

COMMAND SECURITY CORP  
Form 10-Q  
February 12, 2013

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

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

For the quarterly period ended December 31, 2012

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 001-33525

**COMMAND SECURITY CORPORATION**

(Exact name of registrant as specified in its charter)

**New York**

*(State or other jurisdiction of incorporation or organization)*

**14-1626307**

*(I.R.S. Employer Identification No.)*

**1133 Route 55, Suite D, Lagrangeville, New York**

*(Address of principal executive offices)*

**12540**

*(Zip Code)*

**(845) 454-3703**

*(Registrant's telephone number, including area code)*

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definition of "accelerated filer," "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

1 company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

The number of outstanding shares of the registrant's common stock as of February 1, 2013 was 8,989,298.

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**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****COMMAND SECURITY CORPORATION****CONDENSED STATEMENTS OF INCOME****(Unaudited)**

|  | Three Months Ended |              | Three Months Ended |               |
|--|--------------------|--------------|--------------------|---------------|
|  | December           | December     | December 31,       | December 31,  |
|  | 31,                | 31,          | December 31,       | December 31,  |
|  | 2012               | 2011         | 2012               | 2011          |
| Revenues                                 | \$38,930,273       | \$35,784,511 | \$112,736,873      | \$106,678,724 |
| Cost of revenues                         | 33,922,021         | 31,256,017   | 97,815,567         | 92,411,427    |
| Gross profit                             | 5,008,252          | 4,528,494    | 14,921,306         | 14,267,297    |
| Operating expenses                       |                    |              |                    |               |
| General and administrative               | 4,188,517          | 3,983,518    | 12,748,838         | 11,982,515    |
| Provision for doubtful accounts, net     | 74,434             | 75,112       | 221,448            | 152,757       |
|  | 4,262,951          | 4,058,630    | 12,970,286         | 12,135,272    |
| Operating income                         | 745,301            | 469,864      | 1,951,020          | 2,132,025     |
| Interest income                          | 35                 | 31           | 120                | 91            |
| Interest expense                         | (36,688)           | (53,561)     | (99,149)           | (196,636)     |
| Loss on sale of investment               | --                 | (2,137)      | --                 | (2,015)       |
| Equipment dispositions                   | --                 | --           | 7,203              | 4,915         |
| Income before provision for income taxes | 708,648            | 414,197      | 1,859,194          | 1,938,380     |
| Provision for income taxes               | 355,000            | 197,000      | 945,000            | 992,000       |
| Net income                               | 353,648            | 217,197      | 914,194            | 946,380       |

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|  |           |            |           |            |
|--|-----------|------------|-----------|------------|
| Other comprehensive income (loss):                       |           |            |           |            |
| Unrealized gain (loss) on available for sale securities  | --        | 23,590     | --        | (43,494 )  |
| Net gain (loss) recognized in other comprehensive income | --        | 23,590     | --        | (43,494 )  |
| Total comprehensive income                               | \$353,648 | \$240,787  | \$914,194 | \$902,886  |
| Net income per common share                              |           |            |           |            |
| Basic  | \$.04     | \$.02      | \$.10     | \$.09      |
| Diluted  | \$.04     | \$.02      | \$.10     | \$.09      |
| Weighted average number of common shares outstanding     |           |            |           |            |
| Basic  | 9,475,702 | 10,855,331 | 9,602,899 | 10,870,509 |
| Diluted  | 9,582,022 | 10,952,424 | 9,638,339 | 10,966,603 |

*See accompanying notes to condensed financial statements*

**COMMAND SECURITY CORPORATION****CONDENSED BALANCE SHEETS****ASSETS**

|  | December<br>31,<br>2012<br>(Unaudited) | March 31,<br>2012 |
|--|--|-------------------|
| Current assets:  |  |                   |
| Cash and cash equivalents  | \$9,544                                | \$1,175,809       |
| Accounts receivable, net of allowance for doubtful accounts of \$684,866 and \$582,510, respectively | 25,544,662                             | 20,608,677        |
| Prepaid expenses   | 1,210,290                              | 1,744,425         |
| Other assets   | 2,154,736                              | 2,662,904         |
| Total current assets   | 28,919,232                             | 26,191,815        |
| <br>Furniture and equipment at cost, net   | <br>578,085                            | <br>385,664       |
| Other assets:  |  |                   |
| Intangible assets, net   | 2,663,026                              | 3,391,821         |
| Restricted cash  | 83,088                                 | 83,023            |
| Other assets   | 3,403,814                              | 2,989,360         |
| Total other assets   | 6,149,928                              | 6,464,204         |
| <br>Total assets   | <br>\$35,647,245                       | <br>\$33,041,683  |

**LIABILITIES AND STOCKHOLDERS' EQUITY**

|  |               |             |
|--|---------------|-------------|
| Current liabilities:                         |               |             |
| Checks issued in advance of deposits         | \$506,776     | \$884,095   |
| Short-term borrowings                        | 6,834,279     | 6,830,951   |
| Accounts payable                             | 1,221,824     | 997,605     |
| Accrued expenses and other liabilities       | 8,777,732     | 6,523,070   |
| Total current liabilities                    | 17,340,611    | 15,235,721  |
| <br>Insurance reserves                       | <br>1,088,999 | <br>576,342 |
| Total liabilities                            | 18,429,610    | 15,812,063  |
| Stockholders' equity:                        |               |             |
| Preferred stock, Series A, \$.0001 par value | --            | --          |
| Common stock, \$.0001 par value              | 1,074         | 1,074       |

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|  |              |              |
|--|--------------|--------------|
| Treasury stock, at cost                    | (2,885,579 ) | (1,788,505 ) |
| Additional paid-in capital                 | 16,839,413   | 16,668,518   |
| Accumulated earnings                       | 3,262,727    | 2,348,533    |
| Total stockholders' equity                 | 17,217,635   | 17,229,620   |
| Total liabilities and stockholders' equity | \$35,647,245 | \$33,041,683 |

*See accompanying notes to condensed financial statements*



## COMMAND SECURITY CORPORATION

## CONDENSED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(Unaudited)

|  | Preferred<br>Stock | Treasury<br>Stock | Common<br>Stock | Accumulated<br>Other<br>Comprehensive<br>Loss | Additional<br>Paid-In<br>Capital | Accumulated<br>Earnings |
|--|--------------------|-------------------|-----------------|---|----------------------------------|-------------------------|
| Balance at March 31, 2011  | \$ --              | \$--              | \$ 1,087        | \$ (174,571 )                                 | \$ 16,718,779                    | \$ 2,207,773            |
| Stock compensation cost  |                    |                   |                 |   | 142,745                          |                         |
| Other comprehensive loss (a)   |                    |                   |                 | (43,494 )                                     |                                  |                         |
| Repurchase and retirement of shares  |                    |                   | (13 )           |   | (210,990 )                       |                         |
| Net income – nine months ended<br>December 31, 2011                                    |                    |                   |                 | --  | --                               | 946,380                 |
| Balance at December 31, 2011   | --                 | --                | 1,074           | (218,065 )                                    | 16,650,534                       | 3,154,153               |
| Common stock repurchased   |                    | (1,788,505)       |                 |   |                                  |                         |
| Stock compensation cost  |                    |                   |                 |   | 17,984                           |                         |
| Unrealized gain and reclassification<br>adjustment on available for sale<br>securities |                    |                   |                 | 218,065                                       |                                  |                         |
| Net loss – three months ended March<br>31, 2012  |                    |                   |                 |   |                                  | (805,620 )              |
| Balance at March 31, 2012  | --                 | (1,788,505)       | 1,074           | --  | 16,668,518                       | 2,348,533               |
| Common stock repurchased   |                    | (1,097,074)       |                 |   |                                  |                         |
| Stock compensation cost  |                    |                   |                 |   | 170,895                          |                         |
| Net income – nine months ended<br>December 31, 2012                                    |                    |                   |                 |   |                                  | 914,194                 |

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|                              |       |               |          |       |               |              |
|------------------------------|-------|---------------|----------|-------|---------------|--------------|
| Balance at December 31, 2012 | \$ -- | \$(2,885,579) | \$ 1,074 | \$ -- | \$ 16,839,413 | \$ 3,262,727 |
|------------------------------|-------|---------------|----------|-------|---------------|--------------|

(a) – Represents unrealized loss on marketable securities.

*See accompanying notes to condensed financial statements*

## COMMAND SECURITY CORPORATION

## CONDENSED STATEMENTS OF CASH FLOWS

(Unaudited)

|   | Nine months ended<br>December 31, |             |
|---|-----------------------------------|-------------|
|   | 2012                              | 2011        |
| Cash flow from operating activities:  |                                   |             |
| Net income  | \$914,194                         | \$946,380   |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                   |             |
| Depreciation and amortization   | 503,425                           | 635,319     |
| Provision for doubtful accounts, net  | 102,356                           | 321,854     |
| Gain on asset dispositions  | (7,203 )                          | (4,915 )    |
| Loss on sale of investments   | --                                | 2,015       |
| Stock based compensation costs  | 170,895                           | 142,745     |
| Insurance reserves  | 512,657                           | (111,622 )  |
| Deferred income taxes   | (464,738 )                        | (169,252 )  |
| Restricted cash   | (65 )                             | (34 )       |
| (Increase) decrease in receivables, prepaid expenses and other current assets     | (3,205,665 )                      | 706,763     |
| Increase (decrease) in accounts payable and other current liabilities             | 2,478,881                         | (2,259,460) |
| Net cash provided by operating activities   | 1,004,737                         | 209,793     |
| Cash flows from investing activities:   |                                   |             |
| Purchases of equipment  | (367,209 )                        | (53,445 )   |
| Collection on other receivable  | 258,681                           | --          |
| Return of escrow funds related to prior business acquisition                      | 398,946                           | --          |
| Proceeds from sales of marketable securities                                      | --                                | 68,248      |
| Proceeds from asset dispositions  | 8,415                             | 8,641       |
| Net cash provided by investing activities   | 298,833                           | 23,444      |
| Cash flows from financing activities:   |                                   |             |
| Net repayments on short-term borrowings   | (995,442 )                        | (4,181,455) |
| (Decrease) increase in checks issued in advance of deposits                       | (377,319 )                        | 750,319     |
| Repurchase and retirement of shares   | (1,097,074)                       | (211,003 )  |
| Principal payments on capital lease obligations                                   | --                                | (43,235 )   |
| Net cash used in financing activities   | (2,469,835)                       | (3,685,374) |
| Net change in cash and cash equivalents   | (1,166,265)                       | (3,452,137) |
| Cash and cash equivalents, beginning of period                                    | 1,175,809                         | 3,463,461   |
| Cash and cash equivalents, end of period  | \$9,544                           | \$11,324    |

*See accompanying notes to condensed financial statements*

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**COMMAND SECURITY CORPORATION**

**CONDENSED STATEMENTS OF CASH FLOWS**

**(Unaudited)**

Supplemental Disclosures of Cash Flow Information

| Cash paid during the nine months ended December 31 for: | 2012     | 2011      |
|---|----------|-----------|
| Interest  | \$97,673 | \$208,784 |
| Income taxes  | 774,550  | 872,536   |

Supplemental Schedule of Non-Cash Investing and Financing Activities

The Company may obtain short-term premium financing to assist with meeting its annual property and casualty insurance needs. For the nine months ended December 31, 2012 and 2011, \$998,770 and \$3,644,447, respectively, was financed for this purpose. These insurance premium financings have been excluded from the condensed statements of cash flows presented.

During the nine months ended December 31, 2011, the Company received \$73,902 in marketable securities related principally to the bankruptcy filing of a securities services customer. This amount has been excluded from operating activities on the condensed statements of cash flows presented.

*See accompanying notes to condensed financial statements*

**COMMAND SECURITY CORPORATION**

**NOTES TO CONDENSED FINANCIAL STATEMENTS**

**(Unaudited)**

The accompanying condensed financial statements presented herein have not been audited, and have been prepared in accordance with the instructions to Form 10-Q which do not include all of the information and note disclosures required by generally accepted accounting principles in the United States. These financial statements should be read in conjunction with our consolidated financial statements and notes thereto as of and for the fiscal year ended March 31, 2012. In this discussion, the words "Company," "we," "our," "us" and terms of similar import should be deemed to refer to Command Security Corporation.

The condensed financial statements for the interim period shown in this report are not necessarily indicative of our results to be expected for any period after the date hereof, including for the fiscal year ending March 31, 2013 or for any subsequent period. In the opinion of our management, the accompanying condensed financial statements reflect all adjustments, consisting of only normal recurring adjustments, other than the adjustments for relocation expenses as noted, considered necessary for a fair presentation of the financial statements included in this quarterly report. Except for the relocation expenses, all such adjustments are of a normal recurring nature.

1. Recent Accounting Pronouncements

In December 2011, the FASB issued updated authoritative guidance related to new disclosure requirements on offsetting financial assets and liabilities. The new rules require companies to disclose both gross and net information about instruments and transactions eligible for offset in the balance sheet as well as instruments and transactions subject to a netting arrangement. The updated authoritative guidance is effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. We are currently evaluating the potential impact, if any, of the adoption of this updated authoritative guidance on our financial statement disclosures.

In September 2011, the FASB issued ASU 2011-08, Testing Goodwill for Impairment. ASU 2011-08 provides entities with an option to perform a qualitative assessment to determine whether further impairment testing is necessary. ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. This standard is not expected to have a significant impact on our financial statements.

In June 2011, the FASB issued guidance to amend the presentation of comprehensive income to allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. The guidance eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. This guidance is effective for interim and annual periods beginning after December 15, 2011, and is required to be applied retrospectively. We have included such disclosures in the accompanying financial statements.

2.

Short-Term Borrowings:

On February 12, 2009, we entered into a \$20,000,000 credit facility (the "Credit Agreement") with Wells Fargo Bank, National Association ("Wells Fargo"). This credit facility, which was amended in October 2011 and November 2012 as described below, matures in October 2016, contains customary affirmative and negative covenants, including, among other things, covenants requiring us to maintain certain financial ratios and is collateralized by customer accounts receivable and certain other assets of the Company as defined in the Credit Agreement.

**COMMAND SECURITY CORPORATION**

**NOTES TO CONDENSED FINANCIAL STATEMENTS**

**(Unaudited)**

The Credit Agreement provides for a letter of credit sub-line in an aggregate amount of up to \$3,000,000. The Credit Agreement also provided for interest to be calculated on the outstanding principal balance of the revolving loans at the prime rate (as defined in the Credit Agreement) plus 1.50%. For LIBOR loans, interest will be calculated on the outstanding principal balance of the LIBOR loans at the LIBOR rate (as defined in the Credit Agreement) plus 2.75% (see below).

On October 18, 2011, the Company entered into an amendment (the "Amendment") to its Credit Agreement. The Amendment (i) extends the term of the \$20,000,000 Credit Agreement to October 2016, (ii) decreases the interest rate spreads on the outstanding principal balance of the revolving loans to LIBOR plus 1.75% and amends certain covenants including: (a) increasing the amount of capital expenditures that can be incurred in the aggregate during any fiscal year or in any one transaction and (b) permitting the Company to repurchase up to \$2,000,000 of its common stock subject to certain conditions.

On November 6, 2012, the Company entered into an amendment to its Credit Agreement (the "Subsequent Amendment"). The Subsequent Amendment (i) allows for the Company to repurchase up to an additional \$2,000,000 of its common stock, subject to certain conditions; (ii) provides for the consent of Wells Fargo to the consolidation and relocation of the Company's headquarters and (iii) amends a financial covenant of the Credit Agreement for certain expenses associated with the consolidation and relocation of the Company's headquarters.

As of December 31, 2012, the interest rates were 2.00% and 2.125% for LIBOR and revolving loans, respectively. At December 31, 2012, we had \$5,500,000 and \$533,735 in LIBOR and revolving loans, respectively, and \$172,540 under our letters of credit sub-line outstanding under the Credit Agreement, representing approximately 39% of the maximum borrowing capacity under the Credit Agreement based on our "eligible accounts receivable" (as defined under the Credit Agreement) as of such date.

We rely on our revolving loan from Wells Fargo, which contains a fixed charge covenant and various other financial and non-financial covenants. If we breach a covenant, Wells Fargo has the right to immediately request the repayment in full of all borrowings under the Credit Agreement, unless Wells Fargo waives the breach. For the nine months ended December 31, 2012, we were in compliance with all covenants under the Credit Agreement.



We may obtain short-term financing to meet our annual property and casualty insurance needs. For the nine months ended December 31, 2012, \$998,770 was financed for this purpose and, at December 31, 2012, we had \$800,544 of short-term insurance borrowings outstanding.

3.

Other Assets:

| Other assets consist of the following: | December<br>31,<br>2012 | March 31,<br>2012 |
|--|-------------------------|-------------------|
| Workers' compensation insurance        | \$2,148,736             | \$2,397,723       |
| Other receivables                      | --                      | 258,681           |
| Security deposits                      | 205,936                 | 196,982           |
| Deferred tax asset                     | 3,193,769               | 2,729,032         |
| Other                                  | 10,109                  | 69,846            |
|  | 5,558,550               | 5,652,264         |
| Current portion                        | (2,154,736)             | (2,662,904)       |
| Total                                  | \$3,403,814             | \$2,989,360       |

**COMMAND SECURITY CORPORATION****NOTES TO CONDENSED FINANCIAL STATEMENTS****(Unaudited)**4. Accrued Expenses and Other Liabilities:

| Accrued expenses and other liabilities consist of the following: | December<br>31,<br>2012 | March 31,<br>2012  |
|--|-------------------------|--------------------|
| Payroll and related expenses                                     | \$7,612,955             | \$5,343,982        |
| Taxes and fees payable   | 602,137                 | 486,726            |
| Accrued interest payable   | 8,260                   | 7,339              |
| Other  | 554,380                 | 685,023            |
| <b>Total</b>   | <b>\$8,777,732</b>      | <b>\$6,523,070</b> |

5. Insurance Reserves:

We have an insurance policy covering workers' compensation claims in states where we perform services. Estimated accrued liabilities are based on our historical loss experience and the ratio of claims paid to our historical payout profiles. Charges for estimated workers' compensation related losses incurred and included in cost of sales were \$753,633 and \$578,777 and \$2,178,737 and \$1,791,694 for the three and nine months ended December 31, 2012 and 2011, respectively.

The nature of our business also subjects us to claims or litigation alleging that we are liable for damages as a result of the conduct of our employees or others. We insure against such claims and suits through general liability policies with third-party insurance companies. As of December 31, 2012, our insurance coverage limits were \$1,000,000 per occurrence for non-aviation related business (with additional excess umbrella and excess liability policies with a total of \$15,000,000) and \$30,000,000 per occurrence for aviation related business. We retain the risk for the first \$25,000 per occurrence on the non-aviation related policy and \$5,000 on the aviation related policy except for \$25,000 for damage to aircraft (with a \$1,000,000 annual aggregate), \$50,000 for wheelchairs and electric carts, and \$100,000 for skycap operations. Estimated accrued liabilities are based on specific reserves in connection with existing claims as determined by third party risk management consultants and actuarial factors and the timing of reported claims. These are all factored into estimated losses incurred but not yet reported to us.

Cumulative amounts estimated to be payable by us with respect to pending and potential claims for all years in which we are liable under our general liability retention and workers' compensation policies have been accrued as liabilities. Such accrued liabilities are necessarily based on estimates; accordingly, our ultimate liability may exceed or be less than the amounts accrued. The methods of making such estimates and establishing the resultant accrued liability are reviewed continually and any adjustments resulting therefrom are reflected in our current results of operations.

6. Net Income per Common Share:

Under the requirements of FASB ASC 260-10, *Earnings Per Share*, the dilutive effect of our common shares that have not been issued, but that may be issued upon the exercise or conversion, as the case may be, of rights or options to acquire such common shares, is excluded from the calculation for basic earnings per share. Diluted earnings per share reflects the additional dilution that would result from the issuance of our common shares if such rights or options were exercised or converted, as the case may be, and is presented for the three and nine months ended December 31, 2012 and 2011.

**COMMAND SECURITY CORPORATION**

**NOTES TO CONDENSED FINANCIAL STATEMENTS**

**(Unaudited)**

7.

Contingencies:

The nature of our business is such that there is a significant volume of routine claims and lawsuits that are made against us, the vast majority of which never lead to the award of substantial damages. We maintain general liability and workers' compensation insurance coverage that we believe is appropriate to the relevant level of risk and potential liability that we face, relating to these matters. Some of the claims brought against us could result in significant payments; however, effective as of October 1, 2012, the exposure to us under general liability is limited to the first \$25,000 per occurrence on the non-aviation related claims and \$5,000 per occurrence on the aviation related claims except for \$25,000 for damage to aircraft (with a \$1,000,000 annual aggregate), \$50,000 for damage to wheelchairs and electric carts, and \$100,000 for skycap operations. Any punitive damage award would not be covered by the general liability insurance policy. The only other potential impact would be on future premiums, which may be adversely affected by an unfavorable claims history.

In addition to such cases, we have been named as a defendant in several uninsured employment related claims that are pending before various courts, the Equal Employment Opportunities Commission or various state and local agencies. We have instituted policies to minimize these occurrences and monitor those that do occur. At this time, we are unable to determine the impact on the financial position and results of operations that these claims may have, should the investigations conclude that they are valid.

We have employment agreements with certain of our officers and key employees with terms which range from one to three years. The agreements generally provide for annual salaries and for salary continuation for a specified number of months under certain circumstances, including a change in control of the Company.

In connection with the bankruptcy proceedings of one of our customers, on April 11, 2012, an action was filed against the Company in the United States Bankruptcy Court for Southern District of New York seeking the return of alleged preference payments made to the Company by the bankruptcy debtor in the amount of \$774,128. On May 17, 2012, the Company filed an answer and affirmative defenses. The Company intends to conduct a vigorous defense of this case.

The Company entered into an office lease agreement (the "Lease") with FP Van Buren, LLC, a Delaware limited liability company (the "Lessor"), to lease approximately 10,435 square feet of office space (the "Premises") located at 512 Herndon Parkway, Herndon, Virginia. The Company plans to use the Premises as its new corporate headquarters. The term of the Lease is for a period of twelve (12) years which commenced on January 14, 2013, and expires on January 31, 2025, unless earlier terminated pursuant to the Lease. The Lease provides for monthly payments of rent during the Term as set forth in the Lease. No rent will be due during the first twelve months of the Term. Rent shall be \$17.95 per square foot per annum for the first three years of the Term, with rent increasing three percent over the prior year's rent amount for each year thereafter for the duration of the Lease. Additionally, the Lease provides that during the first twelve (12) months of the Term, the rent includes certain operating and property tax expenses. After the first twelve (12) months of the Term, the Company must pay the Lessor for the Company's share of increases in certain operating and property tax expenses in addition to the base rent. The Company's obligations for the full twelve (12) year Lease term are approximately \$2.4 million.

8. Issuer Purchases of Equity Securities:

During December 2012, we repurchased shares of our common stock having a value of \$1,083,520 pursuant to our share repurchase program.

| Period              | Total<br>Number of<br>Shares<br>Purchased<br>as<br>Part of<br>Program | Average<br>Price<br>Paid per<br>Share | Total<br>Number of<br>Shares<br>Purchased<br>as Part of<br>Publicly<br>Announced<br>Plans<br>or Programs | Dollar<br>Value of<br>Shares that<br>May<br>Yet Be<br>Purchased<br>Under<br>the<br>Program(1) |
|---------------------|---|---------------------------------------|--|---|
| October 1-31, 2012  | -   | -                                     | -  |   |
| November 1-30, 2012 | -   | -                                     | -  |   |
| December 1-31, 2012 | 677,200   | \$ 1.60                               | 677,200  | \$ 941,254  |
| Total               | 677,200   | \$ 1.60                               | 677,200  | \$ 941,254  |

(1) Under our stock repurchase program, effective as of November 6, 2012, we can repurchase up to an aggregate of \$4,000,000 of our common stock on the open market. Shares repurchased during December 2012 are being held in treasury. The program does not have a prescribed expiration date.

9. Reclassifications:

Certain amounts previously reported for prior periods have been reclassified to conform to the current year presentation in the accompanying condensed financial statements. Such reclassifications had no effect on the results of operations or shareholders' equity as previously recorded.

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with our condensed financial statements and the related notes contained in this quarterly report.

### **Forward Looking Statements**

Certain of our statements contained in this Management's Discussion and Analysis of Financial Condition and Results of Operations section of this quarterly report and, in particular, those under the heading "Outlook," contain forward-looking statements. The words "may," "will," "should," "expect," "anticipate," "believe," "plans," "intend" and "contingent" and the negative of these words or other variations on these words or comparable terminology typically identify such statements. These statements are based on our management's current expectations, estimates, forecasts and projections about the industry in which we operate generally, and other beliefs of and assumptions made by our management, some or many of which may be incorrect. In addition, other written or verbal statements that constitute forward-looking statements may be made by us or on our behalf. While our management believes these statements are accurate, our business is dependent upon general economic conditions and various conditions specific to the industries in which we operate. Moreover, we believe that the current business environment is more challenging and difficult than it has been in the past several years, if not longer. Many of our customers, particularly those that are primarily involved in the aviation industry, are currently experiencing substantial financial and business difficulties. If the business of any substantial customer or group of customers fails or is materially and adversely affected by the current economic environment or otherwise, they may seek to substantially reduce their expenditures for our services. Any loss of business from our substantial customers could cause our actual results to differ materially from the forward-looking statements that we have made in this quarterly report. Further, other factors, including, but not limited to, those relating to the shortage of qualified labor, competitive conditions and adverse changes in economic conditions of the various markets in which we operate, could adversely impact our business, operations and financial condition and cause our actual results to fail to meet our expectations, as expressed in the forward-looking statements that we have made in this quarterly report. These forward-looking statements are not guarantees of future performance, and involve certain risks, uncertainties and assumptions that we may not be able to accurately predict. We undertake no obligation to update publicly any of these forward-looking statements, whether as a result of new information, future events or otherwise.

As provided for under the Private Securities Litigation Reform Act of 1995, we wish to caution shareholders and investors that the important factors under the heading "Risk Factors" in our Annual Report on Form 10-K filed with the Securities and Exchange Commission with respect to our fiscal year ended March 31, 2012 could cause our actual financial condition and results from operations to differ materially from our anticipated results or other expectations expressed in our forward-looking statements in this quarterly report.

### **Critical Accounting Policies and Estimates**

Critical accounting policies are defined as those most important to the portrayal of a company's financial condition and results and that require the most difficult, subjective or complex judgments. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, the disclosure of contingent assets and liabilities, and the reported amounts of revenues and expenses during the reporting period. The estimates that we make include allowances for doubtful accounts, depreciation and amortization, income tax assets and insurance reserves. Estimates are based on historical experience, where applicable or other assumptions that management believes are reasonable under the circumstances. We have identified the policies described below as our critical accounting policies. Due to the inherent uncertainty involved in making estimates, actual results may differ from those estimates under different assumptions or conditions.



Revenue Recognition

We record revenues as services are provided to our customers. Revenues consist primarily of aviation and security services, which are typically billed at hourly rates. These rates may vary depending on base, overtime and holiday time worked. Revenue for administrative services provided to other security companies are calculated as a percentage of the administrative service customer's revenue and are recognized when billings for the related security services are generated. Revenue is reported net of applicable taxes.

Accounts Receivable

We periodically evaluate the requirement for providing for billing adjustments and/or reflect the extent to which we will be able to collect our accounts receivable. We provide for billing adjustments where management determines that there is a likelihood of a significant adjustment for disputed billings. Criteria used by management to evaluate the adequacy of the allowance for doubtful accounts include, among others, the creditworthiness of the customer, current trends, prior payment performance, the age of the receivables and our overall historical loss experience. Individual accounts are charged off against the allowance as management deems them to be uncollectible.

Intangible Assets

Intangible assets are stated at cost and consist primarily of customer lists and borrowing costs that are being amortized on a straight-line basis over a period of three to ten years, and goodwill, which is reviewed annually for impairment. The life assigned to customer lists acquired is based on management's estimate of our expected customer attrition rate. The attrition rate is estimated based on historical contract longevity and management's operating experience. We test for impairment annually or when events and circumstances warrant such a review, if earlier. Any potential impairment is evaluated based on anticipated undiscounted future cash flows and actual customer attrition in accordance with FASB ASC 360, *Property, Plant and Equipment*.

Insurance Reserves

General liability estimated accrued liabilities are calculated on an undiscounted basis based on actual claim data and estimates of incurred but not reported claims developed utilizing historical claim trends. Projected settlements and incurred but not reported claims are estimated based on pending claims, historical trends and related data.

Workers' compensation annual premiums are based on the incurred losses as determined at the end of the coverage period, subject to minimum and maximum premiums. Estimated accrued liabilities are based on our historical loss experience and the ratio of claims paid to our historical payout profiles.

Income Taxes

Income taxes are based on income (loss) for financial reporting purposes and reflect a current tax liability (asset) for the estimated taxes payable (recoverable) in the current year tax return and changes in deferred taxes. Deferred tax assets or liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using enacted tax laws and rates. A valuation allowance is provided on deferred tax assets if it is determined that it is more likely than not that the asset will not be realized.

We recognize the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. In the event that interest and/or penalties are assessed in connection with our tax filings, interest will be recorded as interest expense and penalties as selling, general and administrative expense. We did not have any unrecognized tax benefits as of December 31, 2012 and 2011.

### Stock Based Compensation

FASB ASC 718, Stock Compensation, 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 at grant date and the recognition of the related expense over the period in which the share-based compensation vests. We use the modified-prospective transition method. Under the modified-prospective transition method, we recognize compensation expense in our financial statements issued subsequent to the date of adoption for all share-based payments granted, modified or settled. Non-cash charges of \$170,895 and \$142,745 for stock based compensation have been recorded for the nine months ended December 31, 2012 and 2011, respectively.

### **Overview**

We principally provide uniformed security officers and aviation services to commercial, residential, financial, industrial, aviation and governmental customers through approximately 35 offices throughout the United States. In conjunction with providing these services, we assume responsibility for a variety of functions, including recruiting, hiring, training and supervising all operating personnel as well as paying such personnel and providing them with uniforms, benefits and workers' compensation insurance.

Our customer-focused mission is to provide the best personalized supervision and management attention necessary to deliver timely and efficient security solutions so that our customers can operate in safe environments without disruption or loss. Technology underpins our efficiency, accuracy and dependability. We use a sophisticated software system that integrates scheduling, payroll and billing functions, giving customers the benefit of customized programs using the personnel best suited to the job.

Renewing and extending existing contracts and obtaining new contracts are crucial to our ability to generate revenues, earnings and cash flow. In addition, our growth strategy involves the acquisition and integration of complementary businesses in order to increase our scale within certain geographical areas, increase our market share in the markets in which we operate, gain market share in the markets in which we do not currently operate and improve our profitability. We intend to pursue suitable acquisition opportunities for contract security officer businesses. We frequently evaluate acquisition opportunities and, at any given time, may be in various stages of due diligence or preliminary discussions with respect to a number of potential acquisitions. However, we cannot assure you that we will identify any suitable acquisition candidates or, if identified, that we will be able to complete the acquisition of such candidates on favorable terms or at all.

The global security industry has grown we believe largely due to an increasing desire for security to combat crime and terrorism. In the United States, the demand for security-related products and central station monitoring services also has grown steadily. We believe that there is continued heightened attention to and demand for security due to worldwide events, and the ensuing threat, or perceived threat, of criminal and terrorist activities. For these reasons, we expect that security will continue to be a key area of focus both domestically in the United States and abroad.

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

## **Results of Operations**

### **Revenues**

Our revenues increased by \$3,145,762, or 8.8%, to \$38,930,273 for the three months ended December 31, 2012 from \$35,784,511 in the corresponding period of the prior year. The increase in revenues for the three months ended December 31, 2012 was due mainly to: (i) expansion of services provided under a contract with a major transportation company of approximately \$600,000; (ii) expansion of aviation services with an existing customer at a domestic airport location of approximately \$1,500,000; (iii) expansion of services to new and existing security and aviation customers that resulted in additional aggregate revenues of approximately \$1,000,000; including a new contract with a large municipal agency which commenced during the fourth quarter of the prior fiscal year, a new contract with an international air freight carrier at four domestic airport locations, a new contract with a community college which commenced during the second half of the prior fiscal year and a large construction contract at a major New York metropolitan area airport and (iv) a new contract to provide security services to an airport facility located in upstate New York of approximately \$230,000. The increase in revenues was partially offset by: (i) the absence in the current period of two large airport construction contracts of approximately \$290,000 and (ii) the loss of a service contract with a large international carrier in the fourth quarter of the prior fiscal year of approximately \$155,000.

Our revenues increased by \$6,058,149, or 5.7%, to \$112,736,873 for the nine months ended December 31, 2012 from \$106,678,724 in the corresponding period of the prior year. The increase in revenues for the nine months ended December 31, 2012 was due mainly to: (i) expansion of services provided under a contract with a major transportation company of approximately \$1,600,000; (ii) expansion of aviation services with an existing customer at a domestic airport location of approximately \$3,200,000; (iii) expansion of services to new and existing security and aviation customers as noted above that resulted in aggregate revenues of approximately \$2,900,000 and (iv) a new contract to provide security services to an airport facility located in upstate New York of approximately \$470,000. The increase in revenues was partially offset by: (i) the previously reported loss of a security services contract for a semiconductor equipment manufacturer's facility of approximately \$215,000; (ii) reductions in service hours and rates of approximately \$460,000 associated with the renewal of a contract with a major international carrier; (iii) the absence in the current period of two large airport construction contracts of approximately \$785,000; (iv) reduction in service hours at a major hospital of approximately \$330,000 and (v) the loss of a service contract with a large international carrier in the fourth quarter of the prior fiscal year of approximately \$495,000.

### **Gross Profit**

Our gross profit increased \$479,758, or 10.6%, to \$5,008,252 (12.9% of revenues) for the three months ended December 31, 2012, from \$4,528,494 (12.7% of revenues) in the corresponding period of the prior year. The increase was primarily due to: (i) expansion of services provided under a contract with a major transportation company; (ii) expansion of aviation services with an existing customer at a domestic airport location; (iii) expansion of services to

new and existing security and aviation customers including; a new contract with a large municipal agency which commenced during the fourth quarter of the prior fiscal year, a new contract with an international air freight carrier at four domestic airport locations, a new contract with a community college which commenced during the second half of the prior fiscal year and a large construction contract at a major New York metropolitan area airport; (iv) a new contract to provide security services to an airport facility located in upstate New York and (v) the absence in the current period of professional and related fees principally associated with settlement of employment related claims in the comparable prior year period. The increase in gross profit was partially offset by: (i) the absence in the current period of two large airport construction contracts and (ii) the loss of a service contract with a large international carrier in the fourth quarter of the prior fiscal year.

Our gross profit increased \$654,009, or 4.6%, to \$14,921,306 (13.2% of revenues) for the nine months ended December 31, 2012, from \$14,267,297 (13.4% of revenues) in the corresponding period of the prior year. The increase was primarily due to: (i) expansion of services provided under a contract with a major transportation company; (ii) expansion of aviation services with an existing customer at a domestic airport location; (iii) expansion of services to new and existing security and aviation customers as noted above; (iv) a new contract to provide security services to an airport facility located in upstate New York and (v) the absence in the current year of professional and related fees principally associated with settlement of employment related claims in the comparable prior year. The increase in gross profit was partially offset by: (i) the previously reported loss of a security services contract for a semiconductor equipment manufacturer's facility; (ii) reductions in service hours and rates associated with the renewal of a contract with a major international carrier; (iii) the absence in the current period of two large airport construction contracts; (iv) reduction in service hours at a major hospital and (v) the loss of a service contract with a large international carrier in the fourth quarter of the prior fiscal year.

**General and Administrative Expenses**

Our general and administrative expenses increased by \$204,999, or 5.1%, to \$4,188,517 (10.8% of revenues) for the three months ended December 31, 2012, from \$3,983,518 (11.1% of revenues) in the corresponding period of the prior year. The increase in general and administrative expenses for the three months ended December 31, 2012 resulted primarily from accrued labor (mainly employee severance) and other related expenses associated with our previously disclosed plan to consolidate and relocate our corporate headquarters to Herndon, Virginia.

Our general and administrative expenses increased by \$766,323, or 6.4%, to \$12,748,838 (11.3% of revenues) for the nine months ended December 31, 2012, from \$11,982,515 (11.2% of revenues) in the corresponding period of the prior year. The increase in general and administrative expenses for the nine months ended December 31, 2012 resulted primarily from accrued labor (mainly employee severance) and other related expenses associated with our previously disclosed plan to consolidate and relocate our corporate headquarters to Herndon, Virginia.

**Provision for Doubtful Accounts**

The provision for doubtful accounts for the three months ended December 31, 2012 was comparable with the corresponding period of the prior year reflecting the timing and amounts of uncollectible accounts charged and/or credited to expense.

The provision for doubtful accounts increased \$68,691 to \$221,448 for the nine months ended December 31, 2012 from \$152,757 in the corresponding period of the prior year. The increase in the provision for doubtful accounts for the nine months ended December 31, 2012 related primarily to stock that we received in the comparable prior year period under our claim related to the bankruptcy filing of a security services customer, which was valued at approximately \$72,000.

We periodically evaluate the requirement for providing for billing adjustments and/or credit losses on our accounts receivable. We provide for billing adjustments in cases where our management determines that there is a likelihood of a significant adjustment for disputed billings. Criteria used by management to evaluate the adequacy of the allowance for doubtful accounts include, among others, the creditworthiness of the customer, current trends, prior payment performance, the age of the receivables and our overall historical loss experience. Individual accounts are charged off against the allowance for doubtful accounts as our management deems them to be uncollectible. We do not know if bad debts will increase in future periods nor do we believe that the increase in the provision for doubtful accounts during the nine months ended December 31, 2012 compared with the corresponding period of the prior year is indicative of a trend.

**Interest Income**

Interest income for the three and nine months ended December 31, 2012 principally represents interest earned on cash balances and was comparable with the corresponding period of the prior year and not deemed significant to our condensed financial statements.



**Interest Expense**

Interest expense decreased by \$16,873, or 31.5%, to \$36,688 for the three months ended December 31, 2012, from \$53,561 in the corresponding period of the prior year. The decrease in interest expense for the three months ended December 31, 2012 was due primarily to lower average outstanding borrowings under our credit agreement with Wells Fargo and reduced borrowing rates.

Interest expense decreased by \$97,487, or 49.6%, to \$99,149 for the nine months ended December 31, 2012, from \$196,636 in the corresponding period of the prior year. The decrease in interest expense for the nine months ended December 31, 2012 was due primarily to lower average outstanding borrowings under our credit agreement with Wells Fargo and reduced borrowing rates.

**Asset Dispositions**

Asset dispositions result primarily from the sale of vehicles, office equipment and security equipment in the ordinary course of business at prices above or below book value.

The gains on asset dispositions for the three and nine months ended December 31, 2012 and 2011 were primarily due to the disposition of transportation equipment at amounts in excess of their respective book values and were not deemed significant to our condensed financial statements.

**Provision for income taxes**

Provision for income taxes increased by \$158,000 for the three months ended December 31, 2012 compared with the corresponding period of the prior year due mainly to the increase in our pre-tax earnings for the three months ended December 31, 2012.

Provision for income taxes decreased by \$47,000 for the nine months ended December 31, 2012 compared with the corresponding period of the prior year due mainly to the decrease in our pre-tax earnings for the nine months ended December 31, 2012 partially offset by the loss of deferred tax assets resulting from the cancellation of stock options previously held by former employees.

**Liquidity and Capital Resources**

During fiscal 2012, we began paying employees and administrative service clients on a bi-weekly basis, except for one operating location at which employees are paid weekly. Customers generally pay for our services within approximately 60 days after we bill them. We maintain a commercial revolving loan arrangement, currently with Wells Fargo. We fund our payroll and operations primarily through borrowings under our \$20,000,000 credit facility with Wells Fargo (the "Credit Agreement"), described below under "Wells Fargo Revolving Credit Facility."

We principally use short-term borrowings under our Credit Agreement to fund our accounts receivable. Our short-term borrowings have supported the increase in accounts receivable associated with our organic growth. We intend to continue to use short-term borrowings to support our working capital requirements.

We believe that our existing funds, cash generated from operations, and existing sources of and access to financing are adequate to satisfy our working capital, capital expenditure and debt service requirements for the foreseeable future. However, we cannot assure you that this will be the case, and we may be required to obtain alternative or additional financing to maintain and expand our existing operations through the sale of our securities, an increase in the amount of available borrowings under our Credit Agreement, obtaining additional financing from other financial institutions or otherwise. The failure by us to obtain such financing, if needed, would have a material adverse effect upon our business, financial condition and results of operations.

### **Wells Fargo Revolving Credit Facility**

On February 12, 2009, we entered into a \$20,000,000 Credit Agreement with Wells Fargo. This credit facility, which was amended in October 2011 and November 2012 as described below, matures in October 2016, and contains customary affirmative and negative covenants, including, among other things, covenants requiring us to maintain certain financial ratios and is collateralized by customer accounts receivable and certain other assets of the Company as defined in the Credit Agreement.

The Credit Agreement provides for a letter of credit sub-line in an aggregate amount of up to \$3,000,000. The Credit Agreement also provides for interest to be calculated on the outstanding principal balance of the revolving loans at the Prime Rate (as defined in the Credit Agreement) plus 1.50%. For LIBOR loans, interest will be calculated on the outstanding principal balance of the LIBOR loans at the LIBOR rate (as defined in the Credit Agreement) plus 2.75% (see below).

On October 18, 2011, we entered into an amendment (the "Amendment") to our Credit Agreement. The Amendment (i) extends the term of the \$20,000,000 Credit Facility to October 2016, (ii) decreases the interest rate spreads on the outstanding principal balance of the revolving loans to LIBOR plus 1.75% and amends certain covenants including: (a) increasing the amount of capital expenditures that can be incurred in the aggregate during any fiscal year or in any one transaction and (b) permitting us to repurchase up to \$2,000,000 of our common stock subject to certain conditions.

On November 6, 2012, the Company entered into an amendment (the "Subsequent Amendment") to the Credit Agreement. The Subsequent Amendment (i) allows for the Company to repurchase up to an additional \$2,000,000 of its common stock, subject to certain conditions; (ii) provides for the consent of Wells Fargo to the consolidation and relocation of the Company's headquarters and (iii) amends a financial covenant of the Credit Agreement for certain expenses associated with the consolidation and relocation of the Company's headquarters.

As of December 31, 2012, the interest rates were 2.00% and 2.125% for LIBOR and revolving loans, respectively. At December 31, 2012, we had \$5,500,000 and \$533,735 in LIBOR and revolving loans, respectively, and \$172,540 under our letters of credit sub-line outstanding under the Credit Agreement, representing approximately 39% of the maximum borrowing capacity under the Credit Agreement based on our "eligible accounts receivable" (as defined under the Credit Agreement) as of such date.

We rely on our revolving loan from Wells Fargo which contains a fixed charge covenant and various other financial and non-financial covenants. If we breach a covenant, Wells Fargo has the right to immediately request the repayment in full of all borrowings under the Credit Agreement, unless Wells Fargo waives the breach. For the nine months

ended December 31, 2012, we were in compliance with all covenants under the Credit Agreement.

#### Other Borrowings

During the nine months ended December 31, 2012, we increased our bank borrowings by \$1,033,735 and decreased our insurance borrowing by \$1,030,407.

We may obtain short-term premium financing to assist with meeting our annual property and casualty insurance needs. For the nine months ended December 31, 2012, \$998,770 was financed for this purpose and, at December 31, 2012, we had \$800,544 of short-term insurance financing outstanding. We have no additional lines of credit other than as described above.

#### Investments and Capital Expenditures

We have no material commitments for capital expenditures at this time.

### Working Capital

Our working capital increased by \$622,527 or 5.7%, to \$11,578,621 as of December 31, 2012, from \$10,956,094 as of March 31, 2012.

We experienced checks issued in advance of deposits (defined as checks drawn in advance of future deposits) of \$506,776 at December 31, 2012, compared with \$884,095 at March 31, 2012. Cash balances, book overdrafts and payroll and related expenses can fluctuate materially from day to day depending on such factors as collections, timing of billing and payroll dates, and are covered via advances from the revolving loan as checks are presented for payment.

### Outlook

#### Strategic Initiatives

Our Board of Directors and management have initiated a number of strategic actions to improve the Company's performance. Craig P. Coy joined the Company as Chief Executive Officer on January 3, 2012, as previously announced. Following Mr. Coy's appointment, we began implementing strategic initiatives designed to further increase efficiencies across the organization and lower the overall cost structure. Key elements of these initiatives include:

The consolidation of our corporate offices and streamlining of our management structure to integrate all of our functions into a common platform and use resources more efficiently.

Renewed focus on operational performance, including managing overtime, to improve our operating margins and service delivery capabilities.

Strategic new hires in the human resources, sales and operations departments, bringing on board a new Vice President of Human Resources, a new Vice President of Sales and Marketing, a new Vice President of Operations and expanding our sales and marketing team with the hiring of additional sales executives to maximize our marketing opportunities.

Reviews of our market position and product and service offerings to ensure that "best in breed" capabilities are brought to market.

These strategic initiatives may result in future costs related to severance and other employee-related matters, litigation risks and expenses, and other costs. While the Company is unable to determine the ultimate impact of the consolidation and relocation of our corporate offices at this time, it currently estimates that costs may range from \$1.5 to \$2.0 million, depending primarily on personnel decisions. As of December 31, 2012, we have recorded \$1,048,818

in selling, general & administrative costs related to this initiative. As previously announced, the Company opened its new corporate headquarters in Herndon, VA which will consolidate headquarters personnel from three existing office locations. The transition of corporate functions is expected to be completed by February 15, 2013.

In connection with our corporate headquarters relocation, we entered into an office lease agreement (the "Lease") with FP Van Buren, LLC, a Delaware limited liability company (the "Lessor"), to lease approximately 10,435 square feet of office space located at 512 Herndon Parkway, Herndon, Virginia. The term of the Lease is for a period of twelve (12) years which commenced on January 14, 2013, and expires on January 31, 2025, unless earlier terminated pursuant to the Lease. The Lease provides for monthly payments of rent during the Term as set forth in the Lease. No rent will be due during the first twelve months of the Term. Rent shall be \$17.95 per square foot per annum for the first three years of the Term, with rent increasing three percent over the prior year's rent amount for each year thereafter for the duration of the Lease. Additionally, the Lease provides that during the first twelve (12) months of the Term, the rent includes certain operating and property tax expenses. After the first twelve (12) months of the Term, we must pay the Lessor for our share of increases in certain operating and property tax expenses in addition to the base rent. Our obligations for the full twelve (12) year Lease term are approximately \$2.4 million.

## Financial Results

Our future revenues will largely depend on our ability to gain additional business from new and existing customers in our security officer and aviation services divisions at acceptable margins, while minimizing terminations of contracts with existing customers. In addition, our growth strategy involves the acquisition and integration of complementary businesses to increase our scale within certain geographical areas, capture market share in the markets in which we operate, enter new markets and improve our profitability. We intend to pursue acquisition opportunities for contract security officer businesses. Our ability to complete future acquisitions will depend on our ability to identify suitable acquisition candidates, negotiate acceptable terms for their acquisition and, if necessary, finance those acquisitions. Our security services division continues to experience organic growth over recent quarters and over the past few years, as demand for our security services has steadily increased. Our current focus is on increasing our revenues, as our sales and marketing team and branch managers' work to develop new business and retain profitable contracts. However, several of our airline and security services customers have reduced capacity within their systems, which typically results in reductions of service hours provided by us to such customers. Also, competition from other security services companies impacts our ability to gain or maintain sales, gross margins and/or employees. Since September 11, 2001, the Department of Homeland Security and the Transportation Security Administration have implemented numerous security measures that affect airline operations, including expanded cargo and baggage screening, and are likely to implement additional measures in the future. Additional measures taken to enhance either passenger or cargo security procedures in the future may increase the airline industry's demand for third party services provided by us. Additionally, our aviation services division is continually subject to such government regulation, which has adversely affected us in the past with the federalization of the pre-board screening services and the document verification process at several of our domestic airport locations.

Our gross profit margin decreased during the nine months ended December 31, 2012 to 13.2% of revenues, compared with 13.4% during the corresponding period of the prior year. We expect our gross profit margins to average between 13.0% and 14.0% of revenue in fiscal 2013 based on current business conditions. We expect gross profit to remain under pressure due primarily to continued price competition, including competition from companies that have substantially greater financial and other resources than we have. However, we expect these effects will be moderated by continued operational efficiencies resulting from better management and leveraging of our cost structures, improved workers' compensation experience ratings, workflow process efficiencies associated with our integrated financial software system and higher contributions from our continuing new business development.

Our cost reduction program is expected to reduce certain of our operating and general and administrative expenses. Additional cost reduction opportunities are being identified and will be pursued as they are determined.

Our security services division generated approximately \$69.1 million or 61.3% of our total revenues in the nine months ended December 31, 2012. One security services customer accounted for approximately \$27.4 million or 24.3% of our total revenues during the nine months ended December 31, 2012. The original term of the contract with this customer was for a period of four years which expires on May 31, 2013. This customer has recently commenced and invited us to participate in a system-wide competitive bidding process for the continued performance of these as

well as additional services. We cannot assure you that we will be able to retain all or a substantial portion of our services with this customer beyond the contract termination date. The loss of this customer or any material reduction in business from this customer would materially and adversely affect our business, financial condition and results of operations.

Our aviation services division generated approximately \$43.5 million or 38.6% of our total revenues in the nine months ended December 31, 2012. The aviation industry continues to face various financial and other challenges, including the cost of security and higher fuel prices. Additional bankruptcy filings by aviation and non-aviation customers could have a material adverse impact on our liquidity, financial condition and results of operations.

As noted earlier, on February 12, 2009, we entered into a \$20,000,000 Credit Agreement with Wells Fargo, which was amended in October 2011 and November 2012, as described above. As of the close of business on February 1, 2013, our cash availability was approximately \$10,100,000 which we believe is sufficient to meet our needs for the foreseeable future barring any increase in reserves imposed by Wells Fargo. We believe that existing funds, cash generated from operations, and existing sources of and access to financing are adequate to satisfy our working capital, planned capital expenditures and debt service requirements for the foreseeable future, barring any increase in reserves imposed by Wells Fargo. However, we cannot assure you that this will be the case, and we may be required to obtain alternative or additional financing to maintain and expand our existing operations through the sale of our securities, an increase in the amount of available borrowings under our Credit Agreement, obtaining additional financing from other financial institutions or otherwise. The financial markets generally, and the credit markets in particular, continue to be volatile, both in the United States and in other markets worldwide. The current market situation has resulted generally in substantial reductions in available loans to a broad spectrum of businesses, increased scrutiny by lenders of the credit-worthiness of borrowers, more restrictive covenants imposed by lenders upon borrowers under credit and similar agreements and, in some cases, increased interest rates under commercial and other loans. If we require alternative or additional financing at this or any other time, we cannot assure you that such financing will be available upon commercially acceptable terms or at all. If we fail to obtain additional financing when and if required by us, our business, financial condition and results of operations would be materially adversely affected.



**Non-GAAP Financial Measures**

In addition to financial measures determined in accordance with United States generally accepted accounting principles (“GAAP”), we are providing certain non-GAAP measures for the three and nine months ended December 31, 2012 for use in assessing our performance. These non-GAAP measures include: (i) adjusted operating income; (ii) adjusted net income, each of which have been adjusted to exclude the impact of certain non-recurring accrued labor charges and expenses related to our corporate headquarter relocation and (iii) adjusted diluted earnings per common share, which we calculate as diluted earnings per share adjusted to exclude the estimated per share impact of the accrued labor charges and expenses related to our corporate headquarter relocation.

Our reported financial results for the three and nine months ended December 31, 2012 include substantial non-recurring charges, primarily from accrued labor (mainly employee severance) and other related expenses associated with our previously disclosed plan to consolidate and relocate our corporate headquarters to Herndon, Virginia. We believe that presentation of operating results and related per share amounts exclusive of these costs provides useful supplemental information to facilitate the analysis of our core operating results and comparison of operating results across reporting periods. We also believe that the supplemental non-GAAP information (presented below, reconciled to the comparable GAAP measures for the three and nine months ended December 31, 2011, and presented with the comparable GAAP measures for the three and nine months ended December 31, 2012) is also useful in analyzing and assessing our past and future operating performance. The usefulness of adjusted operating income, adjusted net income and adjusted diluted earnings per share as performance measures, however, is limited by the fact that they exclude the impact of certain charges and expenses. Therefore, these non-GAAP financial results should be considered as an addition to, and not a substitute for, or superior to, financial measures calculated in accordance with GAAP. We also use, and recommend that your consider, Net Income in accordance with GAAP as a measure of performance. Other companies may define adjusted operating income, adjusted net income and adjusted diluted earnings per share differently and, as a result, our measures of adjusted operating income, adjusted net income and adjusted diluted earnings per share may not be directly comparable to adjusted operating income, adjusted net income and adjusted diluted earnings per share measures of other companies.

Adjusted operating income, adjusted net income and adjusted diluted earnings per share

adjusting for corporate headquarter relocation costs are as follows:

|  | Three Months Ended<br>December 31, |           | Nine Months Ended<br>December 31, |             |
|--|------------------------------------|-----------|-----------------------------------|-------------|
|  | 2012                               | 2011      | 2012                              | 2011        |
| Operating income                           | \$745,301                          | \$469,864 | \$1,951,020                       | \$2,132,025 |
| Relocation expenses                        | 301,786                            | --        | 1,048,818                         | --          |
| Adjusted operating income                  | \$1,047,087                        | \$469,864 | \$2,999,838                       | \$2,132,025 |
| Net income                                 | \$353,648                          | \$217,197 | \$914,194                         | \$946,380   |
| Relocation expenses (net of taxes)         | 150,591                            | --        | 516,018                           | --          |
| Adjusted net income                        | \$504,239                          | \$217,197 | \$1,430,212                       | \$946,380   |
| Diluted earnings per common share          | \$0.04                             | \$0.02    | \$0.10                            | \$0.09      |
| Relocation expenses                        | 0.02                               | --        | 0.05                              | --          |
| Adjusted diluted earnings per common share | \$0.05                             | \$0.02    | \$0.15                            | \$0.09      |

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

During the nine months ended December 31, 2012, we did not hold a portfolio of securities instruments for either trading or speculative purposes. Periodically, we hold securities instruments for other than trading purposes. Due to the short-term nature of our investments, we believe that we have no material exposure to changes in the fair value as a result of market fluctuations.

We are exposed to market risk in connection with changes in interest rates, primarily in connection with outstanding balances under our revolving line of credit with Wells Fargo, which was entered into for purposes other than trading purposes. Based on our average outstanding balances during the nine months ended December 31, 2012, a 1% change in the prime and/or LIBOR lending rates could impact our financial position and results of operations by approximately \$12,000 over the remainder of our fiscal year ending March 31, 2013. For additional information on the revolving line of credit with Wells Fargo, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources –Wells Fargo Revolving Credit Facility.”

Reference is made to Item 2 of Part I of this quarterly report, “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Forward Looking Statements.”

### **Item 4. Controls and Procedures**

We maintain “disclosure controls and procedures”, as such term is defined under Rule 13a-15(e) of the Securities Exchange Act of 1934, that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Principal Financial Officer, as appropriate, to allow timely decisions regarding required disclosures.

We believe that a control system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the control system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected. Our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives and our Chief Executive Officer and Principal Financial Officer have concluded that such controls and procedures are effective at the reasonable assurance level.

An evaluation was performed under the supervision and with the participation of management, including our Chief Executive Officer and Principal Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation and subject to the foregoing, the Chief Executive Officer and Principal Financial Officer concluded that our disclosure controls and procedures were effective as of December 31, 2012. There have been no changes in our internal control over financial reporting that occurred during our third quarter of fiscal 2013 ended December 31, 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION****Item 1. Legal Proceedings**

See our discussion under Note 7 “Contingencies” to the Notes to Condensed Financial Statements included in Item 1 of Part I of this Quarterly Report on Form 10-Q, which is incorporated herein by reference.

**Item 1A. Risk Factors**

There have been no changes to our risk factors from those disclosed in our Annual Report on Form 10-K for our fiscal year ended March 31, 2012.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

Issuer Purchases of Equity Securities:

The number and average price of shares purchased in the three months ended December 31, 2012 are set forth

| Period              | Total<br>Number of<br>Shares<br>Purchased<br>as<br>Part of<br>Program | Average<br>Price<br>Paid per<br>Share | Total<br>Number of<br>Shares<br>Purchased<br>as Part of<br>Publicly<br>Announced<br>Plans<br>or Programs | Dollar<br>Value of<br>Shares that<br>May<br>Yet Be<br>Purchased<br>Under<br>the<br>Program(1) |
|---------------------|---|---------------------------------------|--|---|
| October 1-31, 2012  | -   | -                                     | -  |   |
| November 1-30, 2012 | -   | -                                     | -  |   |

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|                     |         |         |         |            |
|---------------------|---------|---------|---------|------------|
| December 1-31, 2012 | 677,200 | \$ 1.60 | 677,200 | \$ 941,254 |
| Total               | 677,200 | \$ 1.60 | 677,200 | \$ 941,254 |

(1) Under our stock repurchase program, effective as of November 6, 2012, we can repurchase up to an aggregate of \$4,000,000 of our common stock on the open market. Shares repurchased during December 2012 are being held in treasury. The program does not have a prescribed expiration date.

**Item 6. Exhibits**

(a)

Exhibits

Exhibit 10.1 Brost Employment Offer Letter dated January 11, 2013 (Incorporated by reference to the Company's Current Report on Form 8-K dated January 17, 2013.)

Exhibit 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Exhibit 31.2 Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Exhibit 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Exhibit 32.2 Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Exhibit 99.1 Press Release, dated February 12, 2013 announcing December 31, 2012 financial results.

**SIGNATURES**

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

**COMMAND SECURITY  
CORPORATION**

Date: February 12, 2013 By: /s/ Craig P. Coy  
Craig P. Coy  
Chief Executive Officer  
(Principal Executive Officer)

By: /s/ N. Paul Brost  
N. Paul Brost  
Chief Financial Officer  
(Principal Financial Officer)