

Argyle Security Acquisition CORP  
Form 10-Q  
November 14, 2006

**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 September 30, 2006.**

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: 000-51639**

**Argyle Security Acquisition Corporation**  
(Exact name of registrant as specified in its charter)

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

**20-3101079**  
(I.R.S. Employer  
Identification No.)

**200 Concord Plaza, Suite 700, San Antonio, TX 78216**  
(Address of Principal Executive Offices including Zip Code)

**(210) 828-1700**  
(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 Exchange Act 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, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange. (Check one):

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

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

There were 4,781,307 shares of the Registrant's common stock issued and outstanding as of November 10, 2006.

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## ITEM 1 - FINANCIAL STATEMENTS (UNAUDITED)

**Argyle Security Acquisition Corporation**  
(a development stage company)

**Balance Sheet**

	September 30, 2006 (unaudited)	December 31, 2005
<b>ASSETS</b>		
<b>Current assets:</b>		
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
<b>Total current assets</b>	<b>30,023,733</b>	<b>304,353</b>
Deferred income taxes	34,442	-
Property and equipment, net of accumulated depreciation of \$1,075	5,445	-
<b>Total assets</b>	<b>\$ 30,063,620</b>	<b>\$ 304,353</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Current liabilities:</b>		
Accrued expenses	\$ 166,141	\$ 132,096
Notes payable - stockholders	-	155,000
Deferred underwriting costs	1,422,740	-
Accrued income taxes	71,926	-
<b>Total liabilities</b>	<b>1,660,807</b>	<b>287,096</b>
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	-
<b>Stockholders' Equity:</b>		
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)
<b>Total stockholders' equity</b>	<b>22,790,437</b>	<b>17,257</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 30,063,620</b>	<b>\$ 304,353</b>

See notes to unaudited financial statements



**Argyle Security Acquisition Corporation**  
(a development stage company)

**Unaudited Statements of Operations**

	<b>Three months ended September 30, 2006</b>	<b>Three months ended September 30, 2005</b>	<b>Nine months ended September 30, 2006</b>	<b>Inception through September 30, 2005</b>	<b>Inception through September 30, 2006</b>
<b>Operating expenses</b>	\$ 229,829	\$ 3,157	\$ 809,278	\$ 3,246	814,310
<b>Other income and expense</b>					
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
<b>Net income/(loss)</b>	<b>102,047</b>	<b>(4,449)</b>	<b>71,066</b>	<b>(4,538)</b>	<b>63,323</b>
Deferred interest (net of taxes), attributable to common stock subject to possible redemption	38,987	-	152,941	-	152,941
<b>Net income/(loss) allocable to holders of non-redeemable common stock</b>	<b>\$ 63,060</b>	<b>\$ (4,449)</b>	<b>\$ (81,875)</b>	<b>\$ (4,538)</b>	<b>\$ (89,618)</b>
<b>Net income/(loss) per share - - basic and diluted</b>	<b>\$ 0.02</b>	<b>\$ (0.00)</b>	<b>\$ 0.02</b>	<b>\$ (0.00)</b>	<b>\$ 0.02</b>
Weighted average number of shares outstanding - - basic and diluted	4,781,307	937,500	4,375,600	937,500	2,951,666
<b>Net income/(loss) per share exclusive of shares and related interest subject to possible redemption - - basic and diluted</b>	<b>\$ 0.02</b>	<b>\$ (0.00)</b>	<b>\$ (0.02)</b>	<b>\$ (0.00)</b>	<b>\$ (0.04)</b>
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)
<b>Balances</b> , 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
<b>Balances</b> 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
<b>Cash flows from operating activities</b>			
Net income/(loss)	\$ 71,066	\$ (4,538)	\$ 63,323
<b>Adjustment to reconcile net loss to net cash provided by operating activities:</b>			
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
<b>Cash flows from investing activities:</b>			
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)
<b>Cash flows from financing activities</b>			
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
<b>Net increase in cash</b>	<b>910,821</b>	<b>4,324</b>	<b>920,429</b>
<b>Cash, beginning of period</b>	<b>9,608</b>	<b>-</b>	<b>-</b>
<b>Cash, end of period</b>	<b>\$ 920,429</b>	<b>\$ 4,324</b>	<b>\$ 920,429</b>
<b>Supplemental disclosure of cash flow information</b>			
Cash paid for interest	\$ 3,177	\$ -	\$ 3,177
<b>Supplemental schedule of non-cash financing activities:</b>			
Accrual of deferred underwriting costs	\$ 1,377,017	\$ -	\$ 1,377,017



See notes to unaudited financial statements

**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.

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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.

*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.

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**Forward Looking Statements**

This Quarterly Report on Form 10-Q includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. We have based these forward-looking statements on our current expectations and projections about future events. These forward-looking statements are subject to known and unknown risks, uncertainties and assumptions about us that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as "may," "should," "could," "would," "expect," "plan," "anticipate," "believe," "estimate," "continue," or the negative of such terms or other similar expressions. Factors that



might cause or contribute to such a discrepancy include, but are not limited to, those described in our other Securities and Exchange Commission filings. The following discussion should be read in conjunction with our unaudited Financial Statements and related Notes thereto included elsewhere in this report.

## **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.

## **Overview**

Argyle Security Acquisition Corporation is a Delaware corporation 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. We intend to leverage the industry experience of our executive officers by focusing our efforts on identifying a prospective target business in the security industry. We believe that businesses involved in this industry represent attractive acquisition targets for a number of reasons, including the increase in global demand for integrated security-related products and services since September 11, 2001, the development of new technology which has the potential to expand applications and the trend towards integrated networked solutions. During the third quarter we continued to narrow our focus to several potential target businesses regarding a possible business combination.

## **Results of Operations for the nine-month period ended September 30, 2006**

We 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. We incurred a net loss of \$4,538 for the period from inception (June 22, 2005) through September 30, 2005.

Our trust account earned interest of \$952,609 for the nine months ended September 30, 2006 and our funds outside the trust account earned interest of \$11,409. Until we enter into a business combination, we will not generate operating revenues. We had no funds in trust as of September 30, 2005.

For the nine months ended September 30, 2006, we 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 our lease of office space and other operating costs of \$92,873.

## **Results of Operations for the three-month period ended September 30, 2006**

We reported net income of \$102,047 for the three-month period ended September 30, 2006, before the deduction of \$38,987 of interest income, net of taxes, attributable to the common stock subject to possible redemption. We incurred a net loss of \$4,449 for the three-month period ended September 30, 2005.

Our trust account earned interest of \$382,549 for the three months ended September 30, 2006, and our funds outside of the trust account earned interest of \$5,173.

For the three months ended September 30, 2006, we incurred expenses of \$122,177 for consulting and professional fees, \$35,000 for franchise taxes, \$23,745 for insurance expense, \$16,933 for rental expense and other operating costs of \$31,974.



## **Liquidity and Capital Resources**

On January 24, 2006, the Company 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, we consummated our 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 us one share of our 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. Our common stock and warrants started trading separately as of March 2, 2006.

The net proceeds from the sale of our 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 our benefit. Except for reimbursement of taxes payable and \$600,000 in interest from the trust account that was released to us in September 2006 for working capital, we will not be able to access the amounts held in the trust until we consummate 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 our private placement and initial public offering that will be paid to them only in the event of a business combination. The amounts held outside of the trust account are available to be used by us to provide for business, legal and accounting due diligence on prospective acquisitions and continuing general and administrative expenses. As of September 30, 2006, we had approximately \$920,000 outside the trust account to fund our working capital requirements.

We expect to use substantially all of the net proceeds of the initial public offering to acquire a target business, including identifying and evaluating prospective acquisition candidates, selecting the target business, and structuring, negotiating and consummating the business combination. The proceeds held in the trust account as well as any other net proceeds not expended may be used to finance the acquisition and operations of the target business or, if any stockholders choose to redeem their shares, to pay such stockholders the redemption amount due to them.

We estimate that we will have sufficient funds outside of the trust account to operate through the second quarter of 2007, assuming that a business combination is not consummated prior to such time. At this time, we do not believe that we will need to raise additional funds in order to meet the expenditures required for operating our business. However, if we do not consummate a business combination by the middle of 2007, the costs required to consummate a business combination will exceed our available cash, and we will not be able to engage in a business combination without receiving additional funds and/or reaching agreements with our professional service providers to defer their fees and expenses. We expect these expenses would ultimately be borne by the combined company if a business combination were completed.

As of February 1, 2006 we entered into a lease for our office space and began to pay a base rental of approximately \$5,500 per month. The lease terminates on January 31, 2007. In connection with our operations, in March 2006, we paid an outstanding obligation to a consultant for approximately \$53,000 and are currently paying approximately \$24,000 per month in consulting fees for services assisting us 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.

## **Off-Balance Sheet Arrangements**

We do not have any off-balance sheet arrangements.



### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Market risk is the sensitivity of income to changes in interest rates, foreign exchanges, commodity prices, equity prices, and other market-driven rates or prices. We are not presently engaged in and, if a suitable business target is not identified by us prior to the prescribed liquidation date of the trust fund, we may not engage in, any substantive commercial business. Accordingly, we are not and, until such time as we consummate a business combination, we will not be, exposed to risks associated with foreign exchange rates, commodity prices, equity prices or other market-driven rates or prices. The net proceeds of our initial public offering held in the trust account are to be invested only in money market funds meeting certain conditions under Rule 2a-7 promulgated under the Investment Company Act of 1940 or United States treasury bills. Given our limited risk in our exposure to money market funds and treasury bills, we do not view the interest rate risk to be significant.

### **ITEM 4. CONTROLS AND PROCEDURES**

An evaluation of the effectiveness of our disclosure controls and procedures as of September 30, 2006 was made under the supervision and with the participation of our management, including our Co-Chief Executive Officers (one of whom serves as our principal financial officer). Based on that evaluation, our Co-Chief Executive Officers concluded that our disclosure controls and procedures are effective as of the end of the period covered by this report to ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. During the most recently completed fiscal quarter, there has been no significant change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **PART II - OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

None.

### **ITEM 1A. RISK FACTORS**

In addition to the other information set forth in this report, you should carefully consider the risk factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2005 and the risk factors contained in Part II, "Item 1A: Risk Factors" of our Quarterly Report on Form 10-Q for the quarter ended June 30, 2006, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K and Quarterly Report on Form 10-Q are not the only risks facing our Company.

### **ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None.

### **ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

### **ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None.



**ITEM 5. OTHER INFORMATION**

None.

**ITEM 6. EXHIBITS**

**Exhibit**

<b>No.</b>	<b>Description</b>
10.1	Warrant Clarification Agreement between the Company and American Stock Transfer & Trust Company, dated August 10, 2006
10.2	Unit Purchase Option Clarification Agreement between the Company and I-Bankers, Inc., dated August 10, 2006
10.3	Unit Purchase Option Clarification Agreement between the Company and Rodman & Renshaw, LLC, dated August 10, 2006
31.1	Certification of the Co-Chief Executive Officer (Principal Financial Officer) pursuant to Rule 13a-14(a) of the Securities Exchange Act, as amended
31.2	Certification of the Co-Chief Executive Officer and (Principal Executive Officer) pursuant to Rule 13a-14(a) of the Securities Exchange Act, as amended
32.1	Certification of the Co-Chief Executive Officers pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 .

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**SIGNATURES**

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ARGYLE SECURITY ACQUISITION CORPORATION

November 13, 2006

By: /s/ Bob Marbut  
Bob Marbut  
Co-Chief Executive Officer (Principal  
Accounting and Financial Officer)

By: /s/ Ron Chaimovski  
Ron Chaimovski  
Co-Chief Executive Officer (Principal  
Executive Officer)