficiary shall be the Holder's estate.

Section 16.7 Rule 16b-3. It is intended that, at any time when the Common Stock is registered under Section 12 of the Exchange Act, the Plan and any Award made to a person subject to Section 16 of the Exchange Act shall meet all of the requirements of Rule 16b-3. If any provision of the Plan or of any such Award would disqualify the Plan or such Award under, or would otherwise not comply with the requirements of, Rule 16b-3, such provision or Award shall be construed or deemed to have been amended as necessary to conform to the requirements of Rule 16b-3.

Section 16.8 Section 162(m). It is intended that, at any time when the Common Stock is registered under Section 12 of the Exchange Act, the Plan shall comply fully with and meet all the requirements of Section 162(m) of the Code to permit Awards which are made hereunder to Holders who are "covered employees" (as defined in Section 162(m) of the Code) to constitute "performance-based" compensation within the meaning of Section 162(m) of the Code. The performance criteria to be utilized under the Plan for such purposes shall consist of objective tests based on one or more of the following: earnings or earnings per share, cash flow, customer satisfaction, revenues, financial return ratios (such as return on equity and/or return on assets), market performance, shareholder return and/or value, operating profits, EBITDA, net profits, profit returns and margins, stock price, credit quality, sales growth, market share, comparisons to peer companies (on a company-wide or divisional basis), working capital and/or individual or aggregate employee performance. If any provision of the Plan would disqualify the Plan or would not otherwise permit the Plan to comply with Section 162(m) as so intended, such provision shall be construed or deemed amended to conform to the requirements or provisions of Section 162(m); provided, however, that no such construction or amendment shall have an adverse effect on the economic value to a Holder of any Award previously granted hereunder.

Section 16.9 Other Plans. No Award, payment or amount received hereunder shall be taken into account in computing an Employee's salary or compensation for the purposes of determining any benefits under any pension, retirement, life insurance or other benefit plan of the Company or any Affiliate, unless such other plan specifically provides for the inclusion of such Award, payment or amount received.

Section 16.10 Limits of Liability. Any liability of the Company with respect to an Award shall be based solely upon the contractual obligations created under the Plan and the applicable Award Agreement. Neither the Company nor any member of the Committee shall have any liability to any party for any action taken or not taken, in good faith, in connection with or under the Plan.

Section 16.11 Governing Law. Except as otherwise provided herein, the Plan shall be construed in accordance with the laws of the State of Delaware.

Section 16.12 Severability of Provisions. If any provision of the Plan is held invalid or unenforceable, such invalidity or unenforceability shall not affect any other provision of the Plan, and the Plan shall be construed and enforced as if such invalid or unenforceable provision had not been included in the Plan.

Section 16.13 No Funding. The Plan shall be unfunded. The Company shall not be required to establish any special or separate fund or to make any other segregation of funds or assets to ensure the payment of any Award.

Section 16.14 Headings. Headings used throughout the Plan are for convenience only and shall not be given legal significance.

A-25

Annex C

**THIRD AMENDED AND RESTATED
CERTIFICATE OF INCORPORATION OF
ARGYLE SECURITY, INC.**

FIRST: The name of the corporation is Argyle Security, Inc. (the “Corporation”).

SECOND: The registered office of the Corporation is to be located at 615 South DuPont Highway, Kent County, Dover, Delaware. The name of its registered agent at that address is National Corporate Research, Ltd.

THIRD: The purposes for which the Corporation is formed are to engage in any lawful act or activity for which corporations may be organized under the General Corporation Law of Delaware (the “GCL”).

FOURTH: The total number of shares of all classes of capital stock which the Corporation shall have authority to issue is 90,000,000, of which 89,000,000 shares shall be Common Stock of the par value of \$.0001 per share, and 1,000,000 shares shall be Preferred Stock of the par value of \$.0001 per share.

(A) Preferred Stock. The Board of Directors is expressly granted authority to issue shares of the Preferred Stock, in one or more series, and to fix for each such series such voting powers, full or limited, and such designations, preferences and relative, participating, optional or other special rights and such qualifications, limitations or restrictions thereof as shall be stated and expressed in the resolution or resolutions adopted by the Board of Directors providing for the issue of such series (a “Preferred Stock Designation”) and as may be permitted by the GCL. The number of authorized shares of Preferred Stock may be increased or decreased (but not below the number of shares thereof then outstanding) by the affirmative vote of the holders of a majority of the voting power of all of the then outstanding shares of the capital stock of the Corporation entitled to vote generally in the election of directors, voting together as a single class, without a separate vote of the holders of the Preferred Stock, or any series thereof, unless a vote of any such holders is required pursuant to any Preferred Stock Designation.

(B) Common Stock. Except as otherwise required by law or as otherwise provided in any Preferred Stock Designation, the holders of the Common Stock shall exclusively possess all voting power and each share of Common Stock shall have one vote.

FIFTH: The name and mailing address of the sole incorporator of the Corporation are as follows:

Name	Address
Hope Wankel	Loeb & Loeb LLP 345 Park Avenue, 19 th Floor New York, New York 10154

SIXTH: The Board of Directors shall be divided into three classes: Class A, Class B and Class C. The number of directors in each class shall be as nearly equal as possible. At the first election of directors by the incorporator, the incorporator shall elect a Class C director for a term expiring at the Corporation’s third Annual Meeting of Stockholders. The Class C director shall then elect additional Class A, Class B and Class C directors. The directors in Class A shall be elected for a term expiring at the first Annual Meeting of Stockholders, the directors in Class B shall be elected for a term expiring at the second Annual Meeting of Stockholders and the directors in Class C shall be elected for a term expiring at the third Annual Meeting of Stockholders. Commencing at the first Annual Meeting of Stockholders, and at each annual meeting thereafter, directors elected to succeed those directors whose terms expire shall be elected for a term of office to expire at the third succeeding annual meeting of stockholders after their

election. Except as the GCL may otherwise require, in the interim between annual meetings of stockholders or special meetings of stockholders called for the election of directors and/or the removal of one or more directors and the filling of any vacancy in that connection, newly created directorships and any vacancies in the Board of Directors, including unfilled vacancies resulting from the removal of directors for cause, may be filled by the vote of a majority of the remaining directors then in office, although less than a quorum (as defined in the Corporation's Bylaws), or by the sole remaining director. All directors shall hold office until the expiration of their respective terms of office and until their successors shall have been elected and qualified. A director elected to fill a vacancy resulting from the death, resignation or removal of a director shall serve for the remainder of the full term of the director whose death, resignation or removal shall have created such vacancy and until his successor shall have been elected and qualified.

A-26

SEVENTH: The following provisions are inserted for the management of the business and for the conduct of the affairs of the Corporation, and for further definition, limitation and regulation of the powers of the Corporation and of its directors and stockholders:

(A) Election of directors need not be by ballot unless the by-laws of the Corporation so provide.

(B) The Board of Directors shall have the power, without the assent or vote of the stockholders, to make, alter, amend, change, add to or repeal the by-laws of the Corporation as provided in the by-laws of the Corporation.

(C) The directors in their discretion may submit any contract or act for approval or ratification at any annual meeting of the stockholders or at any meeting of the stockholders called for the purpose of considering any such act or contract, and any contract or act that shall be approved or be ratified by the vote of the holders of a majority of the stock of the Corporation which is represented in person or by proxy at such meeting and entitled to vote thereat (provided that a lawful quorum of stockholders be there represented in person or by proxy) shall be as valid and binding upon the Corporation and upon all the stockholders as though it had been approved or ratified by every stockholder of the Corporation, whether or not the contract or act would otherwise be open to legal attack because of directors' interests, or for any other reason.

(D) In addition to the powers and authorities hereinbefore or by statute expressly conferred upon them, the directors are hereby empowered to exercise all such powers and do all such acts and things as may be exercised or done by the Corporation; subject, nevertheless, to the provisions of the statutes of Delaware, of this Certificate of Incorporation, and to any by-laws from time to time made by the stockholders; provided, however, that no by-law so made shall invalidate any prior act of the directors which would have been valid if such by-law had not been made.

A-27

EIGHTH:

(A) A director of the Corporation shall not be personally liable to the Corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, except for liability (i) for any breach of the director's duty of loyalty to the Corporation or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) under Section 174 of the GCL, or (iv) for any transaction from which the director derived an improper personal benefit. If the GCL is amended to authorize corporate action further eliminating or limiting the personal liability of directors, then the liability of a director of the Corporation shall be eliminated or limited to the fullest extent permitted by the GCL, as so amended. Any repeal or modification of this paragraph A by the stockholders of the Corporation shall not adversely affect any right or protection of a director of the Corporation with respect to events occurring prior to the time of such repeal or modification.

(B) The Corporation, to the full extent permitted by Section 145 of the GCL, as amended from time to time, shall indemnify all persons whom it may indemnify pursuant thereto. Expenses (including attorneys' fees) incurred by an officer or director in defending any civil, criminal, administrative, or investigative action, suit or proceeding for which such officer or director may be entitled to indemnification hereunder shall be paid by the Corporation in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of such director or officer to repay such amount if it shall ultimately be determined that he is not entitled to be indemnified by the Corporation as authorized hereby.

NINTH: Whenever a compromise or arrangement is proposed between this Corporation and its creditors or any class of them and/or between this Corporation and its stockholders or any class of them, any court of equitable jurisdiction within the State of Delaware may, on the application in a summary way of this Corporation or of any creditor or stockholder thereof or on the application of any receiver or receivers appointed for this Corporation under Section 291 of Title 8 of the Delaware Code or on the application of trustees in dissolution or of any receiver or receivers appointed for this Corporation under Section 279 of Title 8 of the Delaware Code order a meeting of the creditors or class of creditors, and/or of the stockholders or class of stockholders of this Corporation, as the case may be, to be summoned in such manner as the said court directs. If a majority in number representing three fourths in value of the creditors or class of creditors, and/or of the stockholders or class of stockholders of this Corporation, as the case may be, agree to any compromise or arrangement and to any reorganization of this Corporation as a consequence of such compromise or arrangement, the said compromise or arrangement and the said reorganization shall, if sanctioned by the court to which the said application has been made, be binding on all the creditors or class of creditors, and/or on all the stockholders or class of stockholders, of this Corporation, as the case may be, and also on this Corporation.

Annex D

MERGER AGREEMENT

MERGER AGREEMENT, dated December 8, 2006 (this “Agreement”), by and among Argyle Security Acquisition Corp., a Delaware corporation (“Parent”), ISI Security Group, Inc., a Delaware corporation (“Acquisition Corp.”), ISI Detention Contracting Group, Inc., a Delaware corporation, d/b/a “ISI Security Group” (the “Company”).

W I T N E S S E T H :

WHEREAS, the Company is in the business of providing security solutions for detention facilities and for commercial, industrial and governmental customers (the “Business”);

WHEREAS, William Blair Mezzanine Capital Fund III, L.P. (“Blair”) is converting \$10,000,000 in aggregate principal amount of its outstanding \$15,951,609 promissory note (the “Note”) into shares of the Company’s Class A preferred stock, par value \$.0001 per share (the “Company Preferred Stock”) pursuant to a Note Conversion Agreement, the form of which is attached hereto as Exhibit A (the “Note Conversion Agreement”), with the balance of the Note being represented by a new \$5,951,609 promissory note (the “New Note”) and note purchase agreement, the terms of which shall be agreed upon by Blair, Parent, Acquisition Corp. and the Company, prior to the Closing;

WHEREAS, Parent owns all of the issued and outstanding shares of equity securities of Acquisition Corp.;

WHEREAS, Parent and Acquisition Corp. desire that Acquisition Corp. merge with and into the Company and, to realize the benefits thereof, the Company also desires that Acquisition Corp. merge with and into the Company upon the terms and subject to the conditions set forth herein and in accordance with the General Corporation Law of the State of Delaware, and that the Company Preferred Stock and the outstanding shares of common stock, par value \$.0001 per share, of the Company (“Company Common Stock”), and any securities of the Company convertible into Company Common Stock or Company Preferred Stock, excluding any such shares held in the treasury of the Company, be converted upon such merger (the “Merger”) into the right to receive the Merger Consideration as is provided herein; and

NOW, THEREFORE, in consideration of the foregoing and the representations, warranties, covenants and agreements herein contained and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties hereto hereby agree as follows:

**ARTICLE I
DEFINITIONS**

1.1. **Definitions**. The following terms, as used herein, have the following meanings:

A-29

“2005 Financial Statements” are the Company’s Balance Sheet, Statement of Cash Flows and Statement of Operations prepared as of and for the year ended December 31, 2005 in accordance with GAAP.

“2006 EBITDA” means the Company’s earnings before interest, taxes, depreciation and amortization as calculated from the 2006 Financial Statements.

“2006 Financial Statements” are the Company’s Balance Sheet, Statement of Cash Flows and Statement of Operations prepared as of and for the year ended December 31, 2006 in accordance with GAAP.

“2/28 Backlog” means the backlog of contracts and other work of the Company and all Subsidiaries, as calculated consistent with the past practices of the Company and the Subsidiaries, pursuant to the Work in Process Report of Company for the period ending February 28, 2007.

“Accounts Receivable” has the meaning set forth in Section 3.11.

“Acquisition Corp.” has the meaning set forth in the Preamble.

“Act” has the meaning set forth in Section 8.5.

“Action” means any action, suit, investigation, hearing or proceeding, including any audit for taxes or otherwise.

“Additional Agreements” means each of the Lock-up Agreements, the Life Insurance Agreements, the Amended and Restated Lease Agreements, and the StarCo Termination Agreement.

“Adjusted EBITDA” means the Company’s earnings before interest, taxes, depreciation and amortization, for the year ending December 31, 2006, as calculated in the 2006 Financial Statements, plus normalization adjustments of \$900,000 and such additional normalization adjustments as may be agreed upon by the parties.

“Affiliate” means, with respect to any Person, any Person directly or indirectly controlling, controlled by, or under common control with such other Person. With respect to any natural person, the term Affiliate shall also include any member of said person’s immediate family, any family limited partnership, limited liability company or other entity for said person and any trust, voting or otherwise, of which said person is a trustee or of which said person or any of said person’s immediate family is a beneficiary.

“Agreement” has the meaning set forth in the Preamble.

“Amended and Restated Lease Agreement” means the lease agreements between the Surviving Corporation and the owner of the SA Offices (Green Wing Management, Ltd.),

which will be negotiated and entered into immediately prior to the Effective Time. The terms of the Amended and Restated Lease Agreements will include:

- a term of twelve years beginning on the Effective Date
- a recalculation of the rental rate every three years. At the end of each three-year term, there will be an independent appraisal which will be used as the basis for determining the lease payments during the next three-year term, to be calculated as follows: (a) if the new appraisal is more than the current appraisal, the lease will be at a discount of 10% to the market rate (b) if the new appraisal is less than the last appraisal by less than 10%, the lease will be at the same rate as is applicable on the previous three year agreement or (c) if the new appraisal is lower than the applicable appraisal by more than 10%, the lease will be at the market rate. In other words, if the new appraisal is lower than the immediately prior appraisal, the new lease will be the lower of the current lease or market rate. For example, assuming current market appraisal at \$100 (i.e. lease is \$90 (at a 10% discount including the 10% discount)):

- o if the new appraisal were \$115, the new lease rate would be 90% of \$115 i.e. \$103.5
- o if the new appraisal were \$105, the new lease rate would be 90% of \$105 i.e. \$94.50

oif the new appraisal were \$95, the lease rate would remain at \$90 because 90% of \$95 (\$85.5) is less than the current lease

oif the new appraisal is \$85, then the new lease rate would be \$85 because the market rate is less than the current lease

- Prior to the Effective Date, the lease will be adjusted by an independent appraiser to 10% below market value or the current lease rate, whichever is greater.
- The Parent will have the right, at the Parent's sole discretion, to purchase from the leasehold owner(s) the underlying real properties at market rates (to be agreed by an independent evaluation at that time); provided that such market rates cannot be below the value determined in the last appraisal prior to the Effective Date. The Parent shall also have a right of first refusal to purchase the real property, should such property ever be offered for sale.

“Arbitrator” has the meaning set forth in Section 12.1(b).

“Authority” shall mean any governmental, regulatory or administrative body, agency or authority, any court or judicial authority, any arbitrator, or any public, private or industry regulatory authority, whether international, national, Federal, state or local.

“Benefits Arrangement” has the meaning set forth in Section 3.25.

“Blair” has the meaning set forth in the Recitals.

“Books and Records” means all books and records, ledgers, employee records, customer lists, files, correspondence, and other records of every kind (whether written, electronic, or otherwise embodied) owned or used by the Company or in which the Company’s assets, business, or transactions are otherwise reflected.

“Business” has the meaning set forth in the Recitals.

“Business Day” means any day other than a Saturday, Sunday or a legal holiday on which commercial banking institutions in Texas are not open for business.

“Carr Note” means the promissory note owed by the Company and payable to Don Carr, dated November 1, 2005, in the original principal amount of \$32,469.00.

“Cash Consideration” has the meaning set forth in Section 2.6(c).

“Certificate of Merger” has the meaning set forth in Section 2.3.

“Charter Documents” has the meaning set forth in Section 3.3.

“Closing” has the meaning set forth in Section 2.9.

“Closing Date” has the meaning set forth in Section 2.9.

“Code” means the Internal Revenue Code of 1986, as amended.

“Company” has the meaning set forth in the Preamble. Unless the context otherwise requires, when used in this Agreement, the term “Company” means the Company and all of its Subsidiaries.

“Company Common Stock” has the meaning set forth in the Recitals.

“Company Consent” has the meaning set forth in Section 3.9.

“Company Indemnitees” has the meaning set forth in Section 11.3.

“Company Preferred Stock” has the meaning set forth in the Recitals.

“Company Plan” has the meaning set forth in Section 3.25.

“Company Securities” means, collectively, the Company Common Stock, the Company Preferred Stock and the Company Warrant.

“Company Warrant” means the Common Stock Purchase Warrant to purchase 52.4532 shares of Company Common Stock issued to William Blair Mezzanine Capital Fund III, L.P. by the Company dated October 22, 2004.

“Completed Contracts” has the meaning set forth in the definition of StarCo Termination Agreement.

“Constituent Corporations” has the meaning set forth in Section 2.1(a).

“Contracts” has the meaning set forth in Section 3.19.

“Contracts in Progress” has the meaning set forth in the definition of StarCo Termination Agreement.

“Current Company Plans” has the meaning set forth in Section 3.25.

“Customer” has the meaning set forth in Section 7.2(b) “December Balance Sheet” has the meaning set forth in Section 3.10(a).

“Effective Time” has the meaning set forth in Section 2.4.

“Effectiveness Period” has the meaning set forth in Section 8.5.

“Employment Agreements” mean the agreements to be negotiated by the Surviving Corporation and the Parent and each of the persons listed on Schedule 8.7. These Employment Agreements of Sam Youngblood, Don Carr and Tim Moxon will provide for a term of not less than two years and the Employment Agreement of Mark McDonald will be for a term of not less than five years. The Employment Agreements of Sam Youngblood and Don Carr will require the Surviving Corporation and Parent to agree, as a part of the consideration to Sam Youngblood and Don Carr, that each of them shall serve as a full voting member of the Board of Directors of Surviving Corporation, so long as they are employees of Surviving Corporation.

“Enhanced Cash Consideration” has the meaning set forth in Section 2.6(b) “ERISA” means the Employment Retirement Income Security Act of 1974.

“ERISA Affiliate” has the meaning set forth in Section 3.25.

“ERISA Affiliate Plan” has the meaning set forth in Section 3.25.

“Exchange Act” means the Securities Exchange Act of 1934.

“Exchange Act Filings” means filings under the Exchange Act made by the Parent prior to the Closing Date.

“Financial Statements” has the meaning set forth in Section 3.10(a).

“GAAP” means U.S. generally accepted accounting principles, consistently applied and interpreted, and shall not mean SEC GAAP.

“Indebtedness” includes with respect to any Person, (a) all obligations of such Person for borrowed money, or with respect to deposits or advances of any kind (including amounts by reason of overdrafts and amounts owed by reason of letter of credit reimbursement agreements) including with respect thereto, all interests, fees and costs, (b) all obligations of such Person evidenced by bonds, debentures, notes, liens, mortgages or similar instruments, (c) all obligations of such Person under conditional sale or other title retention agreements relating to property purchased by such Person, (d) all obligations of such Person issued or assumed as the deferred purchase price of property or services (other than accounts payable to creditors for goods and services incurred in the ordinary course of business), (e) all Indebtedness of others secured by (or for which the holder of such Indebtedness has an existing right, contingent or otherwise, to be secured by) any lien or security interest on property owned or acquired by such Person, whether or not the obligations secured thereby have been assumed, (f) all obligations of such Person under leases required to be accounted for as capital leases under GAAP, and (g) all guarantees by such Person.

“Indemnification Notice” has the meaning set forth in Section 11.5(a).

“Indemnified Parties” has the meaning set forth in Section 11.5.

“Indemnifying Party” has the meaning set forth in Section 11.5(a).

“Individual Indemnitees” has the meaning set forth in Section 11.4.

“Insurance Agreements” means the agreements to be negotiated and entered into immediately prior to the Effective Time by Parent and each of Sam Youngblood and Don Carr relating to the respective obligation of Sam Youngblood and Don Carr to maintain their existing key man life insurance policies in a form to be agreed upon prior to Closing. It is understood that the key man life insurance policies will be maintained with benefits not less than those in place as of the date of this Agreement until such time as the Lock-Up Agreements terminate. It is understood that the Surviving Corporation will pay the premiums for Don Carr’s policy.

“Intellectual Property” means any and all of the following: (A) U.S., international and foreign patents, patent applications and statutory invention registrations; (B) trademarks, licenses, inventions, service marks, trade names, trade dress, slogans, logos and Internet domain names, including registrations and applications for registration thereof; (C) copyrights, including registrations and applications for registration thereof, and copyrightable materials; (D) trade secrets, know-how and similar confidential and proprietary information; (E) the additional names listed on Schedule 3.7 and all derivations thereof; (F) u.r.l.s, Internet domain names and

Websites; and (G) any other type of Intellectual Property right, and all embodiments and fixations thereof and related documentation, registrations and franchises and all additions, improvements and accessions thereto, in each case which is owned or licensed or filed by the Company or any Subsidiary or used or held for use in the Business, whether registered or unregistered or domestic or foreign.

“Law” means any domestic or foreign Federal, state, municipality or local law, statute, ordinance, code, rule or regulation or common law.

“Leases” has the meaning set forth in Section 3.14.

“Licensed Intellectual Property” has the meaning set forth in section 3.16(c).

“Lien” means, with respect to any asset, any mortgage, lien, pledge, charge, security interest or encumbrance of any kind in respect of such asset, including any agreement to give any of the foregoing and any conditional sale and including any voting agreement or proxy.

“Lock-Up Agreements” means each of the Lock-Up Agreements between (A) Parent and each of the Company’s stockholders (other than Blair) in the form attached hereto as Exhibit B1 and (B) Parent and Blair in the form attached hereto as Exhibit B2.

“Loss(es)” has the meaning set forth in Section 11.1.

“Material Adverse Change” means a material adverse change in the business, assets, condition (financial or otherwise), liabilities, results of operations or prospects of the Business individually or as a whole; provided, however, without prejudicing whether any other matter qualifies as a Material Adverse Change, any matter outside the ordinary course of business individually or in the aggregate involving a loss or payment in excess of \$100,000 shall constitute a Material Adverse Change, per se.

“Material Adverse Effect” means a material adverse effect on the business, assets, condition (financial or otherwise), liabilities, results of operations or prospects of the Business individually or as a whole; provided, however, without prejudicing whether any other matter qualifies as a Material Adverse Effect, any matter outside the ordinary course of business individually or in the aggregate involving a loss or payment in excess of \$100,000 shall constitute a Material Adverse Effect, per se.

“Merger” has the meaning set forth in the Recitals.

“Merger Consideration” has the meaning set forth in Section 2.6(a).

“Money Laundering Laws” has the meaning set forth in Section 3.33.

“Multiemployer Plans” has the meaning set forth in Section 3.25.

“New Note” has the meaning set forth in the Recitals.

“Note” has the meaning set forth in the Recitals.

“Note Conversion Agreement” has the meaning set forth in the Recitals.

“Offices” has the meaning set forth in Section 3.1.

“Order” means any decree, order, judgment, writ, award, injunction, rule or consent of or by an Authority.

“Outside Closing Date” has the meaning set forth in Section 13.1.

“Owned Intellectual Property” has the meaning set forth in Section 3.16(a).

“Parent” has the meaning set forth in the Preamble.

“Parent’s Accountants” has the meaning set forth in Section 2.7.

“Parent Charter Documents” has the meaning set forth in Section 5.9.

“Parent Common Stock” means the Common Stock, \$.0001 par value per share, of Parent.

“Parent Financial Statements” has the meaning set forth in Section 5.11(a).

“PBGC” has the meaning set forth in Section 3.25.

“Permits” has the meaning set forth in Section 3.20.

“Person” means an individual, a corporation, a partnership, a limited liability company, an association, a trust or other entity or organization, including a government, domestic or foreign, or political subdivision thereof, the Company or an agency or instrumentality thereof.

“Plan” has the meaning set forth in Section 3.25.

“Proceeding” has the meaning set forth in Section 3.27(b).

“Real Property” means, collectively, all real properties and interests therein (including the right to use), together with all buildings, fixtures, trade fixtures, plant and other improvements located thereon or attached thereto; all rights arising out of use thereof (including air, water, oil and mineral rights); and all subleases, franchises, licenses, permits, easements and rights-of-way which are appurtenant thereto.

“Rebate Obligations” has the meaning set forth in Section 3.29(c).

“Reg D” has the meaning set forth in Section 4.5(a).

“Registrable Securities” has the meaning set forth in Section 8.5.

“Restriction Period” has the meaning set forth in Section 7.2(a).

“Restrictive Covenants” has the meaning set forth in Section 7.4.

“SA Offices” means those offices and facilities of the Company included within the term “Offices” as defined in Section 3.1, that are located, or will be located in San Antonio, Texas and are leased by the Company or the Subsidiaries from Green Wing Management, Ltd.

“SEC” means the Securities and Exchange Commission.

“September Balance Sheet” has the meaning set forth in Section 3.10(a).

“Standard Stock Consideration” has the meaning set forth in Section 2.6(a)(i).

“StarCo” has the meaning set forth in Section 9.2(j).

“StarCo Termination Agreement” means the agreement to be negotiated and entered into immediately prior to the Effective Time by the Company and StarCo terminating StarCo’s relationship with the Company in a form to be agreed upon by the Company and Blair prior to Closing. Pursuant to the StarCo Termination Agreement, (i) the Company will agree to pay the account payable balance owed StarCo on the Closing Date (in an amount no greater than \$2 million), (ii) for claims alleged against the Surviving Corporation or StarCo arising from bonded contracts where the contract has been paid in full as of the Closing Date (“Completed Contracts”), the Company will agree to defend all of such claims, pay any proven claims, and perform any required work to satisfy any proven claims, (iii) the Surviving Corporation will have the right of reimbursement for all costs and damages incurred in settling, resolving, or paying any claims that exceed \$250,000 per incident from StarCo and its Affiliates, (iv) StarCo will agree to remain in existence until the end of the contractual warranty period for any Completed Contract, (v) for any claim against the Surviving Corporation or StarCo on any contract of the Company that has not been paid in full as of the Closing Date (“Contracts in Progress”), the Surviving Corporation will agree to be wholly responsible for the defense, resolution and payment of such claims, and agree to indemnify and defend StarCo from such claims, (vi) the Company will agree to indemnify Sam Youngblood and Don Carr from their personal guarantees (and those of their spouses) of any bonding obligation on any Contract in Progress, and (vii) the Parent and Acquisition Corp. will agree to provide their own line of bonding capacity for the Surviving Corporation after the Closing Date, without the guarantees of Sam Youngblood or Don Carr.

“Software” has the meaning set forth in Section 3.16(b).

“Stock Consideration” has the meaning set forth in Section 2.6(a).

A-37

“Stockholder’s Securities” means, with respect to a stockholder of the Company, the Company Common Stock and/or the Company Preferred Stock owned by any such stockholder of the Company, including those set forth on Schedule I hereto.

“Subsidiary” or “Subsidiaries” means one of the Company’s subsidiaries or all of the Company’s subsidiaries, as applicable.

“Surviving Corporation” has the meaning set forth in Section 2.1(a).

“Tangible Assets” means all tangible personal property and interests therein, including inventory, machinery, computers and accessories, furniture, office equipment, communications equipment, vehicles, and other tangible property (collectively, the “Tangible Assets”).

“Tax” has the meaning set forth in Section 3.27(c).

“Tax Liability” has the meaning set forth in Section 3.27(b).

“Tax Return” has the meaning set forth in Section 3.27(c).

“Third Party Accountant” has the meaning set forth in Section 2.7(b).

“Third Party Claim” has the meaning set forth in Section 11.5(a).

“UCC” shall mean the Uniform Commercial Code of the State of Texas, or any corresponding or succeeding provisions of Laws of the State of Texas, or any corresponding or succeeding provisions of Laws, in each case as the same may have been and hereafter may be adopted, supplemented, modified, amended, restated or replaced from time to time.

“Website(s)” shall mean all of the internet domain names for the Company set forth on Schedule 3.16(a).

“Youngblood Note” means the promissory note owed by the Company and payable to Sam Youngblood, dated November 1, 2005, in the original principal amount of \$65,922.00.

ARTICLE II PURCHASE AND SALE

2.1. **The Merger.**

(a) At the Effective Time, (i) the separate existence of Acquisition Corp. will cease and Acquisition Corp. will be merged with and into the Company (Acquisition Corp. and the Company are sometimes referred to herein as the “Constituent Corporations”; with respect to periods after the Effective Time, the Company is sometimes referred to herein as the “Surviving Corporation”); (ii) the Certificate of Incorporation of Acquisition Corp. in

effect immediately prior to the Effective Time shall be the Certificate of Incorporation of the Surviving Corporation; and (iii) the By-laws of Acquisition Corp. as in effect immediately prior to the Effective Time shall be the By-laws of the Surviving Corporation.

(b) At and after the Effective Time, title to all property owned by each of the Constituent Corporations shall vest in the Surviving Corporation without reversion or impairment, and the Surviving Corporation shall automatically assume all of the liabilities of each Constituent Corporation.

(c) Immediately after the Effective Time, Parent shall elect no more than five persons to the Board of Directors of the Surviving Corporation (which persons will constitute the entire Board of Directors of the Surviving Corporation). Neither Parent nor the Surviving Corporation is under any obligation to maintain any person in any such position, except that Sam Youngblood and Don Carr shall be elected to the Board of Directors of the Surviving Corporation.

(d) Immediately after the Effective Time, Parent shall cause the Board of Directors of the Surviving Corporation to name the following persons as officers of the Surviving Corporation in the positions indicated, provided however, neither Parent nor the Surviving Corporation is under any obligation to maintain any person in any such position, except as may be required in the Employment Agreements of Sam Youngblood and Don Carr.

(i) Sam Youngblood - Chief Executive Officer and Secretary

(ii) Don Carr - President

(iii) such other persons as the Board of Directors of the Surviving Corporation shall designate.

2.2. *(This section intentionally left blank)*

2.3. **Certificate of Merger.** As soon as practicable following fulfillment or waiver of the conditions specified in Article IX hereof, and provided that this Agreement has not been terminated and abandoned pursuant to Article XIII hereof, the Company and Acquisition Corp. will cause the Certificate of Merger (the "Certificate of Merger") to be executed and filed with the Delaware Secretary of State as provided in the Delaware General Corporation Law.

2.4. **Effective Time of the Merger.** The Merger shall become effective at 11:59 p.m. on the day of the filing of the Certificate of Merger with the Delaware Secretary of State or at such other date or time thereafter as the parties may agree. The date and time of such effectiveness is herein sometimes referred to as the "Effective Time".

2.5. **Effect on Capital Stock; Exchange Procedures.**

A-39

(a) As of the Effective Time, by virtue of the Merger and without any action on the part of the holders of any Company Securities or the holders of capital stock of Acquisition Corp.:

(i) Each issued share of the Company Common Stock and Company Preferred Stock outstanding prior to the Effective Time shall be converted into the right to receive a portion of the Merger Consideration as defined in Section 2.6. The Company Warrant shall be converted into the right to receive a portion of the Merger Consideration as defined in Section 2.6. All of the Company Securities outstanding prior to the Effective Time shall be cancelled, and each holder of a certificate or agreement representing any of the Company Securities shall thereafter cease to have any rights with respect to the Company Securities except the right to receive the Merger Consideration pursuant to the terms hereof. Any shares of the Company Securities held as treasury shares by the Company shall be canceled and not be converted into the right to receive any consideration.

(ii) Each issued and outstanding share of the capital stock of Acquisition Corp. shall automatically, and without any action on the part of the holder thereof, become a share of Company Common Stock.

(b) As soon as practicable after the Effective Time, each holder of Company Securities prior to the Effective Time will surrender the certificates or agreements representing the Company Securities to the Parent. Upon the surrender of all the Company Securities owned by a stockholder or the holder of the Company Warrant of the Company, such Person shall promptly receive from Parent the portion of the Merger Consideration which such Person is entitled to receive pursuant to Sections 2.6.

(c) If the Merger Consideration (or any portion thereof) to be paid to any stockholder of the Company or the holder of the Company Warrant is to be delivered to any person other than the person in whose name the Company Securities are registered, it shall be a condition to such exchange that the Company Securities so surrendered shall be properly endorsed or otherwise in proper form for transfer and the person requesting such exchange shall (i) establish to the satisfaction of the Parent the propriety of such transfer and (ii) (x) pay any transfer or other taxes required by reason of the payment of such consideration to a person other than the registered holder of the Company Securities surrendered, or (y) establish to the satisfaction of the Parent that such tax has been paid or is not applicable.

(d) If any certificate representing Company Securities outstanding prior to the Effective Time has been lost, stolen or destroyed, Parent shall issue the applicable Merger Consideration deliverable in respect thereof upon (i) the making of an affidavit of that fact by the person claiming such certificate to be lost, stolen or destroyed and (ii) if required by the Parent, the posting by such person of a bond in such reasonable amount as the Parent may direct as indemnity against any claim that may be made against it with respect to such certificate.

(e) From and after the Effective Time, no transfer of any securities of Acquisition Corp. outstanding prior to the Effective Time shall be made on the stock transfer books of Acquisition Corp.

2.6. **Merger Consideration**. The aggregate consideration that the Company's stockholders and the holder of the Company Warrant will be entitled to receive by virtue of the Merger shall be the sum of the cash and Parent Common Stock set forth below (as applicable, the "Merger Consideration").

(a) If, at the time of the Closing, (i) the 2/28 Backlog is less than \$80,000,000, or (ii) the 2/28 Backlog is greater than \$80,000,000 but the Adjusted EBITDA of the Company is less than \$4,500,000, then, subject to the right of the Parent to terminate the Merger Agreement pursuant to Article 13, the Merger Consideration shall consist of:

(i) \$16,300,000 in cash (the "Standard Cash Consideration"); and

(ii) 1,180,000 shares of Parent Common Stock (the "Stock Consideration").

(b) If at the time of the Closing the Adjusted EBITDA of the Company is \$4,500,000 or greater, and the amount of the 2/28 Backlog is \$80,000,000 or greater, then the Merger Consideration shall consist of:

(i) \$18,200,000 in cash (the "Enhanced Cash Consideration"); and

(ii) the Stock Consideration

(c) The terms Standard Cash Consideration and Enhanced Cash Consideration are collectively referred to herein as "Cash Consideration".

2.7. **Procedure to Establish Adjusted EBITDA**.

(a) By February 15, 2007, the Company will provide the Parent with the 2006 Financial Statements and a calculation (with reasonably sufficient detail to allow the Parent to analyze the calculation) of the Company's Adjusted EBITDA for the calendar year ended December 31, 2006.

(b) If Parent seeks to propose any change or modification in the Company's calculation of Adjusted EBITDA and/or the 2006 Financial Statements, Parent must do so in a writing delivered to Company, setting forth in reasonable detail (i) the changes or modifications proposed, (ii) the rationale and evidence justifying the proposed change or modifications, and (iii) if applicable, the provisions of U.S. GAAP (not SEC. GAAP) that clearly and specifically require the proposed change or modifications, within 10 days of receiving such calculation of Adjusted EBITDA and the 2006 Financial Statements. If Company, within 10 days of receiving the proposed changes or modifications of Parent, does not notify Parent in writing that Company has agreed to the changes or modifications in the Company's calculation of Adjusted EBITDA and/or the 2006 Financial Statements proposed

by Parent, then, if within 10 days thereafter, the independent accountants regularly employed by the Parent (the “Parent’s Accountants”) and the independent accountants for the Company (the “Company’s Accountants”) are unable to agree upon the Adjusted EBITDA calculations or the 2006 Financial Statements, the Parent’s Accountants and the Company’s Accountants shall provide their calculations of Adjusted EBITDA and the 2006 Financial Statements to a third-party independent accountant (the “Third Party Accountant”) familiar with businesses similar to the Business and mutually agreed upon by the Parent’s Accountants and the Company’s Accountants, who shall make a determination as to the Company’s Adjusted EBITDA as of the Closing Date. If the Parent’s Accountants and the Company’s Accountants cannot agree upon the Third Party Accountant, then the Third Party Accountant will be Pricewaterhouse Coopers.

(c) The calculation of Adjusted EBITDA as of the Closing Date submitted to Parent by Company, shall be deemed to be irrevocably incontestable and binding upon Parent and Acquisition Corp. unless, as to the issues raised by Parent and submitted for resolution, the Third Party Accountant shall, prior to determination of any other substantive issue, make a finding that, based on standards generally acceptable in the accounting industry, there was no reasonable basis pursuant to U.S. GAAP (not S.E.C. GAAP) for the calculation of Adjusted EBITDA or the 2006 Financial Statements by Company’s Accountant. If the Third Party Accountant does not make such a finding as required herein, the fees of the Third Party Accountant shall be the sole responsibility of Parent. If the Third Party Accountant makes such a finding, the expenses for the Third Party Accountant shall be paid for by the party whose calculation of Adjusted EBITDA was most different from the calculation of such Third Party Accountant, as determined by such Third Party Accountant as reasonable.

2.8. Procedure to Establish 2/28 Backlog

(a) By March 21, 2007, the Company will provide the Parent with a calculation of the Company’s 2/28 Backlog. If Parent seeks to propose any change or modification in the Company’s calculation of 2/28 Backlog, Parent must do so in a writing delivered to Company, setting forth in reasonable detail (i) the changes or modifications proposed, and (ii) the rationale and evidence justifying the Parent’s assertion that the Company’s calculation of 2/28 Backlog does not comply with the Company’s past practices. If Company, within 10 days of receiving the proposed changes or modifications of Parent, does not notify Parent in writing that Company has agreed to the changes or modifications in the Company’s calculation of 2/28 Backlog, the Parent and the Company shall negotiate in good faith the amount of the 2/28 Backlog.

2.9. Payment of the Merger Consideration.

(a) If at the time of the Closing, (i) the 2/28 Backlog is less than \$80,000,000, or (ii) the 2/28 Backlog is greater than \$80,000,000 but the Adjusted EBITDA of the Company is less than \$4,500,000, then, subject to the right of the Parent to terminate the Merger Agreement pursuant to Article 13, the Merger Consideration shall be payable by Acquisition Corp. and Parent as follows, in the following priorities:

- (i) First, Blair, as the holder of all of the Company Preferred Stock, will be entitled to receive a portion of the Cash Consideration in an aggregate amount equal to \$10,000,000.00.
- (ii) Second, but only if the Youngblood Note and the Carr Note are still outstanding as of the Closing Date, the holders of the Youngblood Note and the Carr Note, constituting long term debt of the Company, will be paid in full their respective principal balances due, in an aggregate amount equal to \$98,391.00.
- (iii) Third, the holders of Company Common Stock will be entitled to receive (i) \$5,307,189 (or \$5,405,580 if the Youngblood Note and the Carr Note are not still outstanding as of immediately prior to the Closing Date), to be distributed according to Schedule 2.9 attached hereto and (ii) 739,712 shares of Parent Common Stock , to be distributed according to Schedule 2.9 attached hereto.
- (iv) Fourth, the holder of the Company Warrant will be entitled to receive (i) 440,288 shares of Parent Common Stock and (ii) \$894,420
- (b) If at the time of the Closing the Adjusted EBITDA of the Company is \$4,500,000.00 or greater, and the amount of the 2/28 Backlog is \$80,000,000.00 or more, then the Enhanced Cash Consideration shall be distributed as follows, in the following priorities:
- (i) First, Blair, as the holder of all of the Company Preferred Stock, will be entitled to receive a portion of the Cash Consideration in an aggregate amount equal to \$10,000,000.
- (ii) Second, but only if the Youngblood Note and the Carr Note are still outstanding as of the Closing Date, the holders of the Youngblood Note and the Carr Note, constituting long term debt of the Company, will be paid in full their respective principal balances due, in an aggregate amount equal to \$98,391.00.
- (iii) Third, the holders of Company Common Stock will be entitled to receive (i) \$6,655,529 (or \$6,753,920 if the Youngblood Note and the Carr Note are not still outstanding as of immediately prior to the Closing Date), to be distributed according to Schedule 2.9 attached hereto and (ii) 739,712 shares of Parent Common Stock , to be distributed according to Schedule 2.9 attached hereto.
- (iv) Fourth, the holder of the Company Warrant will be entitled to receive (i) 440,288 shares of Parent Common Stock and (ii) \$1,446,080.

2.10. **Closing.** Subject to the satisfaction or waiver of the conditions set forth in Article IX, the closing (the “Closing”) of the Merger hereunder shall take place at the offices of Hughes & Luce LLP in Austin, Texas, or at such other date, time or place as Parent,

Acquisition Corp. and the Company may agree (the date and time at which the Closing is actually held being the “Closing Date”). In addition to those obligations set forth in Article IX, at the Closing:

(a) Parent shall deliver the Merger Consideration in accordance with Section 2.6; and

(b) Each of the stockholders of the Company and the holder of the Company Warrant will deliver to Parent certificates representing the stockholder’s Company Securities or the Company Warrant, as applicable, duly endorsed, together with any other documents that are necessary to transfer to Parent good title to all of the Company Securities, free and clear of any and all Liens.

2.11. **No Further Transfers; Lost, Stolen or Destroyed Certificates.** The Merger Consideration paid pursuant to the Merger upon the surrender for exchange of shares of Company Securities in accordance with the terms hereof shall be deemed to have been paid in full satisfaction of all rights pertaining to such shares of Company Securities, and upon and after the Effective Time, no transfer of the shares of Company Securities outstanding prior to the Effective Time shall be made on the stock transfer books of the Surviving Corporation. If, after the Effective Time, certificates are presented to the Surviving Corporation for any reason, they shall be cancelled and exchanged as provided in this Article II.

2.12. **Effect of the Merger; Parent Name Change.** Upon and after the Effective Time: (a) the shares of the Company shall be converted as provided in this Agreement; (b) the former holders of such shares will be entitled only to the rights provided in this Agreement, the Additional Agreements and to the rights provided under Delaware General Corporation Law; and (c) the Merger shall otherwise have the effect provided under the applicable laws of the state of Delaware. Subsequent to the Effective Time, the Parent shall change its name from “Argyle Security Acquisition Corp.” to “Argyle Security, Inc.”, or such other name as is legally available.

ARTICLE III REPRESENTATIONS AND WARRANTIES OF THE COMPANY

The Company hereby represents and warrants to Parent and Acquisition Corp. that the statements contained in this Article III are true and correct, except as set forth in the disclosure schedule attached hereto (the “Company Disclosure Schedule”). The Company Disclosure Schedule shall be arranged in paragraphs corresponding to the numbered and lettered paragraphs contained in this Article III, and the disclosure in any paragraph shall qualify the corresponding paragraph in this Article III; *provided, however*, that any item disclosed under any paragraph of the Company Disclosure Schedule shall be deemed to be disclosed with respect to every other applicable paragraph if the disclosure in respect to such paragraph of the Company Disclosure Schedule is sufficient to reasonably inform the reader of the Company Disclosure

Schedule of the information required to be disclosed in respect of other paragraphs of the Company Disclosure Schedule. Any reference in this Article III to an agreement being “enforceable” shall be deemed to be qualified to the extent such enforceability is subject to (i) laws of general application relating to bankruptcy, insolvency, moratorium and the relief of debtors, and (ii) the availability of specific performance, injunctive relief and other equitable remedies. The Company Disclosure Schedule refers to sources of data, documentation and information that are too voluminous to attach to this Agreement, and all such data, documentation and information so referenced are irrevocably deemed to be incorporated by reference herein for all purposes as if set forth verbatim herein.

3.1. **Corporate Existence and Power.** The Company (and not its Subsidiaries) is a corporation duly formed, validly existing and in good standing under and by virtue of the Laws of the State of Delaware. The Company has all power and authority, corporate and otherwise, and all governmental licenses, franchises, permits, authorizations, consents and approvals required to own and operate its properties and assets and to carry on its business as now conducted and as proposed to be conducted, except where failure would not have a Material Adverse Effect. Each Subsidiary is duly formed, validly existing and in good standing under and by virtue of the laws of the State of its organization. Each such Subsidiary has all power and authority, corporate and otherwise, and all governmental licenses, franchises, permits, authorizations, consents and approvals required to own and operate its properties and assets and to carry on its business as now conducted and as proposed to be conducted, except where failure would not have a Material Adverse Effect. Schedule 3.1(a) sets forth each jurisdiction where the Company and each of its Subsidiaries is qualified to do business as a foreign corporation. The only offices, warehouses or business locations of the Company and each Subsidiary are listed on Schedule 3.1(b) (the “Offices”) Neither the Company nor any Subsidiary has taken any action, adopted any plan, or made any agreement in respect of any merger, consolidation, sale of all or substantially all of its respective assets, reorganization, recapitalization, dissolution or liquidation, except as explicitly set forth in this Agreement.

3.2. **Corporate Authorization.** The execution, delivery and performance by the Company of this Agreement and each of the other Additional Agreements to which the Company is named as a party and the consummation by the Company of the transactions contemplated hereby and thereby are within the corporate powers of the Company and have been duly authorized by all necessary action on the part of the Company. This Agreement constitutes, and, upon their execution and delivery, each of the Additional Agreements to which the Company is named as a party will constitute, a valid and legally binding agreement of the Company, enforceable against the Company in accordance with their respective terms, subject to (i) laws of general application relating to bankruptcy, insolvency and the relief of debtors, or (ii) rules of law governing specific performance, injunctive relief or other equitable remedies.

3.3. **Charter Documents; Legality.** The Company has previously delivered to Parent true and complete copies of its Certificate of Incorporation and By-Laws, minute books and stock books (the “Charter Documents”), as in effect or constituted on the date hereof. The execution, delivery, and performance by the Company of this Agreement and any Additional Agreement to which the Company is to be a party has not violated and will not

violate, and the consummation by the Company of the transactions contemplated hereby or thereby will not violate, any of the Charter Documents or any law.

3.4. **Subsidiaries.** Schedule 3.4 sets forth each of the Company's Subsidiaries. The Company has previously delivered to Parent true and complete copies of the Charter Documents for each Subsidiary, as in effect or constituted on the date hereof. The Company is not a party to any agreement relating to the formation of any joint venture, association or other Person.

3.5. **Capitalization and Ownership.** Schedule 3.5 sets forth, with respect to the Company and each Subsidiary, (i) such company's authorized capital, (ii) the number of such company's securities that are outstanding, (iii) each stockholder owning such company's securities and the number of shares of such securities owned by such security holder and (iv) each security convertible into or exercisable or exchangeable for such company's securities, the number and type of securities such security is convertible into, the exercise or conversion price of such security and the holder of such security. Except as set forth on Schedule 3.5, no Person other than the stockholders or the Company owns any securities of the Company or the Subsidiaries. Except as set forth on Schedule 3.5, there is no Contract that requires or under any circumstance would require the Company or any Subsidiary to issue, or grant any right to acquire, any securities of the Company or any Subsidiary, or any security or instrument exercisable or exchangeable for or convertible into, the capital stock or membership interest of the Company or any Subsidiary or to merge, consolidate, dissolve, liquidate, restructure or recapitalize the Company or any Subsidiary. The Company Securities and the securities of each Subsidiary (i) have been duly authorized and validly issued and are fully paid and nonassessable, and the shares of Company Preferred Stock issued to Blair in exchange for \$10,000,000 of the Note will, upon such exchange, be validly issued, fully paid and nonassessable, and (ii) were issued in compliance with all applicable federal and state securities laws.

3.6. **Affiliates.** Other than the stockholders listed on Schedule 3.5, the Company is not controlled by any Person and the Company is not in control of any other Person other than the Subsidiaries. Schedule 3.6 lists each Contract, arrangement, or understanding to which the Company, on the one hand, and any of its stockholders or any Affiliate of any of its stockholders, on the other hand, are parties. Except as disclosed in Schedule 3.6, none of the Company's stockholders or any Affiliate of any of the Company's stockholders (i) own, directly or indirectly, in whole or in part, any tangible or intangible property (including Intellectual Property rights) that the Company or any Subsidiary uses or the use of which is necessary for the conduct of the Business, or (ii) have engaged in any transaction with the Company or any Subsidiary.

3.7. **Assumed Names.** Schedule 3.7 is a complete and correct list of all assumed or "doing business as" names currently or formerly used by the Company or any Subsidiary, including names on any Websites, except for immaterial names no longer used. Neither the Company nor any Subsidiary has used any name other than the names listed on Schedule 3.7 to conduct its business, except for immaterial names no longer used. The Company and each Subsidiary have filed appropriate "doing business as" certificates in all

applicable jurisdictions. Except as indicated on Schedule 3.7, all Websites are in good working order.

3.8. **Governmental Authorization**. None of the execution, delivery or performance by the Company of this Agreement or any Additional Agreement requires any consent, approval, license or other action by or in respect of, or registration, declaration or filing with, any Authority.

3.9. **Consents**. The Contracts listed on Schedule 3.9 are the only material agreements, commitments, arrangements, contracts or other instruments binding upon the Company, any Subsidiary or any of their respective properties requiring a consent, approval, authorization, order or other action of or filing with any Person as a result of the execution, delivery or performance of this Agreement or any of the Additional Agreements to which the Company is named as a party or the consummation of the transactions contemplated hereby or thereby (each of the foregoing, a “Company Consent”).

3.10. **Financial Statements**.

(a) Attached hereto as Schedule 3.10(a) are audited consolidated balance sheets of the Company as of December 31, 2004 and December 31, 2005, and the related consolidated statements of operations, stockholders’ deficit and cash flows for each of the years in the three-year period ended December 31, 2005, and an unaudited balance sheet of the Company as of September 30, 2006 and the related statements of operations, stockholders’ deficit and cash flows for the period ending September 30, 2006 (collectively, the “Financial Statements”). The balance sheet contained in the Financial Statements as of December 31, 2005 is referred to herein as the “December Balance Sheet”. The balance sheet contained in the Financial Statements as of September 30, 2006 is referred to herein as the “September Balance Sheet”. The Financial Statements (i) were prepared from the Books and Records; (ii) except a lack of footnotes with regard to September 30, 2006 financials and except as set forth on Schedule 3.10(a), were prepared in accordance with GAAP; (iii) fairly and accurately present the Company’s financial condition and the results of its operations as of their respective dates and for the periods then ended; (iv) contain and reflect all necessary adjustments and accruals for a fair presentation of the Company’s financial condition as of their dates; and (v) contain and reflect adequate provisions for all reasonably anticipated liabilities for all material income, property, sales, payroll or other Taxes applicable to the Company with respect to the periods then ended. The Company has heretofore delivered to Parent complete and accurate copies of all “management letters” received by it from the Company’s accountants and all responses during the last three years by lawyers engaged by the Company to inquiries from the Company’s accountant or any predecessor accountants.

(b) Except as specifically disclosed, reflected or fully reserved against on the September Balance Sheet and for liabilities and obligations of a similar nature and in similar amounts incurred in the ordinary course of business since the date of the September Balance Sheet and except as set forth on Schedule 3.10(b), there are no liabilities, debts or obligations of any nature (whether accrued, absolute, contingent, liquidated or unliquidated, unasserted or otherwise) relating to the Company. All debts and liabilities, fixed or

contingent, which should be included under GAAP on an accrual basis on the September Balance Sheets are included therein.

(c) The December Balance Sheet and September Balance Sheet accurately reflect the outstanding Indebtedness of the Company as of the dates thereof. Except for liabilities and obligations of a similar nature and in similar amounts incurred in the ordinary course of business since the date of the September Balance Sheet as set forth on the September Balance Sheet and Schedule 3.10(b), the Company does not have any Indebtedness.

(d) All forecasts, presentations or projections relating to the future results of operations of the Company were based upon reasonable assumptions and were prepared in good faith by the Company.

(e) *(This Section intentionally left blank)*

(f) All Books and Records of the Company have been properly and accurately kept and completed in all material respects, and there are no material inaccuracies or discrepancies of any kind contained or reflected therein. The Company has none of its records, systems controls, data or information recorded, stored, maintained, operated or otherwise wholly or partly dependent on or held by any means (including any mechanical, electronic or photographic process, whether computerized or not) which (including all means of access thereto and therefrom) is not under the exclusive ownership (excluding licensed software programs) and direct control of the Company and which is not located at the Offices or at locations set forth on Schedule 3.10(f).

3.11. **Accounts Receivable.** Schedule 3.11(a) sets forth as of a date within three days of the date hereof all accounts, notes and other receivables, whether or not accrued, and whether or not billed, of the Company, in accordance with GAAP ("Accounts Receivable"). Except as set forth in Schedule 3.11(b), all Accounts Receivable represent bona fide revenues of the Company pursuant to the Business and are fully collectible, net of any reserves shown on the September Balance Sheet. Except as set forth on Schedule 3.11(b), all accounts and notes receivable reflected on the December Balance Sheet, or arising since December 31, 2005, have been collected, or are and to the knowledge of the Company will be good and collectible, in each case at the aggregate recorded amounts thereof without right of recourse, defense, deduction, return of goods, counterclaim, offset, or set off on the part of the obligor.

3.12. **Books and Records.**

(a) The Books and Records accurately and fairly, in reasonable detail, reflect the Company's transactions and dispositions of assets. The Company maintains a system of internal accounting controls sufficient to provide reasonable assurance that:

(i) transactions are executed in accordance with management's authorization;

(ii) access to assets is permitted only in accordance with management's authorization; and

(iii) recorded assets are compared with existing assets at reasonable intervals, and appropriate action is taken with respect to any differences.

(b) The Company has heretofore made all of its Books and Records available to Parent for its inspection and has heretofore delivered to Parent complete and accurate copies of documents referred to in the Schedules as Parent has requested. All Contracts, documents, and other papers or copies thereof delivered to Parent by or on behalf of the Company in connection with this Agreement and the transactions contemplated herein are accurate, complete, and authentic.

(c) Schedule 3.12(c) is a complete and correct list of all savings, checking, brokerage or other accounts pursuant to which the Company has cash or securities on deposit and such list indicates the signatories on each account.

3.13. **Absence of Certain Changes.**

(a) Except as set forth in Schedule 3.13(a), since December 31, 2005, the Company and each Subsidiary has conducted its respective business in the ordinary course of business consistent with past practices, and with respect to the conduct of business by Company and each Subsidiary outside the ordinary course of business, there has not been:

(i) any Material Adverse Change or any event, occurrence, development or state of circumstances or facts which could reasonably be expected to result individually or in the aggregate in a Material Adverse Effect on the Company's ability to consummate the transactions contemplated herein or upon the value to Parent or Acquisition Corp. of the transactions contemplated hereby;

(ii) any transaction, contract, agreement or other instrument entered into, or commitment made, by the Company or any Subsidiary relating to the Business or any relinquishment by the Company or any Subsidiary of any Contract or other right, in either case other than transactions and commitments in the ordinary course of business consistent in all respects, including kind and amount, with past practices and those contemplated by this Agreement;

(iii) any increase of bonus, salary or other compensation paid of more than 20% for any employee making an annual salary of greater than \$80,000 or in excess of \$16,000 in the aggregate on an annual basis for any single employee, or change in the bonus or profit sharing policies of the Company;

(iv) any capital expenditure except in the ordinary course of business consistent with past practice;

- (v) any sale, lease, license or other disposition of any of its assets except (a) pursuant to existing Contracts or commitments disclosed herein and (b) sales of products or inventory in the ordinary course of business consistent with past practice;
- (vi) acceptance of any returns except in the ordinary course of business, consistent with past practice;
- (vii) any material default under any term or provision of any Contract;
- (viii) a material increase in the amount of Indebtedness;
- (ix) the incurrence of Liens on any of its assets, other than in the ordinary course of business, consistent with past practice;
- (x) any material damage, destruction or loss of property related to any of its assets not covered by insurance;
- (xi) any delay, acceleration or cancellation of any receivables or indebtedness owed to it or write-off or additional reserves made with respect to the same, other than in the ordinary course of business, consistent with past practice;
- (xii) any merger or consolidation with or acquisition of any other Person;
- (xiii) the lapse of any insurance policy protecting its assets;
- (xiv) any change in its accounting principles or methods or write down of the value of any inventory or assets;
- (xv) any change in location where it conducts business;
- (xvi) any extension of any loans other than travel or other expense advances to employees in the ordinary course of business consistent with past practice exceeding \$5,000 individually or \$50,000 in the aggregate;
- (xvii) any increase or reduction in the prices of products sold except in the ordinary course of business consistent with past practice;
- (xviii) any agreement to change any practices or terms, including payment terms, with respect to customers or suppliers;
- (xix) any change in hiring practices for employees, consultants or advisors;

(xx) any dividend or distribution to the Company's stockholders; or

(xxi) any agreement to do any of the foregoing.

(b) Except as set forth on Schedule 3.13(a) and actions taken in good faith to invest in the Company's business, since December 31, 2005, through and including the Closing Date, neither the Company nor any Subsidiary has taken any action nor has any of them had any event occur which would have violated any covenants of the Company set forth in Article VI hereof.

3.14. Real Property.

(a) Neither the Company nor any Subsidiary owns any Real Property. The Company has delivered to Parent true, correct, and complete copies of the leases and all amendments thereto for the properties listed on Schedule 3.14(a) (the "Leases"). The Leases, together with all amendments, are listed in Schedule 3.14(a) and are valid and enforceable by the Company or the Subsidiary which is a party to such lease against the other parties thereto. Neither the Company nor any Subsidiary has breached or violated and is not in default under any of the Leases or any local zoning ordinance, the breach or violation of which could individually or in the aggregate have a Material Adverse Effect, and no notice from any Person has been received by the Company or any Subsidiary or served upon the Company, any Subsidiary claiming any violation of any Lease or any local zoning ordinance. Neither the Company nor any Subsidiary has other leases for Real Property except as set forth on Schedule 3.14(a).

(b) Neither the Company nor any Subsidiary has experienced any material interruption in the delivery of adequate quantities of any utilities (including electricity, natural gas, potable water, water for cooling or similar purposes and fuel oil) or other public services (including sanitary and industrial sewer service) required by the Company or any Subsidiary in the operation of the Business.

3.15. Tangible Personal Property.

(a) Each piece of Tangible Assets is in operating condition and repair and functions in accordance with its intended use (ordinary wear and tear excepted), has been properly maintained, and is suitable for its present uses. Schedule 3.15(a) sets forth a complete and correct list of the Tangible Assets owned by the Company or any Subsidiary, setting forth a description of such property and its location, as of a date within three days of the Closing Date.

(b) The Company or one of the Subsidiaries has, and upon consummation of the transactions contemplated hereby will continue to have, good, valid and marketable title in and to each piece of Tangible Assets listed on Schedule 3.15(a) hereto, free and clear of all Liens, except as set forth on Schedule 3.15(b).

(c) The Company or one of the Subsidiaries has good title to, or a valid leasehold or license interest in, all its respective properties and assets (whether tangible or intangible), free and clear of all Liens. The personal and other properties and assets owned by the Company or any Subsidiary or leased or licensed by the Company or any Subsidiary from a third party constitute all such properties and assets which are necessary to the Business as presently conducted and as presently proposed to be conducted.

(d) The materials and supplies included in the inventory of the Company or any Subsidiary as of the Closing Date will be (i) substantially equivalent in quality and quantity, subject to seasonality, to the materials and supplies, and additions thereto, generally included in such inventory in the past; and (ii) valued in accordance with GAAP and applied on a basis consistent with that used in the Financial Statements.

(e) Except as indicated on Schedule 3.15(a), all Tangible Assets except for vehicles that are being used in the Business are located at the Offices.

3.16. Intellectual Property.

(a) Schedule 3.16(a) sets forth a true and complete list of all Intellectual Property owned by the Company or any Subsidiary and used or held for use by or otherwise material to the Business (the “Owned Intellectual Property”).

(b) Schedule 3.16(b) sets forth a true and complete list of all material computer software developed in whole or in part by or on behalf of the Company or any Subsidiary, including such developed computer software and databases that are operated or used by the Company or any Subsidiary on its Websites and used or held for use by or otherwise material to the business (collectively, “Software”). Except for the software (including prepackaged third party software) listed on Schedule 3.16(c), the Software is the only computer software that is used or held for use by or otherwise material to the Business.

(c) Schedule 3.16(c) sets forth a true and complete list of all licenses, sublicenses and other agreements pertaining to Intellectual Property or Software to which the Company is a party in each case which are valid and used or held for use by or otherwise material to the Business (collectively, “Licensed Intellectual Property”).

(d) Neither the Company’s nor any Subsidiary’s ownership and use in the ordinary course of the Owned Intellectual Property and the use of the Software and Licensed Intellectual Property does not infringe upon or misappropriate the valid Intellectual Property rights, privacy rights or other right of any third party.

(e) Except as set forth in Schedule 3.16(f), the Company or a Subsidiary is the owner of the entire and unencumbered right, title and interest in and to each item of Owned Intellectual Property, and the Company or a Subsidiary is entitled to use, and is using in the Business, the Owned Intellectual Property, Software and Licensed Intellectual Property in the ordinary course.

(f) Except for the Intellectual Property listed on Schedule 3.16(f) the Owned Intellectual Property, Software and the Licensed Intellectual Property include all of the Intellectual Property used in the ordinary day-to-day conduct of the Business, and there are no other items of Intellectual Property, Software or Licensed Intellectual Property that are material to such ordinary day-to-day conduct of the Business. The Company's rights in the Owned Intellectual Property and, to the knowledge of the Company or any Subsidiary, the Company's rights in the Licensed Intellectual Property, are subsisting, valid and enforceable, and have not been adjudged invalid or unenforceable in whole or part.

(g) To the knowledge of the Company, no Person is engaged in any activity that infringes upon the Owned Intellectual Property, the Licensed Intellectual Property or the Software. Neither the Company nor any Subsidiary has granted any license or other right currently outstanding to any third party with respect to the Owned Intellectual Property, Licensed Intellectual Property or Software, except for (i) licenses issued in the ordinary course, and (ii) those licenses set forth in Schedule 3.16(g). The consummation of the transactions contemplated by this Agreement will not result in the termination or impairment of any of the Owned Intellectual Property, Licensed Intellectual Property or Software.

(h) Neither the Company nor or any Subsidiary has exported the Software outside the U.S. or Canada. No rights in the Software have been transferred by the Company to any third party except to the customers of the Company to whom the Company has licensed such Software in the ordinary course.

(i) The Company or a Subsidiary has the right to use all software development tools, library functions, compilers and other third party software that is material to the Business or that is required to operate or, where modification is essential to the use of the Software, to modify the Software.

(j) The Company and each Subsidiary has taken reasonable steps to maintain the confidentiality of its trade secrets and other confidential Intellectual Property and to the Company's knowledge, (i) there has been no misappropriation of any material trade secrets or other material confidential Intellectual Property of the Company or any Subsidiary by any Person; (ii) no employee, independent contractor or agent of the Company or any Subsidiary has misappropriated any trade secrets of any other Person in the course of his performance as an employee, independent contractor or agent; and (iii) no employee, independent contractor or agent of the Company or any Subsidiary is in default or breach of any term of any employment agreement, non-disclosure agreement, non-compete obligation, assignment of invention agreement or similar agreement or contract relating in any way to the protection, ownership, development, use or transfer of Intellectual Property, other than those which individually or in the aggregate would not have a Material Adverse Effect.

3.17. Relationships With Customers, Suppliers, Etc.

(a) Schedule 3.17(a) identifies during the nine months ended September 30, 2006 and the fiscal year ended December 31, 2005, respectively (i) the 10 largest

customers of the Company and each Subsidiary in the aggregate and the amount of revenues accounted for by such customer during each such period and (ii) the 5 largest suppliers (other than attorneys, accountants and office leases) of the Company and each Subsidiary in the aggregate and the amount of expense accounted for by such supplier during each such period.

(b) Schedule 3.17(b) sets forth (i) all prepayments, pre-billed invoices and deposits that have been received by the Company or any Subsidiary as of the date hereof from customers for products to be shipped, or services to be performed, after the Closing Date, and (ii) with respect to each such prepayment, pre-billed invoice or deposit, (A) the party and contract credited, (B) the date received or invoiced, (C) the products and/or services to be delivered, and (D) the conditions for the return of such prepayment, pre-billed invoice or deposit. All such prepayments, pre-billed invoices and deposits are properly accrued for on the Financial Statements, in accordance with GAAP applied on a consistent basis with the past practice of the Company.

(c) Schedule 3.17(c) sets forth all purchases (other than attorneys, accountants and office leases) since December 31, 2005, with a cost of in excess of \$50,000 for any single item or series of related items.

(d) Except as set forth on Schedule 3.17(d), since December 31, 2005: (i) there has not been any termination of the business relationship of the Company or any Subsidiary with any material licensee, customer or supplier, other than in the ordinary course of business where a contract has been concluded with a customer with no subsequent follow-on business or with a supplier due to the supplier's products being either (A) no longer available or (B) no longer applicable to the Company's ongoing business; (ii) to the knowledge of the Company, there has not been any threatened termination or withholding of payments by, or any material dispute with, any material licensee, customer or supplier; and (iii) neither the Company nor any Subsidiary has received any notice or been informed that any such event described in (a) or (b) above will occur in the future, either as a result of the consummation of the transactions contemplated by this Agreement or otherwise. Except as set forth on Schedule 3.17(d), neither the Company nor any Subsidiary is currently in any dispute over any terms of any contract or agreement to which the Company or any Subsidiary and any material licensee, customer or supplier is a party.

3.18. **Litigation.** Except as set forth in Schedule 3.18, there is no Action pending against, or to the knowledge of the Company, threatened against or affecting the Company or any Subsidiary, any of their respective officers or directors, any stockholder of the Company, where such Action relates directly or indirectly to the business of the Company or such stockholder's ownership interest in the Company, the business of the Company or any Subsidiary, or any Contract before any court or arbitrator or any governmental body, agency or official or which in any manner challenges or seeks to prevent, enjoin, alter or delay the transactions contemplated hereby. There are no outstanding judgments against the Company or any Subsidiary. Neither the Company nor any Subsidiary is now, nor have they been in the past five years, subject to any proceeding with the Federal Trade Commission or the Equal Employment Opportunity Commission or any comparable body of any state or political subdivision.

3.19. **Contracts.**

(a) Except as disclosed on Schedule 3.19(a), each contract to which the Company or any Subsidiary is a party (“Contract”) is a valid and binding agreement, and is in full force and effect, except where a failure would not have a Material Adverse Effect and neither the Company nor any Subsidiary, as applicable, nor, to the knowledge of the Company, any other party thereto, is in breach or default (whether with or without the passage of time or the giving of notice or both) under any material terms of any such Contract. Except as disclosed on Schedule 3.19(a), neither the Company nor any Subsidiary has assigned, delegated, or otherwise transferred any of its rights or obligations with respect to any material Contracts, or granted any power of attorney with respect thereto. The Company and each Subsidiary has made available to Parent an original or a true and correct fully executed copy of each material Contract.

(b) Schedule 3.19(b) lists each material Contract (other than the Charter Documents) of the Company and each Subsidiary, including:

(i) any Contract pursuant to which the Company or any Subsidiary is required to pay, has paid or is entitled to receive or has received an amount in excess of \$100,000 during the current fiscal year or any one of the two preceding fiscal years (other than purchase orders for Inventory entered into in the ordinary course of business (excluding however any such purchase orders which are open for purchases in excess of \$100,000. The Parties hereto have agreed that delivery of Company’s “Work in Process Report”, in the format previously disclosed to Parent shall constitute full compliance with this Section 3.19(b)(i).

(ii) all forms of standard employment contracts and sales representatives contracts, as well as any such contracts that deviate materially from the standard form, together with a list of employees and sales representatives that are parties to such contracts;

(iii) all material sales, agency, factoring, commission and distribution contracts;

(iv) all joint venture, strategic alliance, limited liability company and partnership agreements;

(v) all documents relating to any significant acquisitions or dispositions of assets (other than of dispositions of Inventory in the ordinary course of business);

(vi) all material licensing agreements, including agreements licensing Intellectual Property rights, other than “shrink wrap” licenses;

(vii) all material secrecy, confidentiality and nondisclosure agreements restricting the conduct of the Company or any Subsidiary;

(viii) all material Contracts relating to patents, trademarks, service marks, trade names, brands, copyrights, trade secrets and other Intellectual Property rights;

(ix) all material guarantees, terms and conditions, privacy policies, indemnification arrangements and other hold harmless arrangements made or provided by the Company or any Subsidiary;

(x) all material Website hosting contracts or agreements;

(xi) all Contracts or agreements with or pertaining to the Company or ny Subsidiary to which any of its stockholders or any Affiliate of any of its stockholders is a party;

(xii) all agreements relating to real property, including any real property lease, sublease, or space sharing, license or occupancy agreement, whether the Company is granted or granting rights thereunder to occupy or use any premises;

(xiii) all material agreements relating to Tangible Assets; and

(xiv) all material agreements relating to outstanding Indebtedness.

(c) Except as disclosed on Schedule 3.19(c), the Company is in compliance with all material covenants, including all financial covenants, in all notes, indentures, bonds and other instruments or agreements evidencing any Indebtedness.

3.20. **Licenses and Permits.** Schedule 3.20 is a complete and correct list of each material license, franchise, permit, order or approval or other similar authorization affecting, or relating in any way to, the Business, together with the name of the government agency or entity issuing the same (the “Permits”). Such Permits are valid and in full force and effect and, assuming the related Company Consents, if any, have been obtained prior to the Closing Date, none of the Permits will, assuming the related Company Consents have been obtained or waived prior to the Closing Date, be terminated or impaired or become terminable as a result of the transactions contemplated hereby. The Company or any Subsidiary has all Permits necessary to operate the Business other than those Permits whose absence individually or in the aggregate would not cause a Material Adverse Effect.

3.21. **Compliance with Laws.** Neither the Company nor any Subsidiary, to their knowledge, is in violation of, has not violated, is not under investigation with respect to, nor have they been threatened to be charged with or given notice of, any violation or alleged violation of, any Law or Order, nor does the Company or any Subsidiary have knowledge of any reasonable basis for any such charge.

3.22. **Pre-payments.** Except as set forth on Schedule 3.22, Neither the Company nor any Subsidiary has received any material payments with respect to any services to be rendered or goods to be provided after the Closing.

3.23. **Employees.** Schedule 3.23 sets forth a true and complete list of the names, titles, annual salaries or wage rates and other compensation, vacation and fringe benefits, medical costs incurred on employee claims for the last twelve months that the Company has been made aware of, work permits, visas, and office location of all employees of the Company and each Subsidiary, indicating for which entity the employee is employed, part-time and full-time employment and all changes in salaries and wage rates per employee since January 1, 2006. Except as disclosed on Schedule 3.23, neither the Company nor any Subsidiary has promised any employee, consultant or agent of the Company that he or she will be employed by or receive any particular benefits from the Parent or Acquisition Corp. on or after the Closing. Schedule 3.23 sets forth a true and complete list of the names, addresses and titles of the directors and officers of the Company and each Subsidiary.

3.24. **Compliance with Labor Laws and Agreements.** To the best of its knowledge, the Company has substantially complied with all applicable Laws and Orders relating to employment or labor other than those Laws and Orders with which it could fail to comply, either individually or in the aggregate, without causing a Material Adverse Effect. Except as set forth on Schedule 3.24, no present or former employee, officer or director of the Company or any Subsidiary has, or will have at the Closing Date, any claim against the Surviving Corporation for any matter including for wages, salary, vacation, severance, or sick pay except for the same incurred in the ordinary course of business for the last payroll period prior to the Closing Date. Except as set forth on Schedule 3.24, to the knowledge of the Company, there is no:

- (a) unfair labor practice complaint against the Company or any Subsidiary pending before the National Labor Relations Board or any state or local agency;
- (b) pending labor strike or other material labor trouble affecting the Company or any Subsidiary;
- (c) material labor grievance pending against the Company or any Subsidiary;
- (d) pending representation question respecting the employees of the Company or any Subsidiary; or
- (e) pending arbitration proceeding arising out of or under any collective bargaining agreement to which the Company or any Subsidiary is a party.

In addition, to the Company's knowledge: (i) none of the matters specified in clauses (a) through (e) above is threatened against the Company or any subsidiary; (ii) no union organizing activities have taken place with respect to the Company or any Subsidiary; and (iii)

no basis exists for which a claim may be made under any collective bargaining agreement to which the Company or any Subsidiary is a party.

3.25. Pension and Benefit Plans. Except as set forth on Schedule 3.25, neither the Company nor any Subsidiary is individually or jointly and severally liable, and, to the knowledge of the Company, neither the Company's nor Subsidiary's officers and employees are liable for any liability arising under ERISA, the Code or any other law or regulation, relating to: (1) an employee benefit plan, within the meaning of Section 3(3) of ERISA (a "Plan"), covering or formerly covering any present or former employee of the Company or any Subsidiary (a "Company Plan"); (2) a Plan not described in clause (1) covering or formerly covering any present or former employee of a Person which, together with the Company or any Subsidiary, are treated as a single employer under Code Section 414 (such Person hereinafter being referred to as an "ERISA Affiliate" and such Plan hereinafter being referred to as an "ERISA Affiliate Plan"); or (3) an employee benefit plan or arrangement, other than an ERISA Plan, maintained by the Company or any Subsidiary providing benefits to some or all their employees or directors, including, but not limited to, stock option, stock appreciation, equity incentive and deferred compensation plans and arrangements (a "Benefits Arrangement"), which (in all cases) is not fully and accurately reflected in the Company's most recent Financial Statements or on Schedule 3.25. No Company Plan or ERISA Affiliate Plan has incurred any "accumulated funding deficiency" as that term is defined in Section 412 of the Code (whether or not waived) and, with respect to each Company Plan and ERISA Affiliate Plan, the accumulated benefit obligation of the Plan does not exceed the fair market value of the assets of such Plan based upon actuarial assumptions which are reasonable in the aggregate. The Company Plans and Benefits Arrangements have been maintained and administered in all respects in compliance with all applicable laws, rules and regulations and the applicable plan documents except where any individual failure to comply would not have a Material Adverse Effect. The Company Plans which are intended to be qualified under Code Section 401(a) have received a determination, opinion, or notification letter from the IRS that the Plan satisfies the requirements of the Code, has not been amended since receiving such letter (other than by the adoption of amendments required by the IRS) and nothing has occurred with respect thereto which could reasonably be expected to result in the loss of such qualification. Except as set forth on Schedule 3.25 hereto, (i) neither the Company nor any Subsidiary has received written or oral notice of any Claims pending (other than routine benefit claims) or, to the knowledge of the Company, threatened, relating to the Company Plans or Benefits Arrangement; (ii) neither the Company nor any Subsidiary has received written or oral notice from any Governmental Entity, including the IRS, the Department of Labor and the Pension Benefit Guaranty Corporation ("PBGC"), that such Governmental Entity has initiated an examination, audit or investigation of a Company Plan or Benefits Arrangement which has not been completed; (iii) neither the Company nor any Subsidiary has received written or oral notice of, no event has occurred and, to the Company's knowledge, there does not now exist any condition or set of circumstances, that could subject the Company or any Subsidiary to any material liability arising under the Code, ERISA or any other applicable legal requirement or under any indemnity Agreement to which the Company or any Subsidiary is a party, excluding liability for routine benefit claims and funding obligations payable in the ordinary course; (iv) to the knowledge of the Company, the transactions contemplated by the Transaction Documents will not result in a reportable event, within the meaning of ERISA Section 4043, other than a

reportable event with respect to which the ERISA Section 4043 reportable event notice requirement has been waived or the PBGC has announced that it will not apply a penalty for failure to satisfy the reportable event notice requirement; (v) the transactions contemplated by the Additional Agreements to which the Company is named as a party will not result in a liability for severance or termination pay or result in increased or accelerated employee benefits becoming payable to any of the employees of the Company or any Subsidiary pursuant to the terms of any Contract; (vi) all contributions to Company Plans and Benefit Arrangements (including both employee and employer contributions) which are required to have been made, whether by virtue of the terms of the particular plan or arrangement or by operation of law, have been made by the due date thereof (including all applicable extensions) and all contributions which are not yet due but which relate to periods which began prior to the date hereof have either been paid or have been reflected by the Company as an accrued liability on the Books and Records or are set forth on Schedule 3.25 hereto; (vii) neither the Company nor any Subsidiary maintains any plan or arrangement which provides for retiree health or other retiree welfare benefits, except as required by COBRA; (viii) neither the Company nor any Subsidiary currently participates in or in the past participated in a multiemployer plan, within the meaning of Section 3(37) or 4001(a)(3) of ERISA (a "Multiemployer Plan"); and (ix) neither the Company nor any Subsidiary is under an obligation (express or implied) to modify the Company Plan or Benefit Arrangement. Schedule 3.25 contains a complete list of all Company Plans currently maintained by the Company or any Subsidiary or in which the Company or any Subsidiary currently participates ("Current Company Plans") and all Benefit Arrangements in which the Company or any Subsidiary participates. With respect to each Current Company Plan, the Company has delivered to the Parent a correct and complete copy of (1) the Plan document, (2) if applicable, the summary plan description, (3) if applicable, the most recent Annual Report (Form 5500 series) and accompanying Schedules, (4) if applicable, the most recent certified financial statements, and (5) if applicable, the most recent actuarial valuation report. With respect to each Benefit Arrangement, the Company has delivered to the Parent a correct and complete copy of each applicable plan document, arrangement and/or summary description.

3.26. **Employment Matters.** Schedule 3.26 sets forth a true and complete list of every employment agreement, commission agreement, employee group or executive medical, life, or disability insurance plan, and each incentive, bonus, profit sharing, retirement, deferred compensation, equity, phantom equity, option, equity purchase, equity appreciation right or severance plan of the Company or any Subsidiary now in effect or under which the Company or any Subsidiary has or might have any obligation, or any understanding between the Company or any Subsidiary and any employee concerning the terms of such employee's employment that do not apply to such company's employees generally.

3.27. **Tax Matters.**

(a) **Compliance Generally.** Except as set forth on Schedule 3.27(a), the Company has (i) duly and timely filed all Tax Returns required to be filed by the Company on or prior to the Effective Time, which Tax Returns are true, correct and complete, and (ii) duly and timely paid all Taxes due and payable in respect of all periods up to and including the date which includes the Effective Time or has made adequate provision on its books and

records and Financial Statements in accordance with GAAP for any such Tax which is not due on or before such time. The Company has compiled with all applicable law relating to the reporting, payment, collection and withholding of Taxes and has duly and timely withheld or collected, paid over and reported all Taxes required to be withheld or collected by the Company on or before the date hereof.

(b) **No Audit.** Except as set forth on Schedule 3.27(b), (i) no Taxing authority has asserted in writing any adjustment that could result in an additional Tax for which the Company is or may be liable or that could result in a Lien on any of its assets which has not been fully paid or adequately provided for on the in the Financial Statements (collectively, "Tax Liability"), or which adjustment, if asserted in another period, would result in any Tax Liability, (ii) there is not pending any audit, examination, investigation, dispute, proceeding or claim (collectively, "Proceeding") relating to any Tax Liability, (iii) no statute of limitations with respect to any Tax has been waived or extended (unless the period to which it has been waived or extended has expired), (iv) there is no outstanding power of attorney authorizing anyone to act on behalf of the Company in connection with any Tax Liability, Tax Return or Proceeding relating to any Tax, (v) there is not outstanding any closing agreement, ruling request, request to consent to change a method of accounting, subpoena or request for information with or by any Taxing authority with respect to the Company, its income, assets or business, or any Tax Liability, (vi) the Company is not and has never been a party to any Tax sharing or Tax allocation agreement, arrangement or understanding; and (vii) the Company is not and has never been included in any consolidated, combined or unitary Tax Return.

(c) **Taxes and Tax Return Defined.** For purposes of this Agreement, "Tax" shall mean all federal, state, local and foreign tax, charge, fee, levy, deficiency or other assessment of whatever kind or nature (including without limitation, any net income, gross income, gross receipts, sales, use, ad valorem, transfer, franchise, profits, license, withholding, payroll, employment, unemployment, excise, estimated, severance, stamp, occupation, real property, personal property, intangible property, occupancy, recording, minimum, environmental and windfall profits tax), together with any interest, penalty, addition to tax or additional amount imposed by any federal, state, local or foreign Taxing authority. For purposes of this Agreement, "Tax Return" includes any return, declaration, report, claim for refund or credit, information return or statement, and any amendment thereto, including without limitation any consolidated, combined or unitary return or other document (including any related or supporting information or schedule), filed or required to be filed with any federal, state, local or foreign governmental entity or agency in connection with the determination, assessment, collection or payment of Taxes.

3.28. **Fees.** Except as set forth on Schedule 3.28, there is no investment banker, broker, finder, restructuring or other intermediary that has been retained by or is authorized to act on behalf of the Company, any Subsidiary, any of the Company's stockholders or the holder of the Company Warrant or any of their respective Affiliates who might be entitled to any fee or commission from either Acquisition Corp., the Surviving Corporation, Parent or any of its Affiliates upon consummation of the transactions contemplated by this Agreement. The

amount of any fee owed to any Person and the party obligated to pay such fee is listed on Schedule 3.28 opposite such Person's name.

3.29. Business Operations; Servers.

(a) The Company and each Subsidiary owns all of its servers and other computer equipment (other than web servers) necessary to operate its Business as conducted as of the date hereof and as such Business will be conducted as of the Closing.

(b) Parent has been furnished with complete and correct copies of the standard terms and conditions of sale, if any, of each of the products of the Company and each Subsidiary. Except as set forth on Schedule 3.29(b) or as required by law, no product manufactured, sold or delivered by the Company or any Subsidiary is subject to any guaranty, warranty or other indemnity, express or implied, beyond such standard terms and conditions. Any warranty reserve reflected in the Financial Statements is in accordance with GAAP.

(c) Except in the ordinary course of business or as set forth on Schedule 3.29(c), neither the Company nor any Subsidiary has entered into, or offered to enter into, any written agreement, Contract or other arrangement with respect to the Business pursuant to which the Company or any Subsidiary is or will be obligated to make any rebates, discounts, promotional allowances or similar payments or arrangements to any customer ("Rebate Obligations"). All Rebate Obligations listed on Schedule 3.29(c) and all ordinary course Rebate Obligations are reflected in the 2005 Financial Statements in accordance with GAAP.

(d) Except as set forth in Schedule 3.29(d), neither the Company nor any Subsidiary has experienced any returns of its products since December 31, 2005 other than returns in the ordinary course of business. All product returns listed on Schedule 3.29(d) are reflected on the 2005 Financial Statements in accordance with GAAP.

3.30. Powers of Attorney and Suretyships. Except as set forth on Schedule 3.30, neither the Company nor any Subsidiary has any general or special powers of attorney outstanding (whether as grantor or grantee thereof) or any obligation or liability (whether actual, accrued, accruing, contingent, or otherwise) as guarantor, surety, co-signer, endorser, co-maker, indemnitor or otherwise in respect of the obligation of any Person, excluding ordinary course of business indemnity obligations.

3.31. Other Information. Neither this Agreement, nor any of the documents or other information made available to Parent or its Affiliates, attorneys, accountants, agents or representatives pursuant hereto or in connection with Parent's due diligence review of the Business or the transactions contemplated by this Agreement contains or will contain any untrue statement of a material fact or omits or will omit to state a material fact necessary in order to make the statements contained therein not misleading.

3.32. **Certain Business Practices.** To the Company’s knowledge, neither the Company, nor any Subsidiary, nor any director, officer, agent or employee of the Company or any Subsidiary (in their capacities as such) has (i) used any funds for unlawful contributions, gifts, entertainment or other unlawful expenses relating to political activity, (ii) made any unlawful payment to foreign or domestic government officials or employees, to foreign or domestic political parties or campaigns or violated any provision of the Foreign Corrupt Practices Act of 1977 to the extent applicable to the Company or any Subsidiary or (iii) made any other unlawful payment. Neither the Company, nor any Subsidiary, nor any director, officer, agent or employee of the Company or any Subsidiary (nor any Person acting on behalf of any of the foregoing, but solely in his or her capacity as a director, officer, employee or agent of the Company) has, since January 1, 2000, directly or indirectly, given or agreed to give any gift or similar benefit in any material amount to any customer, supplier, governmental employee or other Person who is or may be in a position to help or hinder the Company or any Subsidiary or assist the Company or any Subsidiary in connection with any actual or proposed transaction, which, if not given could reasonably be expected to have had an adverse effect on the Company or any Subsidiary, or which, if not continued in the future, could reasonably be expected to adversely affect the business or prospects of the Company or any Subsidiary or that could reasonably be expected to subject the Company to penalty in any private or governmental litigation or proceeding.

3.33. **Money Laundering Laws.** To the knowledge of Company, there is no material violation of the laundering statutes of the States in which the Company or the Subsidiaries do business, applicable to the Business, and the Laws of the United States applicable to the Business, the rules and regulations thereunder and any related or similar rules, regulations or guidelines, issued, administered or enforced by any governmental authority (collectively, the “Money Laundering Laws”) that are applicable to the Business, and no criminal or material civil Action involving the Company or any Subsidiary with respect to the Money Laundering Laws is pending or, to the knowledge of the Company, threatened.

ARTICLE IV

REPRESENTATIONS AND WARRANTIES TO BE MADE BY THE COMPANY’S STOCKHOLDERS

The Company hereby agrees that, at the Closing, each of its stockholders and the holder of the Company Warrant shall, severally and not jointly, represent to Acquisition Corp. and the Parent that the following statements are true and correct. Any reference in this Article IV to an agreement being “enforceable” shall be deemed to be qualified to the extent such enforceability is subject to (i) laws of general application relating to bankruptcy, insolvency, moratorium and the relief of debtors, and (ii) the availability of specific performance, injunctive relief and other equitable remedies.

4.1. Ownership of Stock; Authority.

(a) The stockholder or holder of the Company Warrant has good and marketable title to the Stockholder's Securities or the Company Warrant, as applicable, free and clear of any and all Liens.

(b) The stockholder or the holder of the Company Warrant has full legal capacity, power and authority to execute and deliver the agreements to which such Person is a party, to perform such Person's obligations thereunder and to consummate the transactions contemplated thereby. The agreements to which each such Person is named as a party will be duly executed and delivered by each Person and, upon their execution and delivery will be, valid and legally binding obligations of each Person, enforceable against each Person in accordance with their respective terms.

(c) Neither the execution and delivery by the stockholder or the holder of the Company Warrant of any or all of the agreements to which such Person is a party, nor the consummation by such Person of the transaction contemplated thereby, will (i) conflict with, result in a breach of, constitute (with or without due notice or lapse of time or both) a default under, or require any notice, consent or waiver under, any instrument, contract, agreement or arrangement to which such Person is a party or by which such Person is bound, or (ii) result in the imposition of any Lien upon such Person's Company Securities.

4.2. **Approvals.** Except as contemplated by this Agreement, including without limitation Section 3.2, no consent, approval, waiver, authorization or novation will be required to be obtained by the stockholder or the holder of the Company Warrant, as applicable, from, and no notice or filing is required to be given by such Person to or made by any Person with, any Authority or other Person in connection with the execution, delivery and performance by such Person of the agreements executed at Closing.

4.3. **Non-Contravention.** The execution, delivery and performance by the stockholder or the holder of the Company Warrant, as applicable, of the agreements executed at Closing, and the consummation of the transaction will not (a) violate any provision of the articles of incorporation, bylaws or other organizational documents of such Person if it is not a natural person, or (b) violate or result in a breach of or constitute a default under any Law, judgment, injunction, Order, decree or other restriction of any Authority to which such Person, or such Person's Company Securities, is subject.

4.4. **Litigation and Claims.** There is no civil, criminal or administrative action, suit, demand, claim, hearing, proceeding or disclosed investigation pending or threatened against such stockholder or the holder of the Company Warrant and such Person is not subject to any Order, writ, judgment, award, injunction or decree of any Authority of competent jurisdiction or any arbitrator that would prevent consummation of the transaction or materially impair the ability of such Person to perform its obligations under the agreements executed at Closing.

4.5. **Investment Representations.** The stockholder and the holder of the Company Warrant, as applicable, will make the representations in either Section 4.5(a) or 4.5(b):

(a) Accredited Investor

(i) Such Person is an “accredited investor” as such term is defined in Rule 501 of Regulation D (“Reg. D”) promulgated under the Act. Such Person acknowledges that Parent has the right to require evidence of such Person’s status as an accredited investor, if necessary.

(ii) Such Person acknowledges that such Person has prior investment experience, including investments in non-listed and non-registered securities, or has employed the services of an investment advisory, attorney or accountant to evaluate the merits and risks of such an investment on its behalf, and such Person represents that such Person understands the highly speculative nature of an investment in Parent Common Stock which may result in the loss of the total amount of such investment.

(iii) Such Person has adequate means of providing for such Person’s current needs and possible personal contingencies, and each Person has no need, and anticipates no need in the foreseeable future, for liquidity in such Person’s investment in the Parent Common Stock. Such Person is able to bear the economic risks of this investment and, consequently, without limiting the generality of the foregoing, each Person is able to hold the Parent Common Stock for an indefinite period of time and has a sufficient net worth to sustain a loss of the entire investment in the event such loss should occur.

(iv) Such Person has not made an overall commitment to investments which are not readily marketable that are disproportionate to such Person’s net worth, and such Person’s investment in the Parent Common Stock will not cause such overall commitment to become excessive.

(v) Such Person acknowledges that this offering of Parent Common Stock has not been reviewed by the SEC because this is intended to be a non-public offering pursuant to Section 4(2) of the Act and Rule 506 under Regulation D of the Act. Each Person acknowledges that it is not acquiring the Parent Common Stock as a result of any general solicitation or advertising. The Parent Common Stock will be received by each Person for such Person’s own account, for investment and not for distribution or resale to others.

(vi) Except as otherwise set forth in Article V, Parent has not and is not making any representations or warranties to such Persons or providing any advice or information to such Persons.

(vii) Such Person understands and consents to the placement of a legend on any certificate or other document evidencing Parent Common Stock stating that such Parent Common Stock has not been registered under the Act and setting forth or referring to the restrictions on transferability and sale thereof. Each certificate evidencing the shares shall bear the legends set forth below, or legends

substantially equivalent thereto, together with any other legends that may be required by federal or state securities laws at the time of the issuance of the Parent Common Stock:

THE SHARES REPRESENTED HEREBY HAVE NOT BEEN REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE "ACT"), AND MAY NOT BE OFFERED, SOLD OR OTHERWISE TRANSFERRED, PLEDGED OR HYPOTHECATED UNLESS AND UNTIL (I) REGISTERED UNDER THE ACT OR (II) THE ISSUER OF THE SHARES (THE "ISSUER") HAS RECEIVED AN OPINION OF COUNSEL IN FORM AND SUBSTANCE SATISFACTORY TO THE ISSUER THAT SUCH OFFER, SALE OR TRANSFER, PLEDGE OR HYPOTHECATION IS IN COMPLIANCE WITH THE ACT.

(b) Non-accredited Investor

(i) Such Person acknowledges that such Person has prior investment experience, including investments in non-listed and non-registered securities, or has employed the services of an investment advisor, attorney or accountant to evaluate the merits and risks of such an investment on its behalf, and such Person represents that such Person understands the highly speculative nature of an investment in Parent Common Stock which may result in the loss of the total amount of such investment.

(ii) Such Person has adequate means of providing for such Person's current needs and possible personal contingencies, and each Person has no need, and anticipates no need in the foreseeable future, for liquidity in such Person's investment in the Parent Common Stock. Such Person is able to bear the economic risks of this investment and, consequently, without limiting the generality of the foregoing, each Person is able to hold the Parent Common Stock for an indefinite period of time and has a sufficient net worth to sustain a loss of the entire investment in the event such loss should occur.

(iii) Such Person has not made an overall commitment to investments which are not readily marketable that are disproportionate to such Person's net worth, and such Person's investment in the Parent Common Stock will not cause such overall commitment to become excessive.

(iv) Parent has made available to such Person a copy of its (i) Annual Report on Form 10-K for the year ended December 31, 2005, (ii) Quarterly Reports on Form 10-Q for the quarters ended March 31, 2006, June 30, 2006 and September 30, 2006, and (iii) the proxy statement distributed to the Parent's stockholders in connection with the Special Meeting of Stockholders to be held in connection with the approval of the transactions contemplated by this Agreement.

(v) Such Person had the opportunity to (a) ask questions and receive answers from the management of the Parent concerning the Parent and an investment in the Parent Common Stock, and (b) obtain additional information as necessary to verify the accuracy of the information furnished to such Person by the Parent.

(vi) Except as otherwise set forth in Article V, Parent has not and is not making any representations or warranties to such Persons or providing any advice or information to such Persons.

(vii) Such Person acknowledges that this offering of Parent Common Stock has not been reviewed by the SEC because this is intended to be a non-public offering pursuant to Section 4(2) of the Act and Rule 506 under Regulation D of the Act. Each Person acknowledges that it is not acquiring the Parent Common Stock as a result of any general solicitation or advertising. The Parent Common Stock will be received by each Person for such Person's own account, for investment and not for distribution or resale to others.

(viii) Such Person understands and consents to the placement of a legend on any certificate or other document evidencing Parent Common Stock stating that such Parent Common Stock has not been registered under the Act and setting forth or referring to the restrictions on transferability and sale thereof. Each certificate evidencing the shares shall bear the legends set forth below, or legends substantially equivalent thereto, together with any other legends that may be required by federal or state securities laws at the time of the issuance of the Parent Common Stock:

THE SHARES REPRESENTED HEREBY HAVE NOT BEEN REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE "ACT"), AND MAY NOT BE OFFERED, SOLD OR OTHERWISE TRANSFERRED, PLEDGED OR HYPOTHECATED UNLESS AND UNTIL (I) REGISTERED UNDER THE ACT OR (II) THE ISSUER OF THE SHARES (THE "ISSUER") HAS RECEIVED AN OPINION OF COUNSEL IN FORM AND SUBSTANCE SATISFACTORY TO THE ISSUER THAT SUCH OFFER, SALE OR TRANSFER, PLEDGE OR HYPOTHECATION IS IN COMPLIANCE WITH THE ACT.

4.6. **Assumption of Risk of Price Changes in Parent Common Stock.** Such Person acknowledges that from the date of the Merger Agreement such Person assumed the risk related to any diminution in the market price of the Stock Consideration.

A-66

ARTICLE V
REPRESENTATIONS AND WARRANTIES OF PARENT

Parent represents and warrants to the Company that the statements contained in this Article V are true and correct, except as set forth in the disclosure schedule attached hereto (the “Parent Disclosure Schedule”). The Parent Disclosure Schedule shall be arranged in paragraphs corresponding to the numbered and lettered paragraphs contained in this Article V, and the disclosure in any paragraph shall qualify the corresponding paragraph in this Article V; *provided, however,* that any item disclosed under any paragraph of the Parent Disclosure Schedule shall be deemed to be disclosed with respect to every other applicable paragraph if the disclosure in respect to such paragraph of the Parent Disclosure Schedule is sufficient to reasonably inform the reader of the Parent Disclosure Schedule of the information required to be disclosed in respect of other paragraphs of the Parent Disclosure Schedule. Any reference in this Article V to an agreement being “enforceable” shall be deemed to be qualified to the extent such enforceability is subject to (i) laws of general application relating to bankruptcy, insolvency, moratorium and the relief of debtors, and (ii) the availability of specific performance, injunctive relief and other equitable remedies.

5.1. **Due Incorporation.** Parent is a corporation duly organized, validly existing and in good standing under the Laws of the State of Delaware. Except as set forth on Schedule 5.1, the Parent is not qualified to do business as a foreign corporation in any jurisdiction, and there is no jurisdiction in which the character of the property owned or leased by the Parent or the nature of its activities make qualification of the Parent in any such jurisdiction necessary, except where the failure to so qualify would have a Material Adverse Effect. Acquisition Corp. is a corporation duly organized, validly existing and in good standing under the Laws of the State of Delaware. Parent has all requisite power and authority, corporate and otherwise, and all governmental licenses, franchises, permits, authorizations, consents and approvals required to own, lease, and operate its assets, properties and businesses and to carry on its business as now conducted on the date hereof. Acquisition Corp. has not conducted any business to date and has only engaged in certain activities relating to its organization. Parent has not adopted any plan, or made any agreement in respect of any merger, consolidation, sale of all or substantially all of its assets, reorganization, recapitalization, dissolution or liquidation.

5.2. **Corporate Authorization.** Except for a vote of the stockholders of the Parent to approve the transaction contemplated by this Agreement, and provided that fewer than 20% of Parent’s public stockholders exercise their conversion rights (as specified in the Parent’s Certificate of Incorporation), the execution, delivery and performance by Parent and Acquisition Corp. of this Agreement and each of the other Additional Agreements to which either is a party and the consummation by Parent and Acquisition Corp. of the transactions contemplated hereby and thereby are within the corporate powers of Parent and Acquisition Corp. and have been duly authorized by all necessary corporate action on the part of Parent and Acquisition Corp. This Agreement constitutes, and upon their execution and delivery, each of the Additional Agreements to which Parent or Acquisition Corp. is named as a party will constitute, the valid and legally binding agreement of Parent or Acquisition Corp., as applicable, enforceable against each in accordance with their respective terms.

5.3. **Governmental Authorization.** None of the execution, delivery or performance by Parent or Acquisition Corp. of this Agreement or any Additional Agreement requires any consent, approval, license or other action by or in respect of, or registration,

declaration or filing with, any Authority by Parent or Acquisition Corp., except for filing a Form D with the SEC and applicable state authorities and a registration statement upon exercise of the Company's stockholders of their registration rights pursuant to the terms of this Agreement.

5.4. **No Violation.** Provided that Parent presents the transactions contemplated by this Agreement to its stockholders for approval and such stockholders approve the transaction with fewer than 20% of the public stockholders exercising their conversion rights with respect to such transaction (as specified in the Parent's Certificate of Incorporation), neither the execution and delivery of this Agreement nor any Additional Agreement to be executed by Parent or Acquisition Corp. hereunder nor the consummation of the transactions contemplated herein and therein will (a) violate any provision of Parent's or Acquisition Corp.'s Certificate of Incorporation, By-laws or other charter documents; (b) violate any Laws or Orders to which either Parent or Acquisition Corp. or their property is subject, or (c) violate the provisions of any material agreement or other material instrument binding upon or benefiting Parent or Acquisition Corp.

5.5. **Consents.** Except for a vote of the stockholders of the Parent to approve the transaction contemplated by this Agreement, and provided that fewer than 20% of Parent's public stockholders exercise their conversion rights (as specified in the Parent's Certificate of Incorporation), there are no agreements, commitments, arrangements, contracts or other instruments binding upon Parent or Acquisition Corp. or any of their properties requiring a consent, approval, authorization, order or other action of or filing with any Person as a result of the execution, delivery and performance of this Agreement or any of the Additional Agreements to which Parent or Acquisition Corp. is named as a party or the consummation of the transactions contemplated hereby or thereby. Parent's and Acquisition Corp.'s Boards of Directors have approved this Agreement and Parent's Board has approved its submission to Parent's stockholders for approval. Each of the current officers and directors of the Parent has agreed to vote the shares of Parent Common Stock owned by them in the following manner:: with respect to the shares of Parent Common Stock acquired by them prior to the private placement described in the Parent's prospectus from its initial public offering, each of the current officers and directors of the Parent will vote such shares in accordance with the majority of the shares of common stock voted by the public stockholders; with respect to the shares of Parent Common Stock acquired by them in the private placement described in the Parent's prospectus from its initial public offering, each of the current officers and directors of the Parent will vote such shares in favor of the transactions contemplated by this Agreement.

5.6. **Litigation.** There is no action, suit, investigation, hearing or proceeding pending against, or to the best knowledge of Parent, threatened against or affecting, Parent, any of its officers or directors, or the business of Parent, before any court or arbitrator or any governmental body, agency or official which if adversely determined against Parent, has or could reasonably be expected to have a material adverse effect on the business, assets, condition (financial or otherwise), liabilities, results or operations or prospects of Parent, or which in any manner challenges or seeks to prevent, enjoin, alter or delay the transactions contemplated hereby. There are no outstanding judgments against Parent.

5.7. **Issuance of Parent Common Stock.** Upon issuance and delivery of the Parent Common Stock pursuant to Sections 2.5 through 2.8 of this Agreement, the Parent Common Stock will be duly authorized and validly issued, fully paid and nonassessable, free and clear of all Liens, other than (i) restrictions arising from applicable securities laws and the Lock-Up Agreements, and (ii) any Lien created by or through the Company's stockholders. The issuance and sale of the Parent Common Stock pursuant hereto will not be subject to or give rise to any preemptive rights or rights of first refusal.

5.8. **Fees.** Except as set forth on Schedule 5.8, there is no investment banker, broker, finder, restructuring or other intermediary that has been retained by or is authorized to act on behalf of the Parent or Acquisition Corp. or any of their respective Affiliates who might be entitled to any fee or commission from either Acquisition Corp., the Surviving Corporation, Parent or any of its Affiliates upon consummation of the transactions contemplated by this Agreement. Parent agrees to reimburse Company at the Closing for the incremental fees that Company becomes obligated to pay as a result of the transactions contemplated by this Agreement. The amount of any fee owed to any Person listed on Schedule 5.8 is listed opposite such Person's name. Each party acknowledges that Giuliani Capital Advisors has been engaged by the Parent as an advisor.

5.9. **Charter Documents; Legality.** Parent has previously delivered to the Company true and complete copies of its and Acquisitions Corp.'s Certificates of Incorporation and By-Laws (the "Parent Charter Documents"), as in effect or constituted on the date hereof. Provided that Parent presents the transactions contemplated by this Agreement to its stockholders for approval and such stockholders approve the transaction and fewer than 20% of such stockholders exercise their conversion rights with respect to such transaction (as specified in the Parent's Certificate of Incorporation), the execution, delivery, and performance by Parent and Acquisition Corp. of this Agreement and any Additional Agreement to which Parent or Acquisition Corp. is to be a party has not violated and will not violate, and the consummation by Parent and Acquisition Corp. of the transactions contemplated hereby or thereby will not violate any of the Parent Charter Documents or any Law.

5.10. **Capitalization and Ownership of the Parent.** Schedule 5.10 sets forth, with respect to the Parent and Acquisition Corp., (i) their authorized capital, (ii) the number of their securities that are outstanding, and (iii) the number of securities convertible into or exercisable or exchangeable for their securities. Except as set forth in Schedule 5.10, there is no Contract that requires or under any circumstance would require Parent or Acquisition Corp. to issue, or grant any right to acquire, any securities of the Parent or Acquisition Corp., or any security or instrument exercisable or exchangeable for or convertible into, the capital stock or membership interest of Parent or Acquisition Corp. or to merge, consolidate, dissolve, liquidate, restructure, or recapitalize the Parent or Acquisition Corp.

5.11. **Financial Statements.**

(a) Parent has filed with the SEC true and correct copies of the audited consolidated balance sheets of Parent and its consolidated subsidiaries as of December 31, 2005, and the related consolidated statements of operations, comprehensive loss and

stockholders' equity and cash flows for the year then ended, including footnotes thereto, audited by Goldstein Golub Kessler LLP, registered independent public accountants and an interim balance sheet of Parent and its consolidated subsidiaries as of September 30, 2006, and the related consolidated statements of operations, comprehensive loss and stockholders' equity and cash flows for the year then ended, including footnotes thereto, reviewed by Ernst & Young LLP, registered independent public accountants (the "Parent Financial Statements"). The Parent Financial Statements (i) were prepared in accordance with GAAP; (ii) fairly and accurately present the Parent's financial condition and the results of its operations as of their respective dates and for the periods then ended, in all material respects; (iii) contain and reflect all necessary adjustments and accruals for a fair presentation of the Parent's financial condition as of their dates, in all material respects; and (iv) contain and reflect adequate provisions for all reasonably anticipated liabilities for all material income, property, sales, payroll or other Taxes applicable to the Parent with respect to the periods then ended. The Parent has heretofore delivered to the Company complete and accurate copies of all "management letters" received by it from the Parent's accountants and all responses during the last three years by lawyers engaged by the Parent to inquiries from the Parent's accountant or any predecessor accountants.

(b) Except as specifically disclosed or as reflected in the Exchange Act Filings, reflected or fully reserved against in the Parent Financial Statements and for liabilities and obligations of a similar nature and in similar amounts incurred in the ordinary course of business since the date of the Parent Financial Statements, there are no liabilities, debts or obligations of any nature (whether accrued, absolute, contingent, liquidated or unliquidated, unasserted or otherwise) relating to the Parent or Acquisition Corp. All debts and liabilities, fixed or contingent, which should be included under GAAP on an accrual basis on the Parent Financial Statements are included therein.

(c) As of the Closing Date there will have been no Material Adverse Change to the assets of the Parent that are being held in trust for the benefit of the Parent.

5.12. **Other Information.** Neither this Agreement nor any of the documents filed by the Parent with the SEC, nor any other documents or other information made available to the Company, its stockholders or their Affiliates, attorneys, accountants, agents or representatives pursuant hereto or in connection with the Company's and the stockholders' due diligence review of the business of the Parent or the transactions contemplated by this Agreement contains or will contain any untrue statement of a material fact or omits or will omit to state a material fact necessary in order to make the statements contained therein not misleading. To the best knowledge of the Parent, the Parent has provided the Company with all material information regarding its business.

5.13. **Compliance with Laws.** The Parent is not in violation of, has not violated, and to the knowledge of Parent, is not under investigation with respect to nor has Parent been threatened to be charged with or given notice of, any violation or alleged violation of, any Law or Order, nor is there any basis for any such charge.

5.14. **Money Laundering Laws.** The operations of the Parent are and have been conducted at all times in compliance with Money Laundering Laws and no Action involving the Parent with respect to the Money Laundering Laws is pending or, to the knowledge of the Parent, threatened.

5.15. **Acquisition Corp.** Acquisition Corp. was incorporated in the State of Delaware on November 30, 2006. Acquisition Corp. has no operations (and will have none through the Closing Date) and no liabilities, debts or obligations of any nature (whether accrued, absolute, contingent, liquidated or unliquidated, unasserted or otherwise) except those incurred in connection with this Agreement and all of the transactions contemplated hereby.

5.16. **Completion of Due Diligence.**

(a) To the knowledge of Parent, prior to the execution of this Agreement, and for a period of time deemed by Parent to be reasonably sufficient, Parent and, to the extent requested by Parent, all of its representatives, agents, attorneys and advisors have: (i) had prompt, free and unfettered access to all of the Books and Records of the Company and all of the Subsidiaries; (ii) had free and unfettered access to the executives of the Company for interviews and consultations; (iii) conducted a complete and thorough due diligence investigation into the Business of the Company and the financial and operational activities of the Company for a period of time deemed to be acceptable to Parent; (iv) upon request to Company, been promptly provided with copies (digital and/or hard copy) of any and all documents relating to the Company that have been requested; (v) received prompt responses to all questions and requests submitted to the Company; (vi) conducted all interviews with the executives and other employees of Company and the Subsidiaries that Parent deemed advisable; (vii) been promptly provided with reasonable access to the offices and properties of the Company; (viii) been promptly furnished such information relating to the Business as they reasonably requested; (ix) received prompt, and courteous cooperation in their investigation of the Business from the employees, (x) had reasonable access to the counsel, accountants and representatives of the Company and each Subsidiary; and (xi) had full and complete access to the data, information and documentation available in the ISI - Argyle Data Room (a copy of which is included on the ISI - Argyle Data Room Due Diligence CD attached hereto as Exhibit C).

ARTICLE VI
COVENANTS OF THE COMPANY PENDING CLOSING

The Company covenants and agrees that:

6.1. **Conduct of the Business.** From the date hereof through the Closing Date, the Company and each Subsidiary shall conduct the Business only in the ordinary course (including the payment of accounts payable and the collection of accounts receivable), consistent with past practices, and shall not enter into any transactions outside the ordinary course of business without the prior written consent of Parent, and use its commercially

A-71

reasonable efforts to preserve intact the Company's business relationships with employees, suppliers, customers and other third parties with whom, or with which, management of the Company deems it advisable to maintain such relationships. The parties hereto agree that, without limitation, it shall be within the meaning of "ordinary course of business" as used in this ARTICLE VI, for the Company or any Subsidiary to enter into any contract that is reasonably expected by the Company to generate "sales" for the Company or any Subsidiary, consistent with past practice, and to issue purchase orders, and/or otherwise purchase goods, equipment, supplies, services and other things (of any and every nature) that the Company will include within "cost of goods sold" of the Company or any Subsidiary, consistent with past practice. The foregoing sentence shall not be deemed or construed to be a limitation upon the definition of "usual course of business". Without limiting the generality of the foregoing, neither the Company nor any Subsidiary shall be obligated to seek the prior written consent of the Parent, from the date hereof until the Closing Date, unless, outside the ordinary course of business, Company seeks to:

(a) amend, waive any provision of, terminate prior to its scheduled expiration date, or otherwise compromise in any way, any Contract (including contracts described in clause (b) below), or any other right or asset;

(b) except as contemplated by this Agreement, enter into any contract, agreement, lease, license or commitment, which:

(i) is with respect to real property,

(ii) extends for a term of one year or more;

(c) except as contemplated by this Agreement, enter into any contract, purchase or other obligation that is not within the ordinary course of business;

(d) make any capital expenditures in excess of \$250,000 (individually or in the aggregate);

(e) sell, lease, license or otherwise dispose of any assets or assets covered by any Contract except (i) pursuant to existing contracts or commitments disclosed herein and (ii) sales of inventory in the ordinary course of business consistent with past practice;

(f) except for payments to StarCo, pay, declare or promise to pay any dividends or other distributions with respect to its capital stock, or pay, declare or promise to pay any other payments to any of the Company's stockholders or any Affiliate of the Company;

(g) authorize any salary increase of more than 20% for any employee making an annual salary of greater than \$80,000 or in excess of \$16,000 in the aggregate on an annual basis with respect to any single employee or change the bonus or profit sharing policies of the Company;

A-72

- (h) except for Indebtedness listed on Schedule 6.1(h) obtain or suffer to exist any Indebtedness in excess of \$100,000 in the aggregate;
- (i) suffer or incur any Lien on any asset except for Liens existing as of the date hereof as set forth on Schedule 3.15(b);
- (j) allow insurance coverage in less than the amounts and types usual in the ordinary course of the Company's business with respect to any material damage, destruction or loss of property related to any material assets;
- (k) delay, accelerate or cancel any receivables or Indebtedness or write-off or make further reserves against the same, except in the ordinary course of business;
- (l) merge or consolidate with or acquire any other Person or be acquired by any other Person;
- (m) except as required in accordance with GAAP, make any change in its accounting principles or methods or write down the value of any inventory or assets;
- (n) change the place of business of the Company or any Subsidiary;
- (o) extend any loans to any Person, other than travel or other expense advances to employees in the ordinary course of business;
- (p) issue, redeem or repurchase any shares of its capital stock;
- (q) effect or agree to any changes in shipping practices, terms or rates;
- (r) reduce the prices of products sold from Inventory for customers except in the ordinary course of business;
- (s) effect or agree to any change in any practices or terms, including payment terms, with respect to customers or suppliers;
- (t) make or rescind any election related to Taxes, file any amended income Tax Return or make any changes in its methods of Tax accounting; or
- (u) agree to do any of the foregoing.

The Company will not (i) take or agree to take any action that might make any representation or warranty of the Company hereunder inaccurate in any respect at, or as of any time prior to, the Closing Date or (ii) omit to take, or agree to omit to take, any action necessary to prevent any such representation or warranty from being inaccurate in any respect at any such time.

Nothing herein shall be deemed to require the Company or any Subsidiary to request the approval or consent of Parent for the interviewing, hiring, training, assignment, evaluation,

control, management, compensation, promotion, or termination of employees in the ordinary course of business of Company or its Subsidiaries.

6.2. Access to Information

(a) From the date hereof until and including the Closing Date, the Company and each Subsidiary shall (i) continue to give Parent, its counsel and other representatives reasonable access to the offices, properties, Books and Records of the Company; (ii) furnish to Parent, its counsel and other representatives such information relating to the Business as such Persons may reasonably request; and (iii) cause the employees, counsel, accountants and representatives of the Company and each Subsidiary to cooperate with Parent in its investigation of the Business; provided that no investigation pursuant to this Section 6.2 (or any investigation prior to the date hereof) shall affect any representation or warranty given by the Company.

(b) The Company shall arrange for representatives of Parent to meet with or speak to the representatives of the three largest customers of the Company and each Subsidiary.

6.3. Notices of Certain Events. The Company shall promptly notify Parent of:

(a) any notice or other communication from any Person alleging or raising the possibility that the consent of such Person is or may be required in connection with the transactions contemplated by this Agreement or that the transactions contemplated by this Agreement might give rise to any claims or causes of action or other rights by or on behalf of such Person or result in the loss of any rights or privileges of the Company or any Subsidiary to any such Person;

(b) any notice or other communication from any Authority in connection with the transactions contemplated by this Agreement;

(c) any actions, suits, claims, investigations or proceedings commenced or threatened against, relating to or involving or otherwise affecting the Company, any Subsidiary or the Business or that relate to the consummation of the transactions contemplated by this Agreement; and

(d) the occurrence of any fact or circumstance which might make any representation made hereunder by the Company false in any respect or result in the omission or the failure to state a material fact necessary in order to make the statements contained herein, in light of the circumstances under which made, not materially misleading.

6.4. SEC Filings.

(a) The Company acknowledges that:

(i) the Parent's stockholders must approve the transactions contemplated by this Agreement prior to the transactions contemplated hereby being consummated and that, in connection with such approval, the Parent must call a special meeting of its stockholders requiring Parent to prepare and file with the SEC a proxy statement and proxy card;

(ii) the Parent will be required to file Quarterly and Annual reports that may be required to contain information about the transactions contemplated by this Agreement; and

(iii) the Parent will be required to file Current Reports on Form 8-K to announce the transactions contemplated hereby and other significant events that may occur in connection with such transaction.

(b) In connection with any filing the Parent makes with the SEC which requires information about the transactions contemplated by this Agreement to be included, the Company will, and will use commercially reasonable efforts to cause its stockholders to, in connection with the disclosure included in any such filing or the responses provided to the SEC in connection with the SEC's comments to a filing, use their commercially reasonable efforts to (i) cooperate with the Parent, (ii) respond to questions about the Company or the stockholders required in any filing or requested by the SEC, and (iii) provide any information requested by Parent or Parent's representatives in connection with any filing with the SEC.

6.5. **Note Conversion.** The Company will enter into and maintain in full force and effect the Note Conversion Agreement and will issue the Company Preferred Stock and the New Note immediately prior to the Closing in accordance therewith.

6.6. **Opinion of Company Counsel.** The Company shall cause its counsel to issue an opinion to Parent that, to such counsel's knowledge, subject to customary qualifications, the information relating to the Business and the risk factors relating to the Business included in the Parent's proxy/registration statement is true in all material respects and does not fail to state a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, accurate and not misleading. The opinion described in this Section 6.6 will be in a form reasonably acceptable to counsel for the Company and the Parent.

6.7. **Pre-Approved Transactions.** By executing this Agreement, Parent and Acquisition Corp. consent to each of the following leases, contracts, obligations, transactions, indebtedness and other matters. At the Closing, Acquisition Corp. agrees to assume and fully perform each and every duty or obligation imposed by the following matters, that remain a duty or obligation of Company, as the date of Closing:

(a) All indebtedness owed to LaSalle Bank, currently in maximum aggregate principal amount of \$9,000,000.00.

A-75

(b) All reasonable fees, disbursements, costs and expenses to become due and owing as a result of the Merger Agreement, Additional Documents, and the Transactions reasonably anticipated therein.

(c) All inter-company accounts receivable and accounts payable by, among, and between Company and the Subsidiaries.

(d) The obligation of Company to become due and owing to StarCo for financial, contracting and bonding advice and consultation in an amount of up to \$310,000.

(e) All the leases listed in the Schedules to this Agreement between the Company and the Subsidiaries (as Lessee) and Green Wing Management, Ltd, (as Lessor) as amended from time to time.

(f) The new lease which Company or a Subsidiary will enter into with Green Wing Management, Ltd. for the long term lease of a 2-story building in San Antonio, Texas, to be built specifically for Company, at Company's request. The building will be leased to Company upon terms substantially similar to the terms of the existing leases with Green Wing Management, Ltd., including but not limited to a rental rate to be equal to 90% of the current market value of the building to be re-calculated each 3 years.

(g) All Accounts Payable, and other obligations of the Company and the Subsidiaries incurred in the ordinary course of business.

(h) All costs, indebtedness and expenses of the Company related to all leasehold improvements that Company will make, at its sole cost and expense, in the facilities currently being leased from Green Wing Management, Ltd., as identified in the Schedules to this Agreement.

6.8. Notice and Approval Procedure.

(a) Company shall provide Parent with a clear and concise summary of any contract, agreement or other obligation that Company or any Subsidiary seeks to enter into ("Summary Contract"), for which prior written approval of the Parent is required herein. The Summary Contract and the recommendation of the Company or the relevant Subsidiary regarding said contract, agreement or obligation, shall be sent to the attention of Bob Marbut at bmarbut@argylesecurity.com. A separate copy of such data shall be faxed to 210.828.7300. No other notice to the Parent of a proposed contract, agreement or obligation is required for which prior written approval of the Parent is required herein. In the event that Parent does not object in writing to the contract, agreement or obligation described in the Summary Contract within five (5) days after the date and time of the fax transmission described above, as reflected on the facsimile transaction confirmation to be retained by the Company, then the Parent shall be irrevocably deemed to have approved, in writing, the proposed contract, agreement or obligation described in the Summary Contract in all respects.

(b) Parent shall be deemed to have not given its approval to a Summary Contract, when notice of such rejection of approval is delivered by Parent to Sam Youngblood, by facsimile at 512.495.5613, or by such other notification method as Parent and Company may agree in writing.

(c) Company shall provide Parent with a clear and concise summary of any material contract, agreement or other obligation that Company or any Subsidiary seeks to enter into ("Summary Contract"), whose subject matter exceeds \$100,000 in value, for which no prior written approval of the Parent is required herein. The Summary Contract and the recommendation of the Company or the relevant Subsidiary regarding said contract, agreement or obligation, shall be sent to the attention of Bob Marbut at bmarbut@argylesecurity.com. A separate copy of such data shall be faxed to 210.828.7300. No other notice to the Parent of a proposed contract, agreement, or obligation is required for which prior written approval of the Parent is required herein.

ARTICLE VII COVENANTS OF THE PARTIES

The Parent and the Acquisition Corp., on the one hand, jointly and severally, and the Company, on the other hand, covenant and agree with each other to the following terms. The Company hereby agrees that, at the Closing, each of its stockholders shall, severally and not jointly, agree to each of the following with Acquisition Corp. and the Parent, provided, however, that in the event that the subject matter of the following provisions is contemplated in the Employment Agreements, the provisions in the applicable Employment Agreements shall prevail, and provided further, however, that Blair will not enter into any agreement relating to Sections 7.2 or 7.3.

7.1. **Confidentiality.** Except as otherwise required by law, they shall not, without the prior written consent of the other party, or a person authorized thereby, disclose to any other Person or use (whether for itself or any other party) any confidential information or proprietary work product of Parent, Acquisition Corp., the Company or any Subsidiary or any client of Parent, Acquisition Corp., the Company or any Subsidiary. In the event a party believes that it is required to disclose any such confidential information pursuant to applicable Laws, such party shall give timely written notice to the party whose confidential information is to be disclosed so such party has an opportunity to obtain a protective order or other appropriate relief. Each of the parties hereto shall cooperate fully in any such action.

7.2. **Non-Solicitation.**

(a) Each party and its Affiliates may not, during the period beginning on the Closing Date and ending two years after the Closing Date (the "Restriction Period"), directly or indirectly through any other individual, person or entity, employ, solicit or induce any individual who is, or was at any time during the period beginning on or after December 31, 2005 and through and after, the Closing Date, an employee or consultant of the other party to terminate or refrain from renewing or extending his or her employment by or consulting relationship with such party or to become employed by or enter into a consulting

relationship with another party or any of its Affiliates or any other individual, person or entity.

(b) Each party and its Affiliates may not, during the Restriction Period, directly or indirectly through any other individual, person or entity, solicit, persuade or induce any Customer or supplier to terminate, reduce or refrain from renewing or extending his, her or its contractual or other relationship with the other party or to become a customer or supplier of or enter into any contractual or other relationship with another party or any of its Affiliates or any other individual, person or entity, directly or indirectly, in regard to the sale of products or services similar or identical to those manufactured, marketed, purchased or sold by the Company or any Subsidiary as of the Closing Date. For purposes hereof, "Customer" means any individual, person or entity which is or was at any point in time during the two (2) year period prior to the Closing Date a customer of the Company or any Subsidiary.

7.3. **Non-Competition.** During the Restriction Period, no party shall (except on behalf of the Company or any of its Affiliates) directly or indirectly, in his, her and its own capacity or through one or more Affiliates, whether as owner, consultant, executive, partner, member, manager, officer, director, venturer, or agent, or through stock ownership, investment of capital, lending of money or property, or rendering of services, or otherwise, engage in the Business.

7.4. **Reporting and Compliance With Law.** From the date hereof through the Closing Date, each party shall duly and timely file all Tax Returns required to be filed with Authorities, pay any and all Taxes required by any Authority and duly observe and conform, in all material respects, to all applicable Laws and Orders.

7.5. **Injunctive Relief.** If a party breaches, or threatens to commit a breach of, any of the covenants set forth in Section 6.2, 7.1, or Section 14.4 (the "Restrictive Covenants"), the party against which such breach shall be committed or threatened shall have the following rights and remedies, which shall be in addition to, and not in lieu of, any other rights and remedies available to such party by agreement (including those set forth in Section 11.1 hereof), under law or in equity:

(a) The right and remedy to have the Restrictive Covenants specifically enforced by any court having equity jurisdiction, all without the need to post a bond or any other security or to prove any amount of actual damage or that money damages would not provide an adequate remedy, it being acknowledged and agreed that any such breach or threatened breach will cause irreparable injury and that monetary damages will not provide adequate remedy; and

(b) The right and remedy to require such breaching party (i) to account for and pay over all compensation, profits, monies, accruals, increments or other benefits derived or received by them or any associated party as the result of any such breach; and (ii) to indemnify the aggrieved party against any other losses, damages (including special and consequential damages), costs and expenses, including actual attorneys fees and court costs,

which may be incurred by it and which result from or arise out of any such breach or threatened breach.

ARTICLE VIII
COVENANTS OF ALL PARTIES HERETO

The parties hereto, as applicable, covenant and agree that:

8.1. **Best Efforts; Further Assurances.** Subject to the terms and conditions of this Agreement, each party shall use its commercially reasonable efforts to take, or cause to be taken, all actions and to do, or cause to be done, all things necessary or desirable under applicable Laws to consummate and implement expeditiously the transactions contemplated by this Agreement. The parties hereto shall execute and deliver such other documents, certificates, agreements and other writings and take such other actions as may be necessary or desirable in order to consummate or implement expeditiously the transactions contemplated by this Agreement.

8.2. **Confidentiality of Transaction.** Any information (except publicly available or freely usable material obtained from another source) respecting any party or its Affiliates will be kept in strict confidence by all other parties to this Agreement and their agents. Except as required by Law, neither the Company nor any of its Affiliates, directors, officers, employees or agents will disclose the terms of the transactions contemplated hereunder at any time, currently, or on or after the Closing, regardless of whether the Closing takes place, except as necessary to their attorneys, accountants and professional advisors, in which instance such persons and any employees or agents of the Company shall be advised of the confidential nature of the terms of the transaction and shall themselves be required by the Company to keep such information confidential. Except as required by Law, each party shall retain all information obtained from the other and their lawyers on a confidential basis except as necessary to their attorneys, accountants and professional advisors, in which instance such persons and any employees or agents of such party shall be advised of the confidential nature of the terms of the transaction and shall themselves be required by such party to keep such information confidential.

8.3. **Good Faith Efforts to Obtain Consents.** Each party agrees to use its commercially reasonable good faith efforts to obtain each party's respective required consents as promptly as practicable hereafter.

8.4. **Tax Matters.**

(a) The transactions contemplated by this Agreement will cause Acquisition Corp to terminate effective as of the Effective Time. The Surviving Corporation shall prepare and file, or cause to be prepared and filed, any and all Tax Returns required to be filed by the Acquisition Corp. (after giving effect to any valid extensions of the due date for filing any such Tax Returns) on or prior to the Closing Date that have not been prepared or filed on or before the Closing Date and all Tax Returns of Acquisition Corp. due on or

A-79

after the Closing Date. The Surviving Corporation shall timely pay (or cause to be timely paid) all Taxes shown as due and owing by Acquisition Corp. on all such Tax Returns.

(b) The Surviving Corporation will be liable for and will pay all applicable sales, transfer, recording, deed, stamp and other similar Taxes resulting from the consummation of the transactions contemplated by this Agreement.

(c) At the Effective Time, all Tax sharing, indemnity or allocation agreements or arrangements (whether or not written), if any, to which Company is a party will terminate, and, after the date hereof, no Taxes or other amounts will be paid or reimbursed by Company under any such agreement or arrangement, regardless of the taxable year or period for which such Taxes are imposed, and the provisions of this Section 5.14 will govern thereafter.

8.5. **Registration.** Within 30 days of the Closing Date, the Parent shall prepare and file with the SEC, at its sole expense, a registration statement permitting the public offering and sale of the number of shares of Parent Common Stock issued to the Company's stockholders pursuant to this Agreement and any securities issued in exchange for or in replacement of such shares of Parent Common Stock, and any securities issued by way of any stock split, reverse stock split, recapitalization, or other similar transaction affecting such Parent Common Stock (collectively, the "Registrable Securities"). The Parent will use commercially reasonable efforts to have the staff of the SEC declare such registration statement effective as soon as practicable after the Effective Time, but in no event later than 150 days after the Closing Date. The Parent will keep such registration effective until, subject to the terms and provisions of this Agreement, the earlier of the date when (i) all the Registrable Securities covered by the registration statement have been sold pursuant thereto or otherwise or (ii) the Registrable Securities may be publicly sold without volume restrictions under Rule 144(k) (or any similar provisions then in force) of the Securities Act of 1933 as amended (the "Act"), as determined by the counsel to the Parent (collectively, the "Effectiveness Period"). The registration statement shall be on any form the Parent is eligible to use to register for resale the Registrable Securities. The Parent shall use commercially reasonable efforts to cause such registration statement filed pursuant to this Section to become effective as soon as possible following the Effective Time. Pursuant to the Lock-Up Agreements (a) between Blair and the Parent, Blair may not, except as otherwise provided in the Lock-Up Agreements, sell any shares of Parent Common Stock it receives pursuant to this Agreement for a period of six months from the Effective Time, and (b) between the Parent and each stockholder of the Company other than Blair, each such stockholder may not, except as otherwise provided in the Lock-Up Agreements, sell any shares of Parent Common Stock it receives pursuant to this Agreement until such time as the original stockholders of the Parent are able to sell their Shares or January 30, 2009, whichever is earlier.

8.6. **Procedures on Registration.** If and whenever the Parent is required by the provisions hereof or any Lock-Up Agreements to effect the registration of any Registrable Securities under the Act, the Parent will, at its sole cost and expense:

A-80

- (a) respond as promptly as commercially reasonable to any comments received from the SEC, and use its commercially reasonable efforts to cause such registration statement to become effective as required herein or in the Lock-Up Agreements, and promptly provide to the holders of Company Securities copies of all filings and SEC letters of comment relating thereto provided that such letters do not contain material non-public information, in which case such letters may be redacted by the Parent;
- (b) furnish to each holder of Company Securities such number of copies of the registration statement and the prospectus included therein as such holder reasonably may request to facilitate the public sale or disposition of the Registrable Securities covered by such registration statement;
- (c) use its commercially reasonable efforts to register or qualify the Registrable Securities of each of the holders of Company Securities covered by such registration statement under the securities or “blue sky” laws of such jurisdictions within the United States as such holder may reasonably request; provided, however, that the Parent shall not for any such purpose be required to qualify generally to transact business as a foreign corporation in any jurisdiction where it is not so qualified or to consent to general service of process in any such jurisdiction;
- (d) list the Registrable Securities covered by such registration statement with any securities exchange on which the Parent Common Stock is then listed;
- (e) immediately notify the holder of Company Securities at any time when a prospectus relating thereto is required to be delivered under the Act of the happening of any event of which the Parent has knowledge as a result of which the prospectus contained in such registration statement, as then in effect, includes an untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary to make the statements therein not misleading in light of the circumstances then existing; and
- (f) immediately notify the holder of Company Securities of the effectiveness of each registration statement filed.

8.7. **Employment Agreements.** Promptly after the Effective Time and the formation of a compensation committee by Parent, Surviving Corporation and Parent will negotiate an Employment Agreement in good faith with each person listed on Schedule 8.7. The Company acknowledges agrees that such Employment Agreements will be subject to the final approval of the compensation committee of the Parent.

ARTICLE IX CONDITIONS TO CLOSING AND DELIVERIES ON CLOSING

9.1. **Condition to the Obligations of Parent, Acquisition Corp., and the Company.** The obligations of Parent, Acquisition Corp. and the Company to consummate the Closing are subject to the satisfaction of all the following conditions:

A-81

(a) No provision of any applicable Law or Order shall prohibit or impose any condition on the consummation of the Closing or limit in any material way Parent's right to control or operate Acquisition Corp., the Surviving Corporation or any material portion of the Business.

(b) There shall not be pending or threatened any proceeding by a third-party to enjoin or otherwise restrict the consummation of the Closing.

(c) Parent's stockholders shall have approved the transaction and fewer than 20% of the issued and outstanding shares of Parent Common Stock owned by Parent's public stockholders will have exercised their conversion rights (as specified in the Parent's Certificate of Incorporation).

(d) The Closing contemplated herein is completed in all respects on or before July 1, 2007.

9.2. Conditions to Obligations of Parent and Acquisition Corp. In addition to the terms and provisions of Section 9.1, the obligation of Parent and Acquisition Corp. to consummate the Closing is subject to the satisfaction, or the waiver at Parent's and Acquisition Corp.'s sole and absolute discretion, of all the following further conditions:

(a) (i) The Company shall have duly performed in all material respects all of its obligations hereunder required to be performed by it at or prior to the Closing Date; (ii) the representations and warranties of the Company contained in this Agreement, the Additional Agreements to which the Company is named as a party and in any certificate or other writing delivered by the Company pursuant hereto, shall be true and correct at and as of the Closing Date, as if made at and as of such date; (iii) there shall have been no event, change or occurrence which individually or together with any other event, change or occurrence, could reasonably be expected to constitute a Material Adverse Change or to have a Material Adverse Effect; and (iv) Parent and Acquisition Corp. shall have received a certificate signed by the President and Secretary of the Company to the effect set forth in clauses (i), (ii) and (iii) of this Section 9.2(a).

(b) Parent shall have received (i) a certified copy of the certificate of incorporation of the Company and each Subsidiary; (ii) copies of the By-Laws of the Company and each subsidiary as effective on the date hereof; (iii) copies of resolutions duly adopted by (A) the Board of Directors of the Company and (B) by the vote or consent of the Company's stockholders, authorizing this Agreement and the Additional Agreements (if necessary) and the transaction contemplated hereby and thereby; (iv) a certificate of the Secretary of the Company certifying each of the foregoing and as to signatures of the officer(s) authorized to execute this Agreement and any certificate or document to be delivered pursuant hereto, together with evidence of the incumbency of such Secretary; and (v) a recent good standing certificate regarding the Company from the office of the Secretary of State of the State of Delaware, and each other jurisdiction in which the Company is qualified to do business.

- (c) Parent or Acquisition Corp. shall have reasonably determined that, after Parent or Acquisition Corp. has had the opportunity to meet or speak to representatives of the three largest customers of the Company and each Subsidiary pursuant to Section 6.2, all such customers will continue the relationship such customer had with the Company.
- (d) Parent shall have received a copy of all material Company Consents (including any required consents of the landlords under the Leases), in form and substance reasonably satisfactory to Parent, and no such material Company Consent shall have been revoked.
- (e) Except as set forth in Schedule 9.2(e), the Company shall have delivered to Parent documents satisfactory to Parent to evidence the release of all Liens on any portion of the assets of the Company and the filing of appropriate UCC-3 Termination Statements.
- (f) The Parent shall have received updated Schedules to this Agreement as of a date within three business days of the Closing Date. Such updated Schedules shall include the 2006 Financial Statements and any subsequent interim period that would be required under GAAP.
- (g) Parent's stockholders approve the transactions contemplated by this Agreement by July 1, 2007.
- (h) Parent will have received an opinion of counsel to the Company in a form to be agreed upon prior to Closing.
- (i) Certificates representing all of the issued and outstanding shares of the Company Securities as of the Effective Time and the Company Warrant shall be presented at the Closing for cancellation, together with the original stock ledgers and minute books of the Company.
- (j) The Company will have agreed to pay no more than \$2,000,000 to ISI*MCS, Ltd. ("StarCo"), which will be in full satisfaction of the account payable of the Company in favor of StarCo.
- (k) The Surviving Corporation's Director and Officer insurance policy shall include the officers and directors of the Parent.
- (l) Adjusted EBITDA as calculated herein is equal to or greater than \$4,500,000 and 2/28 Backlog is equal to or greater than \$70,000,000.

9.3. **Conditions to Obligations of the Company.** In addition to the terms and provisions of Section 9.1, the obligation of the Company to consummate the Closing is subject to the satisfaction, or the waiver at the Company's discretion, of all the following further conditions:

(a) (i) Parent and Acquisition Corp. shall have performed in all material respects all of their respective obligations hereunder required to be performed by it at or prior to the Closing Date; (ii) the representations and warranties of Parent contained in this Agreement, the Additional Agreements and in any certificate or other writing delivered by Parent or Acquisition Corp. pursuant hereto, disregarding all qualifications and expectations contained therein relating to materiality, shall be true and correct in all material respects at and as of the Closing Date, as if made at and as of such date; (iii) there shall have been no event, change or occurrence which individually or together with any other event, change or occurrence, could reasonably be expected to have a Material Adverse Effect, regardless of whether it involved a known risk, on the business, assets, condition (financial or otherwise), liabilities, result of operations of prospects of the Parent; and (iv) the Company shall have received a certificate signed by an authorized officer of Parent and Acquisition Corp. to the foregoing effect.

(b) The Company shall have received (i) a copy of the certificate of incorporation of each of Parent and Acquisition Corp.; (ii) copies of the bylaws of each of Parent and Acquisition Corp. as effective on the date hereof; (iii) copies of resolutions duly adopted by the Board of Directors of the Company authorizing this Agreement and the Additional Agreements (if necessary) and the transaction contemplated hereby and thereby; (iv) a certificate of the Secretary or Assistant Secretary of Parent and Acquisition Corp. certifying each of the foregoing and as to signatures of the officer(s) authorized to execute this Agreement and any certificate or document to be delivered pursuant hereto, together with evidence of the incumbency of such Secretary or Assistant Secretary; and (v) a recent good standing certificate regarding Parent and Acquisition Corp. from the office of the Secretary of State of its respective jurisdiction of organization and each other jurisdiction in which each of Parent and Acquisition Corp. is qualified to do business.

(c) The stockholders of the Parent shall have approved an equity incentive plan that will provide incentives to the members of the Company's management team (as well as members of the Parent's management team) listed on Schedule 9.3(d) based on the long term performance of the Surviving Corporation.

9.4. **Closing Deliveries.** .

(a) On the Closing Date, each party hereto will execute each of the Additional Agreements to which it is a party.

ARTICLE X RELIANCE ON REPRESENTATIONS AND WARRANTIES

10.1. **Reliance on Representations and Warranties of the Company.** Notwithstanding any right of Parent and Acquisition Corp. to fully investigate the affairs of the Company and notwithstanding any knowledge of facts determined or determinable by Parent

and Acquisition Corp. pursuant to such investigation or right of investigation, Parent and Acquisition Corp. shall have the right to rely fully upon the representations, warranties, covenants and agreements of the Company contained in this Agreement.

10.2. **Reliance on Representations and Warranties of Parent and Acquisition Corp.** Notwithstanding any right of the Company to fully investigate the affairs of Parent and Acquisition Corp. and notwithstanding any knowledge of facts determined or determinable by the Company pursuant to such investigation or right of investigation, the Company shall have the right to rely fully upon the representations, warranties, covenants and agreements of Parent and Acquisition Corp. contained in this Agreement.

ARTICLE XI INDEMNIFICATION

11.1. **Definition.** As used in this ARTICLE XI, the term “Loss” shall mean loss, payments, demand, penalty, liability, judgment, damage, diminution in value, claim or out-of-pocket costs and expenses (including actual costs of investigation and attorneys’ fees and other costs and expenses) (all of the foregoing collectively, “Losses”).

11.2. **This section intentionally left blank.**

11.3. **Indemnification of Company and Stockholders.** Parent and Acquisition Corp. hereby jointly and severally agree to indemnify and hold harmless each of the Company and the holders of the Company Securities and their respective Affiliates, and each of their respective directors, officers, employees, shareholders, attorneys, agents and permitted assignees (the “Company Indemnitees”) against and in respect of any Losses incurred, sustained or to be incurred or sustained by the Company Indemnitees arising from (i) any breach, inaccuracy or nonfulfillment or the alleged breach, inaccuracy or nonfulfillment of any of the representations, warranties and covenants of Parent or Acquisition Corp. contained herein or in the Additional Agreements to which Parent or Acquisition Corp. are named as a party or any certificate or other writing delivered pursuant hereto, (ii) actions or inactions of the Surviving Corporation with regard to the Business occurring after the Closing, provided that the activities of the Company’s current stockholders have not caused or resulted in such action or inaction, (iii) the Proxy Statement to be filed by Parent relating to this Agreement, or any other public disclosure relating to this Agreement or the transactions contemplated thereby, unless the Loss indemnified pursuant to this subsection arises from a material misstatement made to the Parent by the Company or any Company Indemnitee to the Parent; and (iv) any contract or agreement that the Company or a Subsidiary is a party, or is obligated to perform, where: (y) said contract is the subject of a performance or payment bond provided by StarCo and (z) said contract has not been fully paid as of the Closing Date.

11.4. **Indemnification of Individual Indemnitees.** Parent and Acquisition Corp. hereby jointly and severally agree to indemnify and hold harmless Sam Youngblood, individually, and Don Carr, individually, their spouses, attorneys, agents and permitted

assignees (the “Individual Indemnitees”) against and in respect of any Losses incurred, sustained or to be incurred or sustained by the Individual Indemnitees arising from:

(i) any contract or agreement which the Company or a Subsidiary is obligated to perform in whole or in part, where

(w) said contract or agreement is the subject of a performance or payment bond provided by StarCo and

(x) said contract has not been fully paid as of the date of Closing.

(ii) guarantees by the Individual Indemnitees relating to any of the performance or payment bonds provided by StarCo on any contract or agreement which the Company or a Subsidiary is obligated to perform in whole or in part, where

(y) such contract or agreement is the subject of a performance or payment bond provided by StarCo and

(z) said contract has not been fully paid as of the date of Closing.

11.5. **Procedure.** The following shall apply with respect to all claims by a Company Indemnitee or an Individual Indemnitee (collectively, “Indemnified Party”) for indemnification:

(a) An Indemnified Party shall give the Parent or Acquisition Corp., or the Indemnification Agent, as applicable (either, “Indemnifying Parties”), prompt notice (an “Indemnification Notice”) of any third-party claim, investigation, action, suit, hearing or proceeding with respect to which such Indemnified Party seeks indemnification pursuant to Section 11.3 or 11.4 (a “Third Party Claim”), which shall describe in reasonable detail the loss, liability or damage that has been or may be suffered by the Indemnified Party. The failure to give the Indemnification Notice shall not impair any of the rights or benefits of such Indemnified Party under Section 11.3 or 11.4, except to the extent such failure materially and adversely affects the ability of the Indemnifying Parties to defend such claim or to the limited extent the failure to give such notice increases the amount of such liability.

(b) In the case of any Third Party Claims as to which indemnification is sought by any Indemnified Party, such Indemnified Party shall be entitled, at the sole expense and liability of the Indemnifying Parties, to exercise full control of the defense, compromise or settlement of any Third Party Claim unless the Indemnifying Parties, within a reasonable time after the giving of an Indemnification Notice by the Indemnified Party (but in any event within 10 days thereafter), shall (i) deliver a written confirmation to such Indemnified Party that the indemnification provisions of Section 11.3 or 11.4 are applicable to such claim, investigation, action, suit, hearing or proceeding and the Indemnifying Parties will indemnify such Indemnified Party in respect of such claim, investigation, action or proceeding pursuant to the terms of Section 11.3 or 11.4 and, notwithstanding anything to the

contrary, shall do so without asserting any challenge, defense, or limitation on the Indemnifying Parties liability for Losses, counterclaims or offsets, (ii) notify such Indemnified Party in writing that the Indemnifying Parties is assuming the defense thereof, and (iii) retain legal counsel reasonably satisfactory to such Indemnified Party to conduct the defense of such Third Party Claim.

(c) If the Indemnifying Parties assume the defense of any such Third Party Claim then the Indemnified Party shall cooperate with the Indemnifying Parties in any manner reasonably requested in connection with the defense, compromise or settlement thereof. If the Indemnifying Parties so assume the defense of any such Third Party Claim the Indemnified Party shall have the right to employ separate counsel and to participate in (but not control) the defense, compromise, or settlement thereof, but the fees and expenses of such counsel employed by the Indemnified Party shall be at the expense of such Indemnified Party unless (i) the Indemnifying Parties have agreed to pay such fees and expenses, or (ii) the named parties to any such Third Party Claim (including any impleaded parties) include an Indemnified Party and an Indemnifying Party and such Indemnified Party shall have been advised by its counsel that there may be a conflict of interest between such Indemnified Party and the Indemnifying Parties in the conduct of the defense thereof, and in any such case the reasonable fees and expenses of such separate counsel shall be borne by the Indemnifying Parties.

(d) If the Indemnifying Parties assume the defense of any Third Party Claim, the Indemnified Party shall not pay, or permit to be paid, any part of any claim or demand arising from such asserted liability unless the Indemnifying Parties withdraw from or fail to vigorously prosecute the defense of such asserted liability, or unless a judgment is entered against the Indemnified Party for such liability. If the Indemnifying Parties do not elect to defend, or if, after commencing or undertaking any such defense, the Indemnifying Parties fail to prosecute or withdraw such defense, the Indemnified Party shall have the right to undertake the defense or settlement thereof, solely at the Indemnifying Parties' expense. Notwithstanding anything to the contrary, the Indemnifying Parties shall not be entitled to control, but may participate in, and the Indemnified Party (at the expense of the Indemnifying Parties) shall be entitled to have sole control over, the defense or settlement of (x) that part of any Third Party Claim (i) that seeks a temporary restraining order, a preliminary or permanent injunction or specific performance against the Indemnified Party, or (ii) to the extent such Third Party Claim involves criminal allegations against the Indemnified Party or (y) the entire Third Party Claim if such Third Party Claim could impose liability upon the Indemnified Party in an amount which is greater than the amount as to which the Indemnified Party is entitled to indemnification under this Agreement. In the event the Indemnified Party retains control of the Third Party Claim, the Indemnified Party may, in its sole discretion, settle the subject claim without the prior written consent of the Indemnifying Party.

(e) If the Indemnified Party assumes the defense of any such Third Party Claim pursuant to this Section 11.5 and proposes to settle the same prior to a final judgment thereon or to forgo appeal with respect thereto, then the Indemnifying Parties shall have no right to participate in the settlement, assume or reassume the defense thereof or prosecute such appeal. Any such settlement by the Indemnified Party shall, in each case, shall be at the

Indemnifying Parties' expense. The Indemnifying Parties shall not, without the prior written consent of such Indemnified Party, settle or compromise or consent to entry of any judgment with respect to any such Third Party Claim (i) in which any relief other than the payment of money damages is or may be sought against such Indemnified Party or (ii) which does not include as an unconditional term thereof, the giving by the claimant, person conducting such investigation or initiating such hearing, plaintiff or petitioner to such Indemnified Party a release from all liability with respect to such Third Party Claim and all other claims or causes of action (known or unknown) arising or which might arise out of the same facts.

11.6. **Periodic Payments.** Any indemnification required by Section 11.3 or 11.4 for costs, fees, disbursements or expenses of any and every kind, by an Indemnified Party in connection with investigating, preparing to defend or defending any claim, action, suit, hearing, proceeding or investigation, shall be made by periodic payments by the Indemnifying Parties to each Indemnified Party during the course of the investigation or defense, as and when bills are received or costs, disbursements or expenses are incurred, and no later than ten (10) business days after demand for such payments by the Indemnified Party.

11.7. **Insurance.** Any indemnification payments hereunder shall only be reduced by any insurance proceeds or other third party reimbursement actually received by the Indemnified Party.

11.8. **Survival of Indemnification Rights.** The representations and warranties of the Company, the Parent and Acquisition Corp. shall survive until the third anniversary of the Closing Date. The indemnification to which any Indemnified Party is entitled from the Indemnifying Parties pursuant to Section 11.3 or 11.4 for Losses shall be effective so long as it is asserted prior to the fourth anniversary of the Closing Date in the case of all representations and warranties of the Company and Parent hereunder.

ARTICLE XII DISPUTE RESOLUTION

12.1. **Arbitration.**

(a) In the event a dispute arises relating to this Agreement, the parties agree to meet to resolve their disputes in good faith. Any party may seek injunctive relief, without the need to post a bond, pending the completion of arbitration under this Agreement for any material breach or threatened material breach of any covenant contained herein.

(b) If after good faith negotiations the dispute is not resolved, the parties shall promptly submit any dispute, claim, or controversy arising out of or relating to this Agreement, or any Additional Agreement (including with respect to the meaning, effect, validity, termination, interpretation, performance, or enforcement of this Agreement or any Additional Agreement) or any alleged breach thereof (including any action in tort, contract, equity, or otherwise), to binding arbitration before one arbitrator that is familiar with the Business and not an Affiliate of any party to this Agreement ("Arbitrator"). The parties

agree that binding arbitration shall be the sole means of resolving any dispute, claim, or controversy arising out of or relating to this Agreement or any Additional Agreement (including with respect to the meaning, effect, validity, termination, interpretation, performance or enforcement of this Agreement or any Additional Agreement) or any alleged breach thereof (including any claim in tort, contract, equity, or otherwise).

(c) If the parties cannot agree upon the Arbitrator, the Arbitrator shall be selected by the Chief Administrative District Judge for the State Courts sitting in San Antonio, Texas, upon the request of either side. The Arbitrator shall be selected within 30 days of request.

(d) The laws of the State of Texas shall apply to any arbitration hereunder. In any arbitration hereunder, this Agreement and any agreement contemplated hereby shall be governed by the laws of the State of Texas applicable to a contract negotiated, signed, and wholly to be performed in the State of Texas, which laws the Arbitrator shall apply in rendering its decision. The Arbitrator shall issue a written decision, setting forth findings of fact and conclusions of law, within sixty (60) days after the Arbitrator shall have been selected. The Arbitrator shall have no authority to award punitive or other exemplary damages.

(e) The arbitration shall be held in the City of San Antonio, Texas in accordance with and under the then-current provisions of the rules of the American Arbitration Association, except as otherwise provided herein.

(f) On application to the Arbitrator, any party shall have rights to discovery to the same extent as would be provided under the Federal Rules of Civil Procedure, and the Federal Rules of Evidence shall apply to any arbitration under this Agreement; provided, however, that the Arbitrator shall limit any discovery or evidence such that the Arbitrator's decision shall be rendered within the period referred to in Section 12.1(d).

(g) The Arbitrator may, at the Arbitrator's discretion and at the expense of the party who will bear the cost of the arbitration, employ experts to assist him in the Arbitrator's determinations.

(h) The costs of the arbitration proceeding and any proceeding in court to confirm any arbitration award or to obtain relief as provided in Section 12.1, as applicable (including actual attorneys' fees and costs), shall be borne by the unsuccessful party and shall be awarded as part of the Arbitrator's decision, unless the Arbitrator shall otherwise allocate such costs for the reasons set forth in such decision. The determination of the Arbitrator shall be final and binding upon the parties and not subject to appeal.

(i) Any judgment upon any award rendered by the Arbitrator may be entered in and enforced by any court of competent jurisdiction. The parties expressly consent to the exclusive jurisdiction of the courts (Federal and state) in the City of San Antonio, County of Bexar, State of Texas to enforce any award of the Arbitrator or to render

any provisional, temporary, or injunctive relief in connection with or in aid of the Arbitration. The parties expressly consent to the personal and subject matter jurisdiction of the Arbitrator to arbitrate any and all matters to be submitted to arbitration hereunder. None of the parties hereto shall challenge any arbitration hereunder on the grounds that any party necessary to such arbitration (including the parties hereto) shall have been absent from such arbitration for any reason, including that such party shall have been the subject of any bankruptcy, reorganization, or insolvency proceeding.

(j) The parties shall indemnify the Arbitrator and any experts employed by the Arbitrator and hold them harmless from and against any claim or demand arising out of any arbitration under this Agreement or any agreement contemplated hereby, unless resulting from the willful misconduct of the person indemnified.

(k) This arbitration clause shall survive the termination of this Agreement and any agreement contemplated hereby.

12.2. **Waiver of Jury Trial; Exemplary Damages.** ALL PARTIES HEREBY WAIVE THEIR RIGHTS TO TRIAL BY JURY WITH RESPECT TO ANY DISPUTE ARISING UNDER THIS AGREEMENT OR ANY ADDITIONAL AGREEMENT. No party shall be awarded punitive or other exemplary damages respecting any dispute arising under this Agreement or any Additional Agreement.

12.3. **Attorneys' Fees.** The unsuccessful party to any court or other proceeding (including any arbitration proceeding pursuant to this Article XII) arising out of this Agreement that is not resolved by arbitration under Section 12.1 shall pay to the prevailing party all actual attorneys' fees and costs actually incurred by the prevailing party, in addition to any other relief to which it may be entitled. As used in this Section 12.3 and elsewhere in this Agreement, "actual attorneys' fees" means the full and actual cost of any legal services actually performed in connection with the matter for which such fees are sought (including all reasonable expenses, costs, and disbursements of such attorneys), calculated on the basis of the usual fees charged by the attorneys performing such services.

ARTICLE XIII TERMINATION

13.1. **Termination Without Default.**

(a) In the event that the Closing of the transactions contemplated hereunder has not occurred by July 1, 2007 (the "Outside Closing Date"), then Parent and Acquisition Corp. on the one hand, and the Company on the other hand, shall all have the right, at its or their sole option, to terminate this Agreement without liability or prejudice to any party. Such right may be exercised by Parent and Acquisition Corp., on the one hand, or the Company on the other, as the case may be, giving written notice to the other at any time prior to the Outside Closing Date.

(b) In the event that Adjusted EBITDA as calculated herein is determined to be less than \$4,500,000 or the 2/28 Backlog is determined to be less than \$70,000,000, then Parent shall have the right, at its sole option, to terminate this Agreement without liability or prejudice to any party. Such right may be exercised by Parent giving written notice to the Company at any time prior to the Outside Closing Date.

13.2. **Termination Upon Default.**

(a) Parent and Acquisition Corp. may terminate this Agreement by giving notice to the Company on or prior Closing, without prejudice to any rights or obligations Parent and Acquisition Corp. may have, if the Company shall have materially breached any representation or warranty or breached any agreement or covenant contained herein or in any Additional Agreement to be performed prior to Closing and such breach shall not be cured within the earlier of the Outside Closing Date and ten (10) business days following receipt by the Company of a notice describing in reasonable detail the nature of such breach.

(b) The Company may terminate this Agreement by giving prior written notice to Parent on or prior to the Closing, without prejudice to any rights or obligations the Company may have, if Parent or Acquisition Corp. shall have materially breached any of its covenants, agreements, representations, and warranties contained herein to be performed prior to Closing and such breach shall not be cured within the earlier of the Outside Closing Date or ten (10) business days following receipt by Parent of a notice describing in reasonable detail the nature of such breach.

13.3. **Survival.** The provisions of Article XI and Article XII and Sections 8.2 and 14.4 shall survive any termination hereof pursuant to this Article XIII.

ARTICLE XIV
MISCELLANEOUS

14.1. **Notices.** All notices, requests, demands and other communications to any party hereunder shall be in writing and shall be given to such party at its address or telecopier number set forth below, or such other address or telecopier number as such party may hereinafter specify by notice to each other party hereto:

if to Parent and Acquisition Corp., to:

Argyle Security Acquisition Corporation
200 Concord Plaza, Suite 700
San Antonio, TX 78216
Attn: Bob Marbut
Telecopy: (210) 828-7300

A-91

with a copy to:

Loeb & Loeb LLP
345 Park Avenue
New York, New York 10154
Attention: Mitchell S. Nussbaum
Telecopy: 212-407-4990
if to the Company:

ISI Detention Contracting Group, Inc.
12903 Delivery Drive
San Antonio, Texas 78247
Attention: Sam Youngblood
Telecopy: 210.495.5613

with a copy to:

Hughes & Luce, LLP
111 Congress Ave; Ste. 900
Austin, TX 78701
Attention: Hull Youngblood
Telecopy : 512.482.6859

with an additional copy to:

William Blair Mezzanine Capital Fund III, L.P.
c/o Merit Capital Partners
Attention: David Jones
303 West Madison Street
Suite 2100
Chicago, Illinois 60606

and an additional copy to:

Vedder, Price, Kaufman and Kammholz, P.C.
222 North LaSalle Street, Suite 2600
Chicago, IL 60601
Attention: Dana Armagno
Telecopy: (312) 609-5005

Each such notice, request or other communication shall be effective (i) if given by telecopy, when such telecopy is transmitted to the telecopy number specified herein and the appropriate answer back is received or, (ii) if given by certified mail, 72 hours after such communication is deposited in the mails with first class and certified postage prepaid, properly addressed or, (iii) if given by any other means, when delivered at the address specified herein.

14.2. **Amendments; No Waivers.**

(a) Any provision of this Agreement may be amended or waived if, and only if, such amendment or waiver is in writing and signed, in the case of an amendment, by each party hereto, or in the case of a waiver, by the party against whom the waiver is to be effective.

(b) No failure or delay by any party hereto in exercising any right, power or privilege hereunder shall operate as a waiver thereof nor shall any single or partial exercise thereof preclude any other or further exercise thereof or the exercise of any other right, power or privilege. Except as specifically provided otherwise herein, the rights and remedies herein provided shall be cumulative and not exclusive of any rights or remedies provided by law.

14.3. **Ambiguities.** The parties acknowledge that each party and its counsel has materially participated in the drafting of this Agreement and consequently the rule of contract interpretation that, and ambiguities if any in, the writing be construed against the drafter, shall not apply.

14.4. **Publicity.** Except as required by law, the parties agree that neither they nor their agents shall issue any press release or make any other public disclosure concerning the transactions contemplated hereunder without the prior approval of the other party hereto.

14.5. **Successors and Assigns.** The provisions of this Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors and assigns; provided, that (i) the Company may not assign, delegate or otherwise transfer any of its rights or obligations under this Agreement without the prior written consent of Parent; (ii) in the event Parent assigns its rights and obligations under this Agreement to an Affiliate, Parent shall continue to remain liable for its obligations hereunder; and (iii) Parent, the Surviving Corporation or Acquisition Corp. may assign any of its rights and benefits under this Agreement to secured lenders of Parent, the Surviving Corporation or Acquisition Corp. Except as specifically set forth in clauses (ii) and (iii) above, neither Parent nor Acquisition Corp. may assign, delegate or otherwise transfer any of its rights or obligations under this Agreement without the prior written consent of the Company.

14.6. **Governing Law; Jurisdiction.** This Agreement has been entered into in the State of Texas. This Agreement shall be construed in accordance with and governed by the laws of the State of Texas, without giving effect to the conflict of laws principles thereof. Solely to the extent that the Parties hereto are permitted by the terms of this Agreement to pursue litigation or other legal processes, the parties hereto hereby irrevocably consent to the exclusive jurisdiction of the state, county and federal courts sitting in the City of San Antonio, County of Bexar, State of Texas in connection with any controversy or claim arising out of or relating to this Agreement, or the negotiation or breach thereof, and hereby waive any claim or defense that such forum is inconvenient or otherwise improper. Each party hereby agrees that any such court shall have in personam jurisdiction over it and consents to service of process in any manner authorized by Texas law.

14.7. **Counterparts; Effectiveness.** This Agreement may be signed by facsimile signatures and in any number of counterparts, each of which shall be an original and all of which shall be deemed to be one and the same instrument, with the same effect as if the signatures thereto and hereto were upon the same instrument.

14.8. **Entire Agreement.** This Agreement, together with the Schedules and the Exhibits attached hereto, constitutes the entire agreement among the parties with respect to the subject matter hereof and supersedes all prior agreements, understandings and negotiations, both written and oral, among the parties with respect to the subject matter of this Agreement. No representation, inducement, promise, understanding, condition or warranty not set forth herein has been made or relied upon by any party hereto. Neither this Agreement nor any provision hereof is intended to confer upon any Person other than the parties hereto any rights or remedies hereunder other than Indemnified Parties as set forth in ARTICLE XI hereof, which shall be third party beneficiaries hereof.

14.9. **Severability.** If any one or more provisions of this Agreement shall, for any reasons, be held to be invalid, illegal or unenforceable in any respect, such invalidity, illegality or unenforceability shall not affect any other provision of this Agreement, but this Agreement shall be construed as if such invalid, illegal or unenforceable provision had never been contained herein.

14.10. **Captions.** The captions herein are included for convenience of reference only and shall be ignored in the construction or interpretation hereof.

14.11. **Construction.** References in this Agreement to “Articles,” “Sections,” “Schedules” and “~~Exhibits~~” to the Articles, Sections, Schedules and Exhibits of this Agreement, unless otherwise specifically provided herein. All Schedules to this Agreement are incorporated herein by reference. Any use in this Agreement of the singular or plural, or the masculine, feminine or neuter gender, shall be deemed to include the others, unless the context otherwise requires. The words “herein”, “hereof” and “hereunder” and words of similar import, when used in this Agreement, shall refer to this Agreement as a whole and not to any particular provision of this Agreement. The word “including” when used in this Agreement shall mean “including without limitation”. Except as otherwise specified in this Agreement, all references in this Agreement (a) to any agreement, document, certificate or other written instrument shall be a reference to such agreement, document, certificate or instrument, in each case together with all exhibits, schedules, attachments and appendices thereto, and as amended, restated, supplemented or otherwise modified from time to time in accordance with the terms thereof; and (b) to any law, statute or regulation shall be deemed references to such law, statute or regulation as the same may be supplemented, amended, consolidated, superseded or modified from time to time.

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IN WITNESS WHEREOF, Parent, Acquisition Corp. and the Company have caused this Agreement to be duly executed by their respective authorized officers as of the day and year first above written.

ARGYLE SECURITY ACQUISITION CORP

By: /s/ Bob Marbut

Name: Bob Marbut
Title: Co-Chief Executive Officer

ISI SECURITY GROUP, INC.

By: /s/ Bob Marbut

Name: Bob Marbut
Title: President

ISI DETENTION CONTRACTING GROUP, INC.

By: /s/ Sam Youngblood

Name: Sam Youngblood
Title: Chief Executive Officer

List of Schedules

Schedule I - Security Holders of ISI

Schedule 2.9 - Distribution of merger consideration to ISI stockholders

Schedule 3.1(a) - Corporate Existence and Power - Jurisdiction

Schedule 3.1(b) - Corporate Existence and Power - Offices

Schedule 3.4 - Subsidiaries

Schedule 3.5 - Capitalization and Ownership

Schedule 3.6 - Affiliates

Schedule 3.7 - Assumed Names

Schedule 3.9 - Consents

Schedule 3.10(a) - Financial Statements

Schedule 3.10(b) - Liabilities Not Reflected on September 30, 2006 Balance Sheet

Schedule 3.10(f) - Location of Books and Records

Schedule 3.11(a) - Accounts Receivable

Schedule 3.11(b) - Bad Debts

Schedule 3.12(c) - Bank Accounts

Schedule 3.13(a) - Absence of Certain Changes

Schedule 3.14(a) - Real Estate

Schedule 3.15(a) - Tangible Assets

Schedule 3.15(b) - Liens existing on Company Tangible Assets after Closing

Schedule 3.16(a) - Intellectual Property

Schedule 3.16(b) - Intellectual Property

Schedule 3.16(c) - Intellectual Property

Schedule 3.16(f) - Intellectual Property

Schedule 3.16(g) - Intellectual Property

Schedule 3.17(a) - Relationships with Customers, Suppliers, Etc.

Schedule 3.17(b) - Relationships with Customers, Suppliers, Etc.

Schedule 3.17(c) - Relationships with Customers, Suppliers, Etc.

Schedule 3.17(d) - Relationships with Customers, Suppliers, Etc.

Schedule 3.18 - Litigation

Schedule 3.19(a) - Contracts

Schedule 3.19(b) - Contracts

Schedule 3.19(c) - Compliance

Schedule 3.20 - Licenses and Permits

Schedule 3.22 - Pre-Payments

Schedule 3.23 - Employees

Schedule 3.24 - Compliance with Labor Laws and Agreements

Schedule 3.25 - Pension and Benefit Plans

Schedule 3.26 - Employment Matters

Schedule 3.27(a) - Compliance

Schedule 3.27(b) - No Audit

Schedule 3.28 - Fees

Schedule 3.29(b) - Business Operations; Servers

Schedule 3.29(c) - Business Operations; Servers

Schedule 3.29(d) - Business Operations; Servers

Schedule 3.30 - Powers of Attorney and Suretyships

Schedule 5.1 - Foreign Jurisdictions

Schedule 5.8 - Fees

Schedule 5.10 - Capitalization and Ownership

Schedule 6.1(h) - Indebtedness

Schedule 8.7 - Persons with Whom Employment Agreements will be Negotiated after the Effective Time

Schedule 9.3(c) - List of Employees to be eligible to Participate in Plan

A-97

PART II

INFORMATION NOT REQUIRED IN PROSPECTUS

ITEM 20. INDEMNIFICATION OF DIRECTORS AND OFFICERS

Our second amended and restated certificate of incorporation provides that all directors, officers, employees and agents of the registrant shall be entitled to be indemnified by Argyle to the fullest extent permitted by Section 145 of the Delaware General Corporation Law.

Section 145 of the Delaware General Corporation Law concerning indemnification of officers, directors, employees and agents is set forth below.

“Section 145. Indemnification of officers, directors, employees and agents; insurance.

“(a) A corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of the corporation) by reason of the fact that the person is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses (including attorneys’ fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by the person in connection with such action, suit or proceeding if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe the person’s conduct was unlawful. The termination of any action, suit or proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent, shall not, of itself, create a presumption that the person did not act in good faith and in a manner which the person reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had reasonable cause to believe that the person’s conduct was unlawful.

“(b) A corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action or suit by or in the right of the corporation to procure a judgment in its favor by reason of the fact that the person is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against expenses (including attorneys’ fees) actually and reasonably incurred by the person in connection with the defense or settlement of such action or suit if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation and except that no indemnification shall be made in respect of any claim, issue or matter as to which such person shall have been adjudged to be liable to the corporation unless and only to the extent that the Court of Chancery or the court in which such action or suit was brought shall determine upon application that, despite the adjudication of liability but in view of all the circumstances of the case, such person is fairly and reasonably entitled to indemnity for such expenses which the Court of Chancery or such other court shall deem proper.

“(c) To the extent that a present or former director or officer of a corporation has been successful on the merits or otherwise in defense of any action, suit or proceeding referred to in subsections (a) and (b) of this section, or in defense of any claim, issue or matter therein, such person shall be indemnified against expenses (including attorneys’ fees) actually and reasonably incurred by such person in connection therewith.

“(d) Any indemnification under subsections (a) and (b) of this section (unless ordered by a court) shall be made by the corporation only as authorized in the specific case upon a determination that indemnification of the present or former director, officer, employee or agent is proper in the circumstances because the person has met the applicable standard

of conduct set forth in subsections (a) and (b) of this section. Such determination shall be made, with respect to a person who is a director or officer at the time of such determination, (1) by a majority vote of the directors who are not parties to such action, suit or proceeding, even though less than a quorum, or (2) by a committee of such directors designated by majority vote of such directors, even though less than a quorum, or (3) if there are no such directors, or if such directors so direct, by independent legal counsel in a written opinion, or (4) by the stockholders.

II-1

“(e) Expenses (including attorneys’ fees) incurred by an officer or director in defending any civil, criminal, administrative or investigative action, suit or proceeding may be paid by the corporation in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of such director or officer to repay such amount if it shall ultimately be determined that such person is not entitled to be indemnified by the corporation as authorized in this section. Such expenses (including attorneys’ fees) incurred by former directors and officers or other employees and agents may be so paid upon such terms and conditions, if any, as the corporation deems appropriate.

“(f) The indemnification and advancement of expenses provided by, or granted pursuant to, the other subsections of this section shall not be deemed exclusive of any other rights to which those seeking indemnification or advancement of expenses may be entitled under any bylaw, agreement, vote of stockholders or disinterested directors or otherwise, both as to action in such person’s official capacity and as to action in another capacity while holding such office.

“(g) A corporation shall have power to purchase and maintain insurance on behalf of any person who is or was director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against any liability asserted against such person and incurred by such person in any such capacity, or arising out of such person’s status as such, whether or not the corporation would have the power to indemnify such person against such liability under this section.

“(h) For purposes of this section, references to (the corporation) shall include, in addition to the resulting corporation, any constituent corporation (including any constituent of a constituent) absorbed in a consolidation or merger which, if its separate existence had continued, would have had power and authority to indemnify its directors, officers, and employees or agents, so that any person who is or was a director, officer, employee or agent of such constituent corporation, or is or was serving at the request of such constituent corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, shall stand in the same position under this section with respect to the resulting or surviving corporation as such person would have with respect to such constituent corporation if its separate existence had continued.

“(i) For purposes of this section, references to (other enterprises) shall include employee benefit plans; references to “fines” shall include any excise taxes assessed on a person with respect to any employee benefit plan; and references to “serving at the request of the corporation” shall include any service as a director, officer, employee or agent of the corporation which imposes duties on, or involves services by, such director, officer, employee or agent with respect to an employee benefit plan, its participants or beneficiaries; and a person who acted in good faith and in a manner such person reasonably believed to be in the interest of the participants and beneficiaries of an employee benefit plan shall be deemed to have acted in a manner “not opposed to the best interests of the corporation” as referred to in this section.

“(j) The indemnification and advancement of expenses provided by, or granted pursuant to, this section shall, unless otherwise provided when authorized or ratified, continue as to a person who has ceased to be a director, officer, employee or agent and shall inure to the benefit of the heirs, executors and administrators of such a person.

“(k) The Court of Chancery is hereby vested with exclusive jurisdiction to hear and determine all actions for advancement of expenses or indemnification brought under this section or under any bylaw, agreement, vote of stockholders or disinterested directors, or otherwise. The Court of Chancery may summarily determine a corporation’s obligation to advance expenses (including attorneys’ fees).”

Paragraph B of Article Eighth of our amended and restated certificate of incorporation provides:

“The Corporation, to the full extent permitted by Section 145 of the GCL, as amended from time to time, shall indemnify all persons whom it may indemnify pursuant thereto. Expenses (including attorneys’ fees) incurred by an

officer or director in defending any civil, criminal, administrative, or investigative action, suit or proceeding for which such officer or director may be entitled to indemnification hereunder shall be paid by the Corporation in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of such director or officer to repay such amount if it shall ultimately be determined that he is not entitled to be indemnified by the Corporation as authorized hereby.”

II-2

Insofar as indemnification for liabilities arising under the Securities Act may be permitted to our directors, officers, and controlling persons pursuant to the foregoing provisions, or otherwise, we have been advised that in the opinion of the SEC such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment of expenses incurred or paid by a director, officer or controlling person in a successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, we will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to the court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

ITEM 21. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) Exhibits

Exhibit	Description
2.1	Merger Agreement dated December 8, 2006 by and among the Registrant, ISI Security, Inc and ISI Detention Contracting Group, Inc. (Included as Annex D to the proxy statement/prospectus)
3.1	Registrant's Certificate of Incorporation, as amended, as currently in effect(1)
3.2	Registrant's Bylaws as currently in effect(1)
4.1	Specimen Unit Certificate(1)
4.2	Specimen Common Stock Certificate(1)
4.3	Specimen Warrant Certificate(1)
4.4	Form of Warrant Agreement between American Stock Transfer & Trust Company and the Registrant(1)
4.5	Form of Unit Purchase Option to be granted to Rodman & Renshaw, LLC(2)
5.1	Opinion of Loeb & Loeb LLP
10.1	Form of Letter Agreement among the Registrant, Rodman & Renshaw, LLC and Argyle Joint Venture(1)
10.2	Form of Letter Agreement among the Registrant, Rodman & Renshaw, LLC and Argyle New Ventures L.P.(1)
10.3	Form of Letter Agreement among the Registrant, Rodman & Renshaw, LLC and John J. Smith(1)
10.4	Form of Letter Agreement among the Registrant, Rodman & Renshaw, LLC and Ron Chaimovski(1)
10.5	Form of Letter Agreement among the Registrant, Rodman & Renshaw, LLC and Bob Marbut(1)
10.6	Form of Letter Agreement among the Registrant, Rodman & Renshaw, LLC and Wesley Clark(1)
10.7	Form of Investment Management Trust Agreement between American Stock Transfer & Trust Company and the Registrant(1)
10.8	Form of Stock Escrow Agreement between the Registrant, American Stock Transfer & Trust Company and the pre-offering stockholders(1)
10.9	Form of Registration Rights Agreement among the Registrant and the pre-offering stockholders(1)
10.10	Form of Voting Agreement by John J. Smith and Wesley Clark(1)
10.11	Lease between the Company and Frost National Bank, Trustee For A Designated Trust(3)
10.12	Form of Lock-up Agreement for preferred stockholders of ISI**
10.13	Form of Lock-up Agreement for the other stockholders of ISI**

- 23.1 Consent of Goldstein Golub Kessler LLP.
- 23.2 Consent of Padgett, Stratemann & Co., L.L.P.
- 23.3 Consent of Loeb & Loeb LLP (included in Exhibit 5.1)
- 99.1 Letter to SEC dated February 12, 2007

* To be filed by amendment.

** Previously filed.

- (1) Incorporated by reference to the Registrant's Registration Statement on Form S-1 (File No. 333-124601).
- (2) Incorporated by reference to the Registrant's Current Report on Form 8-K dated January 30, 2006.
- (3) Incorporated by reference to the Registrant's Current Report on Form 8-K dated April 20, 2006.

(b) Financial Statement Schedules

None.

II-3

ITEM 22. UNDERTAKINGS

Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers and controlling persons of the registrant pursuant to the foregoing provisions, or otherwise, the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such Director, officer or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Act and will be governed by the final adjudication of such issue.

The undersigned registrant hereby undertakes as follows: that prior to any public reoffering of the securities registered hereunder through use of a prospectus which is a part of this registration statement, by any person or party who is deemed to be an underwriter within the meaning of Rule 145(c), the issuer undertakes that such reoffering prospectus will contain the information called for by the applicable registration form with respect to reofferings by persons who may be deemed underwriters, in addition to the information called for by the other Items of the applicable form.

The registrant undertakes that every prospectus (i) that is filed pursuant to the immediately preceding paragraph, or (ii) that purports to meet the requirements of Section 10(a)(3) of the Act and is used in connection with an offering of securities subject to Rule 415, will be filed as a part of an amendment to the registration statement and will not be used until such amendment is effective, and that, for purposes of determining any liability under the Securities Act of 1933, each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

The undersigned registrant hereby undertakes to respond to requests for information that is incorporated by reference into the prospectus pursuant to Item 4, 10(b), 11, or 13 of this form, within one business day of receipt of such request, and to send the incorporated documents by first class mail or other equally prompt means. This includes information contained in documents filed subsequent to the effective date of the registration statement through the date of responding to the request.

The undersigned registrant hereby undertakes to supply by means of a post-effective amendment all information concerning a transaction, and the company being acquired involved therein, that was not the subject of and included in the registration statement when it became effective.

SIGNATURES

Pursuant to the requirements of the Securities Act, the registrant has duly caused this registration statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of San Antonio, State of Texas, on the 12th day of February, 2007.

ARGYLE SECURITY ACQUISITION CORPORATION

By: /s/ Bob Marbut

 Name: Bob Marbut
 Title: Chairman and Co-Chief Executive Officer

Pursuant to the requirements of the Securities Act of 1933, this registration statement has been signed by the following persons in the capacities and on the dates indicated.

Name	Title	Date
/s/ Bob Marbut _____ Bob Marbut	Chairman of the Board and Co-Chief Executive Officer (Principal accounting and financial officer)	February 12, 2007
/s/ Ron Chaimovski _____ Ron Chaimovski	Vice-Chairman of the Board and Co-Chief Executive Officer (Principal Executive Officer)	February 12, 2007
/s/ Wesley Clark _____ Wesley Clark	Director	February 12, 2007
/s/ John J. Smith _____ John J. Smith	Director	February 12, 2007

FOLD AND DETACH HERE AND READ THE REVERSE SIDE

PROXY

**ARGYLE SECURITY ACQUISITION CORPORATION
200 CONCORD PLAZA, SUITE 700
SAN ANTONIO, TX 78216**

SPECIAL MEETING OF STOCKHOLDERS

THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS

OF ARGYLE SECURITY ACQUISITION CORPORATION

The undersigned appoints _____ and _____, and each of them with full power to act without the other, as proxies, each with the power to appoint a substitute, and thereby authorizes either of them to represent and to vote, as designated on the reverse side, all shares of common stock of Argyle held of record by the undersigned on _____, 2007 at the Special Meeting of Stockholders to be held on _____, 2007, and any postponement or adjournment thereof.

THIS PROXY REVOKES ALL PRIOR PROXIES GIVEN BY THE UNDERSIGNED.

THIS PROXY WILL BE VOTED AS DIRECTED. IF NO DIRECTIONS ARE GIVEN WITH RESPECT TO A PROPOSAL, THIS PROXY WILL BE VOTED "FOR" THE PROPOSAL. ARGYLE'S BOARD OF DIRECTORS RECOMMENDS A VOTE "FOR" THE PROPOSALS SHOWN ON THE REVERSE SIDE.

(Continued and to be signed on reverse side)

P-1

FOLD AND DETACH HERE AND READ THE REVERSE SIDE

PROXY

THIS PROXY WILL BE VOTED AS DIRECTED. IF NO DIRECTIONS ARE GIVEN WITH RESPECT TO A PROPOSAL, THIS PROXY WILL BE VOTED “FOR” THE PROPOSAL. ARGYLE’S BOARD OF DIRECTORS RECOMMENDS A VOTE “FOR” EACH OF THE PROPOSALS.

1. To approve the merger of a wholly-owned subsidiary of Argyle into ISI, resulting in ISI becoming a wholly-owned subsidiary of Argyle and the transactions contemplated by the merger agreement dated December 8, 2006 among Argyle, the wholly-owned subsidiary of Argyle, and ISI.

FOR **AGAINST** **ABSTAIN**

Only if you voted “AGAINST” Proposal Number 1 and you hold shares of Argyle common stock issued in its initial public offering, you may exercise your redemption rights and demand that Argyle redeem your shares of common stock into a pro rata portion of the trust account by marking the “Exercise Redemption Rights” box below. If you exercise your redemption rights, then you will be exchanging your shares of Argyle common stock for cash and will no longer own these shares. You will only be entitled to receive cash for these shares if the merger is completed and you continue to hold these shares through the effective time of the merger and tender your stock certificate to the combined company after consummation of the merger.

EXERCISE REDEMPTION RIGHTS

2. To approve the adoption of Argyle’s 2007 Omnibus Securities and Incentive Plan, which provides for the grant of up to 1,000,000 shares of Argyle’s common stock or cash equivalents to directors, officers, employees and/or consultants of Argyle and its subsidiaries.

FOR **AGAINST** **ABSTAIN**

3. To approve an amendment to Argyle’s Second Amended and Restated Certificate of Incorporation changing its corporate name to “Argyle Security, Inc.”

FOR **AGAINST** **ABSTAIN**

4. To approve an amendment to Argyle’s Second Amended and Restated Certificate of Incorporation to remove those provisions of

FOR **AGAINST** **ABSTAIN**

Article Sixth regarding certain procedural and approval requirements applicable to Argyle prior to the combination of a business combination that will no longer be operative upon consummation of the merger.

5. To approve any adjournment or postponement of the special meeting for the purpose of soliciting additional proxies.

FOR
..

AGAINST
..

ABSTAIN
..

**MARK HERE FOR ADDRESS CHANGE
AND NOTE AT LEFT**

..

P-2

PLEASE MARK, DATE AND RETURN THIS PROXY PROMPTLY.

Signature

Signature

Date

Sign exactly as name appears on this proxy card. If shares are held jointly, each holder should sign. Executors, administrators, trustees, guardians, attorneys and agents should give their full titles. If stockholder is a corporation, sign in full name by an authorized officer.

P-3
