STRATESEC INC
Form 10KSB
April 12, 2002

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-KSB

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

For the fiscal year ended December 31, 2001

Commission File Number 1-13427

STRATESEC INCORPORATED
(Exact name of registrant as specified in its charter)

Delaware	22-2817302
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

14360 Sullyfield Circle, Ste. B Chantilly, Virginia	20151
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (703) 995-2121

Securities registered pursuant to Section 12(b) of the Act:

Title of Class	Name of Exchange
Common Stock, $.01 par value	American Stock Exchange

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

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

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

State issuer's revenue for most recent fiscal year: $9,077,330.

The aggregate market value of the registrant's Common Stock held by non-affiliates of the registrant as of March 31, 2002 (computed by reference to the closing price of such stock on the American Stock Exchange) was $6,136,867.

As of March 31, 2002 there were 10,401,471 shares of the registrant's Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

DOCUMENT	WHERE INCORPORATED
Portions of the Registrant's definitive Proxy Statement	

regarding the 2002 Annual Meeting of Stockholders Part III

STRATESEC Incorporated

FORM 10-K

Cross Reference Sheet

Item		Page
	Part I	
1	Business	1
2	Properties	7
3	Legal Proceedings	7
4	Submission of Matters to a Vote of Security Holders	8
	Part II	
5	Market for Registrant's Common Equity and Related Stockholder Matters.	8
6	Selected Financial Data	9
7	Management's Discussion and Analysis of Financial Condition and Results of Operations	9
7a	Quantitative and Qualitative Disclosures About Market Risk	14
8	Financial Statements	14
9	Changes in and Disagreements With Accountants on Accounting and Financial Disclosure	15
	Part III	
10	Directors and Executive Officers of the Registrant	15
11	Executive Compensation	15
12	Security Ownership of Certain Beneficial Owners and Management	15
13	Certain Relationships and Related Transactions	15
	Part IV	
14	Exhibits, Financial Statement Schedules and Reports on Form 8-K	16
	Signatures	17

Part I

Item 1. Business.

General

The Company is a single-source provider of comprehensive technology-based security solutions for medium and large commercial and government facilities in the United States and abroad. The Company offers a broad range of services, including: (i) consulting and planning; (ii) engineering and design; (iii) systems integration; and (iv) maintenance and technical support. This full range of capabilities enables the Company to provide its clients with any combination of these services or complete turnkey solutions for complex security projects. The solutions provided by the Company include integrated security systems comprised of a command center managing one or more subsystems or components, primarily access control systems, intrusion detection systems, closed circuit television systems, critical condition monitoring systems and fire detection systems. The Company has signed a set of agreements with software security vendors and has added these products to its offering. The Company has added software salesmen and intends to significantly increase security software sales as a percentage of total sales.

The Company serves more than 50 clients including airports, hospitals, prisons, corporations, utilities, universities and government facilities. These clients include Washington Metropolitan Transit Authority, Auto Fina, AT&T, EDS, Kaiser Permanente and MCI WorldCom, Inc. In addition, the Company also provides the same full range of security systems services to the Government. The Company has an open-ended contract with the General Services Administration (GSA) that allows the government to purchase materials and services from the Company without having to go through a full competition. The Company has completed projects for the U.S. Military and several other government agencies throughout the world. These projects often require state-of-the-art security solutions for classified or high-risk government sites. The clients include the U.S. Army, U.S. Navy, U.S. Air Force, and the Department of Justice.

The Company began operations in 1987 in association with a large privately held engineering firm. In 1992, the Company became independent from the engineering firm in conjunction with a capital infusion from a private investment group. Since 1992, the Company has devoted a substantial amount of resources and capital to enhancing its technical capability and services offerings, hiring and training key personnel and expanding its client base. In the fourth quarter of 2000, the Company merged with Security Systems Integration (SSI) through an exchange of stock. In addition to its headquarters office in Chantilly, Virginia, which is in the Washington, D.C. metropolitan area, the Company has regional offices in Atlanta and Dallas and Sacramento, California.

Integrated Security Systems

Integrated security systems are comprised of one or more subsystems and components that perform a variety of security functions for a facility or group of facilities under the direction of a single command center. The command center consists of a central processor, a common database and software that enable various subsystems and components to communicate with each other and integrate the subsystems and components into a single system. Subsystems and components consist primarily of the following:

Access control systems, which are designed to exclude unauthorized personnel from specified areas and provide access control that is typically card-activated. Entry and exit activity can be monitored or recorded and may be controlled on the basis of time and authority level.

Intrusion detection systems, which incorporate ultrasonic, infrared, microwave and other sensors to detect unauthorized door and window openings, glass breakage, vibration, motion and noise, and alarms and other peripheral equipment.

Closed circuit television systems, which monitor and record entry and exit activity or provide surveillance of designated areas. These systems can

deter theft and vandalism and support other access control systems. They can be monitored either by a video recorder or by a monitoring screen.

Critical condition monitoring systems, which provide supervision of various systems and processes such as sprinkler systems, heating and refrigeration systems, power levels, water levels and general manufacturing processes.

Fire detection systems, which incorporate heat, ionization, smoke and flame sensing devices, manual pull stations, evacuation sounders and systems, sprinkler systems and elevator controls.

The Company's Services

The Company offers a full range of security services, consisting of: (i) consulting and planning; (ii) engineering and design; (iii) systems integration; and (iv) maintenance and technical support. The Company has also added a series of software security products and services to its offering. The Company's engagement may include one or more of the elements described below.

Consulting and Planning. Security consulting and planning are the initial phases of determining a security solution for a project. The Company has developed a planning process that identifies all systems, policies and procedures that are required for the successful operation of a security system that will both meet a client's current needs and accommodate its projected future requirements. The Company's consulting and planning process includes the following steps:

Identify the client's objectives and security system requirements
Review the existing security system plan
Survey the site, including inventory of physical components and software and evaluation of client's existing infrastructure and security system
Identify and prioritize the client's vulnerabilities
Develop and evaluate system alternatives
Recommend a conceptual security plan design
Estimate the cost of implementing the conceptual plan
Develop a preliminary implementation schedule

As a result of this process, the Company provides the client with a master plan for security services which recommends an effective security solution that addresses routine operating needs as well as emergency situations. The Company believes that its comprehensive planning process enables its clients to budget for their security requirements on a long-term basis, identify opportunities for cost reduction and prepare for future risks.

Engineering and Design. The engineering and design process involves preparation of detailed project specifications and working drawings by a team of the Company's engineers, systems designers and computer-aided design system operators. These specifications and drawings detail the instrument sensitivity requirements, layout of the control center, placement of equipment and electrical requirements. Throughout the engineering and design process, the Company utilizes its expertise in advanced technologies and its understanding of its client's operational preferences to design a system that is functional, cost-effective and accommodates the client's present and future requirements. In addition, the Company attempts to incorporate its client's existing personnel, equipment and other physical resources into the system design.

When retained as a single-source provider for turnkey security solutions, the Company also selects the system components required under the specifications and drawings it has prepared. To the extent possible, the Company uses off-the-shelf equipment to minimize the cost of developing custom

equipment. The Company has made a strategic decision not to represent any equipment manufacturer exclusively, thereby maintaining objectivity and flexibility in equipment selection. The Company believes that its technical proficiency with the products of a wide range of manufacturers enables it to select components that will best meet a project's requirements.

Systems Integration. Systems integration involves (i) equipment procurement; (ii) custom systems modeling and fabrication; (iii) facility installation; (iv) hardware, software and network integration; and (v) system validation and testing. In addition to these basic integration services, the Company provides engineering services to enhance the compatibility of the client's subsystems. The Company prepares technical documentation of the system and operations manuals and provides on-site training to client personnel.

Under the supervision of a project manager, the Company's technicians conduct hardware installation, hardware and software integration, system validation and testing. The aspects of systems integration that do not require a high level of technical expertise, such as wire installation and basic construction, are typically performed by the Company's subcontractors.

Maintenance and Technical Support. The Company provides maintenance and technical support services on a scheduled, on-call, or emergency basis. These services include developing and implementing maintenance programs both for security systems designed, engineered, or integrated by the Company and for existing systems.

Software Security Products and Services. The Company has signed agreements with providers of a set of specific security software products. These products support key initiatives in both the Government and Commercial Sectors in this world of heightened security risks. These initiatives include telecommuting employees, decentralized office locations, mobile computing, securing laptops and workstations at the application level and securing company and agency networks. The Company also offers the services necessary to establish and implement software security policies.

Marketing

The Company's marketing activities are conducted on both national and regional levels. The Company obtains engagements through existing contract vehicles with commercial and government organizations, direct negotiation with clients, competitive bid processes and referrals. At the national level, the Company conducts analyses of various government agencies and industries and targets those with significant potential demand for security solutions. At a regional level, under the supervision of senior management, each office develops and implements a marketing plan for its region. The plan identifies prospective clients within the region and sets forth a strategy for developing relationships with them. Each regional office works with the headquarters office in expanding relationships with existing national, commercial and government clients to include facilities within the region.

The Company has identified several key industries or facility types that it believes have substantial and increasing requirements for security services, including healthcare and technology companies, corporate complexes and industries and facilities for which security systems are required by regulation. The Company has developed expertise in the security regulations applicable to airports, healthcare companies, prisons and nuclear utilities, military chemical demilitarization facilities, U.S. Military installation facilities and classified government facilities.

The Company's marketing strategy emphasizes developing long-term relationships with clients that have multiple facilities and complex security requirements so that the Company can continue to provide services over a

recurring basis after the initial contract. The Company undertakes significant pre-assessment of a prospective client's needs before an initial contact is made. Engagements for maintenance and technical support enable the Company to maintain long-term contact with customers and to identify new requirements as they arise and to offer its solutions to such requirements. In the Government Division, the Company has developed strong relationships and open-ended contract vehicles that allow the Company to provide recurring services to its customers for several years. As a result of successful performance, the Company receives positive references and referrals from its existing customers to new government customers. The Company is aggressively adding to its GSA Schedule and is using that open contract vehicle to grow its presence in Federal Government Agencies.

The Company employs a variety of pricing strategies for its services. Proposals for consulting services are priced based on an estimate of hours multiplied by standard rates. Systems integration engagements are priced based upon the estimated cost of the components of the engagement, including subcontractors and equipment, plus a profit margin. Pricing for engineering and maintenance services vary widely depending on the scope of the specific project and the length of engagement. All proposals are reviewed by the Company's senior management.

Clients

During the past three years the Company has provided services to approximately 90 clients, including airports, hospitals, prisons, corporations, utilities, universities and government facilities. The Company's clients have included the following:

Airports and Aviation

Fresno Airport
United Airlines
Washington-Dulles International Airport
Washington Reagan National Airport
Yuma International Airport
Seattle-Tacoma Airport
Dallas Fort Worth Airport

Corporations

AT&T
EDS
Gillette Corporation
Hewlett-Packard Company
Lazard Freres
Lucent Technologies
Mary Kay Cosmetics
MCI WorldCom, Inc.
Mobil Corporation
NationsBank
US WEST
Wachovia Bank
Alltel Corporation
Koch Industries
Nokia
Fina Oil and Gas Company
Kodak
Amtrak
Hearst Corporation
Kaiser Permanente

Government

Los Alamos National Laboratory
Sandia National Laboratory
Tennessee Valley Authority
U.S. Department of Energy
U.S. Navy
U.S. Army
U.S. Department of Justice

Other

City of Baltimore Central
Booking and Intake Facility
Moscow Local Telephone System
New York City's World TradeCenter
Rostelecom
Rowan County (N.C.) Prison
Washington Metropolitan Area
Transit Authority

During 2001, the U.S. military accounted for 26%, MCI accounted for 11%, and Kaiser accounted for 8% of the Company's revenue. The loss of a significant portion of the revenue from any of these clients would need to be replaced to avoid a material adverse effect upon the Company's business, operating results and financial condition. Although the U.S. military and security software products and services accounted for a substantial portion of the Company's revenue, work performed for them was comprised of multiple projects at numerous different facilities.

Competition

The security industry is highly competitive. The Company competes on a local, regional and national basis with systems integrators, consulting firms and engineering and design firms. The Company believes that it is the only provider that focuses solely on its comprehensive range of security services including software security to government and commercial clients on a national basis. As a result, the Company competes with different companies depending upon the nature of the project and the services being offered. For example, the Company has competed with ADT, Siemens, and Pinkerton for systems integration work. Many of its competitors have greater name recognition and financial resources than the Company. The Company may face future competition from potential new entrants into the security industry and increased competition from existing competitors that may attempt to develop the ability to offer the full range of services offered by the Company. The Company believes that competition is based primarily on the ability to deliver solutions that effectively meet a client's requirements and, to a lesser extent and primarily in competitive bid situations, on price. There can be no assurance that the Company will be able to compete successfully in the future against existing or potential competitors.

Backlog

The Company's backlog consists of confirmed orders, including the balance of projects in process. The backlog also includes projects for which the Company has been notified it is the successful bidder even though a binding agreement has not been executed. Projects for which a binding contract has not been executed may be canceled at any time. Binding contracts may also be subject to cancellation or postponement, although cancellation generally obligates the client to pay the costs incurred by the Company. Long-term maintenance contracts may be canceled without cause. As of December 31, 2000 and 2001, the Company's backlog was approximately $4.25 million and $1.1 million, respectively. Backlog orders as of any particular date may not be indicative of actual operating results for any fiscal period. There can be no assurance that any amount of backlog will be realized. In addition, the Company has existing contractual relationships with customers who have identified $4.5 million of additional projects expected to be awarded within 12 months.

Employees

As of December 31, 2001, the Company had 45 employees, of which 19 were based in the Company's headquarters located in Chantilly, Virginia; the balance work out of the Company's regional offices. Seven of the Company's employees are engaged exclusively in marketing and sales, 29 employees are engaged in engineering, project management, and technical functions, and seven employees are engaged in executive management and administration. Eight of the Company's employees are represented by a labor union in California and the Company believes its employee relations are good.

Insurance

The Company maintains in force commercial umbrella liability insurance with coverage of $10 million per occurrence and $10 million in the aggregate, with a $10,000 deductible. The Company also maintains a $1.0 million insurance

policy to cover any error or omission by the Company that may result in a breach of a security system designed, installed, maintained, or engineered by the Company. There is no assurance that the amount of insurance carried by the Company would be sufficient to protect it fully in the event of a significant liability claim; however the Company believes that the amounts and coverages of its insurance are reasonable and appropriate for its business operations. There is no assurance that such insurance will continue to be available on commercially reasonable terms, and the Company may elect not to retain liability insurance at any time.

Item 2. Properties.

The Company's headquarters office is located in Chantilly, Virginia, which is in the Washington, D.C. metropolitan area. This office is in space the Company shares with NetCom Solutions, a shareholder of the Company. In addition, the Company leases between approximately 2,000 and 4,000 square feet of office space in each of the Atlanta, Dallas, and Sacramento metropolitan areas to support its regional operations. The Company believes that its facilities are adequate and suitable for its current operations, and that additional space is readily available if needed to support future growth.

Item 3. Legal Proceedings.

As of December 31, 2001, the Company was a defendant in three lawsuits regarding disputes over payments to vendors with an aggregate total of $88,000.00. As a significant subsequent event, the Company has notified the former owner of SSI that he is in material breach of the merger agreement between SSI and Stratesec Incorporated. The Company has terminated the individual's employment, vacated a facility owned by him and demanded return, or cancellation, of all 2 million shares issued as part of the merger. If the shares are not returned, the Company intends to proceed with a lawsuit seeking damages, as well as the return of the shares.

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

No matters were submitted to a vote of the stockholders of the Company during the fourth quarter of the fiscal year covered by this report.

Part II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters.

The Company's Common Stock is traded on the American Stock Exchange under the symbol SFT. The following table sets forth the quarterly range of high and low closing sale prices per share for the Common Stock during the periods indicated.

	High	Low
2000		
First Quarter............................	4 1/8	2
Second Quarter...........................	3 7/8	1 7/8
Third Quarter............................	3	2
Fourth Quarter...........................	2 5/8	2
2001		

First Quarter............................	2 3/4	2
Second Quarter...........................	1.59	1.10
Third Quarter............................	1.52	.50
Fourth Quarter...........................	1.22	.43
2002		
First Quarter (through March 23, 2001).....	.80	.40

The Company has not paid any cash dividends on its Common Stock since its formation. It presently intends to retain its earnings for use in its business and therefore does not anticipate paying any cash dividends in the foreseeable future. The payment of any future dividends will be determined by the Board of Directors in light of conditions then existing, including the Company's earnings, financial condition and requirements, restrictions in financing agreements, business conditions, and other factors.

In the fourth quarter of 1999 and the first quarter of 2000, the Company completed a private placement of 1,204,855 shares of its common stock to a limited number of sophisticated and/or accredited investors at a price of $1.50 per share for aggregate cash proceeds of $1,807,282. In the first quarter of 2000, the Company sold 700,000 shares of its common stock to a company at a price of $1.50 per share for aggregate proceeds of $1,050,000 consisting of cash of $500,000 and a note payable of $550,000. In the fourth quarter of 2000, the Company issued 1,650,000 shares of stock and reissued 350,000 shares of treasury stock in connection with the Company's merger with Security Systems Integrations, Inc. (SSI). Each of these transactions was exempt from the registration requirements of the Securities Act of 1933 (the "Act") pursuant to section 4(2) of the Act because they did not involve a public offering of securities.

Item 6. Selected Financial Data.

The selected financial data presented below (in thousands, except for per share data) should be read in conjunction with the consolidated financial statements and notes thereto of the Company and Managements' Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this report.

	Year Ended December 31, 2000	2001
	(in thousands)	
Statement of Operations Data:		
Revenue..............................	$ 23,983	$ 9,077
Cost of revenue.....................	(15,375)	(6,866)
Gross profit......................	8,608	2,211
Selling, general and administrative expenses..........................	(7,179)	(9,058)
Operating income................	1,429	(6,847)
Interest and financing fees...........	(748)	(1,148)

Interest and other income............	75	211
Income (loss) before income taxes..	756	(7,784)
Provision for income taxes...........	(800)	289
Net loss..........................	$ (44)	$ (7,495)
Basic and diluted loss per share...	$ (0.00)	$ (0.73)
Diluted income per share..........	$ (0.00)	$ (0.00)
Weighted average number of shares outstanding:		
Basic................	10,027	10,290
Diluted.............	N/A	N/A

	Year Ended December 31, 2000	2001
Balance Sheet Data:		
Cash and cash equivalents.................	$ 887	$ 238
Working capital (deficit)................	1,947	(4,983)
Total assets.............................	10,999	5,797
Long-term debt, less current maturities...	23	0
Total stockholders' equity (deficiency)...	3,052	(4,377)

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

Overview

The Company is a single-source provider of comprehensive, technology-based security solutions for medium and large commercial and government facilities in the United States and abroad. The Company offers a broad range of services, including: (i) consulting and planning; (ii) engineering and design; (iii) systems integration; (iv) maintenance and technical support; and (v) information security products and services.

The Company began operations in 1987 in association with a large privately held engineering firm. As a start-up, the Company expended significant capital on the development of the Company's business and infrastructure, and it accumulated losses of approximately $2.8 million from 1987 through 1991 on aggregate revenues of approximately $17.2 million. The Company's revenues from 1990 through 1994 were generated primarily by a contract to design and integrate extensive security upgrades at three nuclear facilities for the Tennessee Valley Authority (the "TVA"). In 1992, the Company became independent from the engineering firm in conjunction with a capital infusion from a private investor group. At the same time, the Company hired new management with extensive expertise in the security industry. Since 1992, the Company has devoted a substantial amount of resources and capital to enhancing its technical capability and services offerings, hiring and training key personnel and expanding its client base. As part of this effort, the Company opened four regional offices in the United States. In November 2000, the Company merged with SSI, a security systems integration firm exclusively providing security systems and services to the U.S. Government. The resources and contracts of SSI were combined with those of the Company and became the Government Division of the Company. During 2001, the Government Division failed to generate revenues at expected levels, and will be reorganized.

The Company derives its revenue primarily from long-term, fixed-price contracts. Earnings are recognized based upon the Company's estimates of the

cost and percentage of completion of individual contracts. Earned revenue equal the project's total contract amount multiplied by the proportion that direct project costs incurred on a project bear to estimated total project costs. Project costs include direct labor and benefits, direct material, subcontract costs, project related travel and other direct expenses.

Clients are invoiced based upon negotiated payment terms for each individual contract. Terms usually include a 25% down payment and the balance as stages of the work are completed. Maintenance contracts are billed either in advance, monthly, or quarterly. As a result, the Company records as an asset, costs and estimated earnings in excess of billings and as a liability, billings in excess of costs and estimated earnings.

Results of Operations

The following table sets forth the percentages of earned revenues represented by certain items reflected in the Company's statements of operations.

	Year Ended December 31, 2000	2001
Revenue	100.0%	100.0%
Cost of revenue	(64.1%)	(75.6%)
Gross profit	35.9%	24.4%
Selling, general and administrative expenses	(29.9%)	(99.8%)
Operating income	6.0%	(75.4%)
Gain on sale of plant and equipment	0.0%	0.0%
Interest and financing fees	(3.1%)	(12.7%)
Interest and other income	0.3%	2.3%
Provision for income taxes	(3.4%)	3.2%
Net loss	(0.2%)	(82.6%)

Year Ended December 31, 2001 Compared with Year Ended December 31, 2000

Revenue decreased by 62.1% from 24.0 million in 2000 to $9.0 million in 2001. The decrease was due to a severe decrease in revenue from existing commercial customers as a result of a freeze or reduction in capital spending in the telecom and information technology (IT) sectors. In addition, ramp up of new commercial customers in other business sectors was slow due to economic conditions. The Government sector revenue from existing customers also declined dramatically and no new Government customers were added.

Cost of revenue decreased from $15.4 million in 2000 to $6.9 million in 2001, primarily due to the decrease in revenue. Gross margin decreased from 35.9% in 2000 to $24. 4% in 2001. The gross margin was adversely affected by the trailing costs associated with completion of 3 large Government and one commercial contract.

Selling, general and administrative expenses increased by 27.0% from $7.2 million in 2000 to $9.1 million in 2001. The increase is due to the increase in reserves and write-offs from $687,000 in 2000 to $3.9 million in 2001 that are included in selling, general and administrative expenses. Without the reserves and write-offs, selling, general and administrative expenses

actually decreased by $1.8 million to $5.1 million or 26%. The circumstances giving rise to these reserves and write-offs are discussed below under "Management Plan for Improvement."

Interest expense and financing fees increased 47% from $0.75 million in 2000 to $1.1 million in 2001. The growth was due to the increased use of the line of credit as compared with in 2000 when private equity was used.

Net income decreased from a net loss of $0.04 million in 2000 to a net loss of $7.5 million in 2001. These decreases in net income were primarily due to the significant decrease in revenue and the write-offs and reserves the Company recorded for obsolete inventory and uncollectable receivables.

Management Plan For Improvement

The following plan addresses management's approach to improving the financial condition of the Company as well as the plan to regain compliance with the American Stock Exchange's continued listing standards.

The Company's revenues grew from $6 million of revenue in 1998, $14 million in 1999 and $24 million in 2000. However, the Company's financial results for 2001 were impacted by the severe downturn in the economy, especially in the Telecom and IT sectors. The Company had concentrated on those areas for its national commercial accounts because of the approach taken by companies within those sectors with regard to security. Companies within those segments typically have multiple sites but exercise central control over security policies and system implementations. As a result, the Company had grown that business segment to $14 million a year. When the Telecom and IT sectors crashed most of these companies instituted a freeze or reduction of capital spending and the Company's contracts were scaled back or cancelled causing a reduction of over one million dollars a month in business. The Company did not immediately reduce staff, as our customers believed that the reductions would be temporary. In addition, the entire economy continued to deteriorate causing not only further reductions in business, but causing several of our customers to go out of business or to stop paying outstanding payables.

As a result of the foregoing, revenue for 2001 was $9,077,330 with a loss after unusual items of $7,495,493. The unusual items recorded during the year consists of the following:

- o Disputed accounts receivable for terminated contracts due to customer economic conditions..$
- o Costs associated with completion of contracts in the Texas region after closure of that regional office...$
- o Potentially uncollectable accounts as a result of customer economic difficulties...$1,
- o Write off of, or reserve for, obsolete inventory recovered from previous contracts over the last 36 months..$
- o Costs associated with settlements over disputed charges from subcontractors and vendors...$
- o Excess overhead expenses associated with financial commitments as a result of the merger agreement between SSI and Stratesec...................$1,
- o Excess interest charges due to the requirement to use a factor to

provide the company credit facility...$

Total..........................$5,

In 2002, sales are expected to remain slow through the first quarter, averaging from $300,000 to $500,000 in monthly in revenue. Based on sales projections, the Company expects revenue to improve in the second quarter to an average of $800,000 per month by the end of the quarter. The Company projects sales per month of $1 million by the end of the third quarter and $1.2 million per month by the end of the fourth quarter. To achieve this improvement in sales, the Company has added several major accounts to replace the accounts that froze their capital budgets. For example, we have added Hewitt and Associates, EMC Corporation, Kaiser Permanente, Veritas Software, Clarion Realty, The Washington Metropolitan Transit Authority, Guinette County in Georgia, CMT Construction, San Jose Construction Group, Devcon Construction and American University. In addition, we have restarted projects with EDS, Trammel Crow, Amtrak and several other prior customers.

As of March 31, 2002, there were $3.6 million in projects on which the Company has been informed that it is the vendor of choice; there are $4.8 million more in high probability proposals outstanding. The Company has contracts on $1.2 million of the $3.6 million, and has been verbally notified on the other $2.4 million of projects. The Company believes that all of the remaining $2.4 million will be awarded to the Company over the next 60 days but even if 80% of the amount is awarded, there will be $1 million dollars of new business awarded each month of the second quarter. If the company merely maintains that rate of new business, it will begin to generate operating profits.

The Company has also obtained the commitment from its finance company, E.S. Bankest, to finance the material and the cash flow necessary to work as much business as the Company can win; as a result the Company's financial condition should not prevent execution of its projects.

In order to expand its offering and add higher margin revenue, the Company has also added the capability to provide software security products and services to its customers. The Company has software in evaluation at the U.S. Postal Service now for a potential major sale. The Company will add more security software products and services and expects to expand its customer base significantly in this area. The fixed overhead required to support these products and services is very low and the profitability is very high. We expect that the overall Company profitability will be significantly improved as software sales are recorded.

The Company is also in the process of adding products for sale to the federal government to its GSA schedule. Since the Company has its headquarters in the Washington, D.C. suburbs, we expect the business with the federal government to grow over the next 12 months. Security funding for federal government buildings has been increased tremendously since September 11, 2001. The federal government recently allocated the fiscal year 2002 budget, but through March had operated under a condition of no new projects since September 2001. Contacts inside the federal government have informed us that the budgets have now been allocated and we expect sales to the federal government to increase..

The Company has also implemented the following initiatives to reduce its overhead expenses so that break-even revenue will be $600,000 per month:

o Reduced full-time and temporary corporate staff

- Reduced executive management

- Relocated headquarters to shared facilities with Netcom Solutions, a privately held IT company and shareholder of STRATESEC

- Restructured salaries of sales force to lower base and higher commissions

- Consolidated costs (telephones, utilities, etc.) with Netcom Solutions

- Restructured operations to increase use of subcontractors on a fixed price basis

Based on the projected increase in monthly sales and the decrease in overhead, the Company expects to be profitable on an operating basis by the end of the second quarter. In order to improve the equity position on its balance sheet, the Company is aggressively exploring mergers and acquisitions with other physical and software security firms as well as pursuing external equity funding. In addition, to reduce the liabilities on its balance sheet, the Company has prepared an offer in compromise to the IRS that will eliminate $930,000 of tax liability, if accepted. The Company also intends to attempt to convert a significant amount of the line of credit debt to equity.

Liquidity and Capital Resources

During February 1999, the $1.9 million the Company was required to post as collateral for a bond pending its appeal of a lawsuit was released when the trial court's judgment was reversed. The Company paid off $0.9 million of the convertible subordinated debentures during the first quarter 1999. In September 1999 all of the holders of the remaining subordinated debentures agreed to exchange their notes for the Company's common stock valued at $1.50 per share. Additionally, to support the significant increase in business, the Board approved a private placement of 500,000 shares at $1.50 per share, which was subsequently increased to 1,204,855 shares. The board also approved the sale of up to 21% equity in the company to a minority partner. Netcom Solutions International subsequently purchased approximately 8% or 700,000 shares of the Company at $1.50 per share. As of March 2000, $930,000 of debt was converted to equity, the private placement and $1.05 million in the form of cash received $1.8 million and a short-term note was received from the sale of a minority interest.

The Company's principal capital requirements are increased working capital needed to support its growth. The Company currently is funding its working capital requirements with cash generated by operations and a receivables factoring facility with a financial institution. The Company is seeking additional financing to reduce outstanding aged accounts payable and to provide the working capital to fund the sales projected for 2002. If it is unable to obtain additional financing, its ability to obtain new business and increase revenue may be limited.

Forward-Looking Statements

This Form 10-KSB includes certain statements that may be deemed to be "forward-looking statements" within the meaning of Section 27A of the Securities Act. All statements, other than statements of historical fact, included in this Form 10-KSB that address activities, events, or developments that the Company expects, projects, believes, or anticipates will or may occur in the future, including matters having to do with existing or future contracts, the Company's ability to fund its operations and repay debt, business strategies, expansion and growth of operations and other such matters, are forward-looking statements. These statements are based on certain assumptions and analyses made by our management in light of its experience and its perception of historical trends, current conditions, expected future developments, and other factors it believes

are appropriate in the circumstances. These statements are subject to a number of assumptions, risks and uncertainties, including general economic and business conditions, the business opportunities (or lack thereof) that may be presented to and pursued by the Company, the Company's performance on its current contracts and its success in obtaining new contracts, the Company's ability to attract and retain qualified employees, and other factors, many of which are beyond the Company's control. You are cautioned that these forward-looking statements are not guarantees of future performance and those actual results or developments may differ materially from those projected in such statements.

Item 7a. Quantitative and Qualitative Disclosures About Market Risk.

Not Applicable.

Item 8. Financial Statements.

The Financial Statements of the Company, together with the reports thereon of Argy, Wiltse & Robinson, P.C. dated March 8, 2002 are listed in Item 14(a)(1) and are included at the end of this Report on Form 10-K, beginning on page F-1, and are incorporated herein by reference.

Part III

Item 9. Directors and Executive Officers of the Registrant.

The information required by Item 9 will be contained in the Company's Proxy Statement for the 2002 Annual Meeting of Stockholders under the captions "Directors and Nominees" and "Compliance with Section 16(a) of the Securities Exchange Act of 1934."

Item 10. Executive Compensation.

The information required by Item 10 will be contained in the Company's Proxy Statement for the 2002 Annual Meeting of Stockholders under the caption "Executive Compensation", and is incorporated herein by reference.

Item 11. Security Ownership of Certain Beneficial Owners and Management.

The information required by Item 11 will be contained in the Company's Proxy Statement for the 2002 Annual Meeting of Stockholders under the caption "Common Stock Ownership of Certain Beneficial Owners and Management", and is incorporated herein by reference.

Item 12. Certain Relationships and Related Transactions.

The information required by Item 12 will be contained in the Company's Proxy Statement for the 2002 Annual Meeting of Stockholders under the caption "Compensation Committee Interlocks and Insider Participation and Certain Transactions", and is incorporated herein by reference.

Part IV

Item 13. Exhibits, Financial Statement Schedules and Reports on Form 8-K.

(a) (1) List of Financial Statements. The following is a list of the financial statements included at the end of this Report of Form 10-KSB beginning

on page F-1:

Reports of Independent Certified Public Accountants
Balance Sheets as of December 31, 2001 and 2000
Statements of Operations for the Years Ended December 31, 2001 and 2000
Statement of Stockholders' Equity for the Years Ended December 31, 2001 and 2000
Statements of Cash Flows for the Years Ended December 31, 2001 and 2000
Notes to Financial Statements

(2) List of Financial Statement Schedules.

Schedule II - Valuation and Qualifying Accounts

All other schedules have been omitted because they are not applicable or not required, or the required information is provided in the financial statements or notes thereto.

(b) Reports on Form 8-K.

The Company filed a report on Form 8-K on December 13, 2000 to report a change in its independent public accountants under Item 4 of the report. The Company filed a report on Form 8-K on December 15, 2000 to report its merger with SSI. The report was amended on February 13, 2001. The Company filed a report on Form 8-K on February 23, 2001 to report a change in its independent public accountants. The report was amended on February 27, 2001.

(c) List of Exhibits. The following is a list of exhibits furnished. Copies of exhibits will be furnished upon written request of any stockholder at a charge of $0.25 per page plus postage.

Exhibit Number	Exhibits
3.1	Form of Restated Certificate of Incorporation1
3.2	Form of Bylaws1
4	Form of Rights Agreement1
10.1	Stock Option Plan1
10.2	Employment Agreement with Ronald C. Thomas1
10.4	Consulting Agreement with Wirt D. Walker, III1
23.2	Consent of Argy, Wiltse & Robinson, P.C.

1 Filed as an exhibit of the same number to the Company's registration statement on Form S-1 (File No. 333-26439) and incorporated by reference.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

STRATESEC INCORPORATED

By: /s/BARRY W. MCDANIEL
Barry W. McDaniel
President/Chief Executive Officer

Pursuant to the requirements of the Securities Act of 1933, the following persons in the capacities and on the dates indicated have signed this registration statement.

Signature	Title	
/s/ BARRY W. MCDANIEL Barry W. McDaniel	Co-President/Chief Executive Officer (Principal Executive Officer)	Apri
/s/ WIRT D. WALKER, III Wirt D. Walker, III	Chairman and Director	Apri
/s/ ALBERT V. GRAVES Albert V. Graves	Chief Financial Officer (Principal Accounting Officer)	Apri
/s/ JAMES A. ABRAHAMSON James A. Abrahamson	Director	Apri
/s/ CHARLES W. ARCHER Charles W. Archer	Director	Apri
/s/ EMMIT J. MCHENRY Emmit J. McHenry	Director	Apri

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholders of STRATESEC Incorporated:

In our opinion, the accompanying consolidated balance sheets and the related statements of operations, of stockholders' equity, and of cash flows present fairly, in all material respects, the financial position of STRATESEC Incorporated (formerly known as Securacom, Incorporated) at December 31, 2001 and 2000, and the result of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

We have also audited Schedule II of STRATESEC Incorporated for the years ended December 31, 2001 and 2000. In our opinion, this schedule presents fairly, in all material respects, the information required to be set forth therein.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As described in Note 2 to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency that raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 2. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

McLean, Virginia
March 8, 2002

STRATESEC INCORPORATED

CONSOLIDATED BALANCE SHEETS

DECEMBER 31, 2001 AND 2000

	2001

ASSETS

Current assets		
Cash and cash equivalents	$	238,20
Accounts receivable, net of allowance for doubtful accounts of $750,000 at 2001 and $350,000 at 2000		4,108,69
Costs and estimated earnings in excess of billings on uncompleted contracts, net of allowance of $300,000 at 2001 and $0 at 2000		582,69
Inventory, net of allowance of $400,000 at 2001 and $70,000 at 2000		190,60
Other current assets		70,72
Total current assets		5,190,92
Property and equipment, net		483,90
Note receivable from stockholder, net		
Deposits		121,76
Total assets	$	5,796,59

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities		
Accounts payable	$	2,287,71
Accrued expenses		304,96
Income taxes payable		955,95
Bank and other lines-of-credit		6,325,49
Billings in excess of costs and estimated earnings on uncompleted contracts		276,98
Capital lease obligations		22,61
Total current liabilities		10,173,72
Capital lease obligations		
Total liabilities		10,173,72
Stockholders' (deficit) equity		
Common stock, $0.01 par value per share; 20,000,000 shares authorized; 10,401,471 issued and 10,392,550 outstanding shares at 2001, and 10,280,043 issued and 10,279,964 outstanding shares at 2000		104,01
Additional paid-in capital		24,363,70
Accumulated deficit		(28,826,31
Less: treasury stock of 8,921 shares at 2001 and 79 shares at 2000, at cost		(18,53
Total stockholders' (deficit) equity		(4,377,12
Commitments		
Total liabilities and stockholders' equity	$	5,796,59

STRATESEC INCORPORATED

CONSOLIDATED STATEMENTS OF OPERATIONS

YEARS ENDED DECEMBER 31, 2001 AND 2000

	2001
Revenue	$ 9,077,330
Cost of revenue	(6,865,988)
Gross profit	2,211,342
Selling, general and administrative expenses	(5,179,313)
Bad debt expense	(3,878,922)
Operating (loss) profit	(6,846,893)
Interest and financing fees	(1,148,563)
Interest and other income	210,509
(Loss) income before income taxes	(7,784,947)
Benefit from (provision for) income taxes	289,046
Net loss	$ (7,495,901)
Basic and diluted net loss per share	$ (0.73)
Weighted-average shares outstanding	10,290,162

STRATESEC INCORPORATED

STATEMENTS OF STOCKHOLDERS' EQUITY

YEARS ENDED DECEMBER 31, 2001 AND 2000

	Common Stock		Treasury Stock		Addit Paid Capi
	Shares	Amount	Shares	Amount	

Balance at December 31, 1999	8,540,189	$ 85,402	98,000	$ (203,086)	$ 21,686
Net loss	0	0	0	0	
Dividends paid	0	0	0	0	
Private placement of common stock	1,738,188	17,382	0	0	2,589
Sale of common stock	1,666	16	0	0	3
Purchase of treasury stock	0	0	(98,079)	(203,250)	
Balance at December 31, 2000	10,280,043	102,800	(79)	(164)	24,279
Net loss	0	0	0	0	
Sale of common stock	121,428	1,215	0	0	83
Purchase of treasury stock	0	0	(8,842)	(18,369)	
Balance at December 31, 2001	10,401,471	$ 104,015	(8,921)	$ (18,533)	$ 24,363

STRATESEC INCORPORATED

CONSOLIDATED STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2001 AND 2000

	2001
Cash flows from operating activities:	
Net loss	$ (7,495,901
Adjustments to reconcile net loss to net cash used in operating activities:	
Depreciation and amortization	257,535
Change in allowances for doubtful accounts, inventory obsolescence, and note receivable, net	1,357,277
Deferred income taxes	0
(Increase) decrease in:	
Accounts receivable	(555,032
Costs and estimated earnings in excess of billings on uncompleted contracts	3,732,542
Inventory	(149,724
Other current assets	(25,578
Increase (decrease) in:	
Accounts payable	(832,678
Accrued expenses	(715,785

Income taxes payable	(289,046
Billings in excess of costs and estimated earnings on uncompleted contracts	139,675
Total adjustments	2,919,186
Net cash used in operating activities	(4,576,715
Cash flows from investing activities:	
Purchases of property and equipment, net	(65,526
Decrease in deposits	2,304
Net cash used in investing activities	(63,222
Cash flows from financing activities:	
Net borrowings under bank and other lines-of-credit	3,993,935
Principal payments under capital lease obligations	(69,643
Repurchase of common stock	(18,369
Proceeds from the issuance of common stock	85,001
Dividend payments	0
Net cash provided by financing activities	3,990,924
Net decrease in cash and cash equivalents	(649,013
Cash and cash equivalents at the beginning of the year	887,214
Cash and cash equivalents at the end of the year	$ 238,201

STRATESEC INCORPORATED

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2001 AND 2000

NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Description of business and principles of consolidation

The accompanying financial statements include the accounts of STRATESEC Incorporated (SFT) and its wholly-owned subsidiary, Security Systems Integration, Inc. (SSI) (collectively referred to as the Company). SFT, formerly known as Securacom Incorporated, is incorporated under the laws of the State of Delaware to provide comprehensive security solutions for large commercial and government facilities worldwide.

At December 31, 1996, SFT was approximately 91 percent owned by KuwAm Corporation, two private investment partnerships (of which KuwAm serves as general partner), Special Situations Investment Holdings, Ltd., and Special Situations Investments Holdings L.P. II; and certain individual limited partners of the investment partnerships (the KuwAm Group). On October 1, 1997, SFT completed an initial public offering and sold 1,400,000 shares of common stock and the KuwAm Group sold 808,000 shares of stock. At December 31, 2001 and 2000, the KuwAm Group owned approximately 10 percent and 11 percent of the Company, respectively.

On November 30, 2000, the Company acquired Security Systems Integration, Inc. (SSI). To effect the combination, SSI merged into a newly organized wholly-owned subsidiary of the Company (Note 3). SSI is a security systems company that provides design, engineering, installation, maintenance, technical support, and training services, primarily to the federal government.

All significant intercompany balances and transactions have been eliminated in consolidation.

Use of estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions regarding certain types of assets, liabilities, revenues, and expenses. Such estimates primarily relate to unsettled transactions and events as of the date of the financial statements. Accordingly, upon settlement, actual results may differ from estimated amounts.

Concentrations of credit risk and fair value of financial instruments

The Company's financial instruments that are exposed to concentrations of credit risk consist primarily of cash, money market funds and trade accounts receivable. The Company places its cash and money market funds with high credit quality institutions. In general, such investments exceed the FDIC insurance limit.

The Company provides credit to its clients in the normal course of business. The Company routinely assesses the financial strength of its clients and, as a consequence, believes its trade accounts receivable exposure is limited.
The carrying value of financial instruments potentially subject to valuation risk (principally consisting of cash, accounts receivable and accounts payable) approximates fair market value.

Revenue recognition

The Company derives its revenue principally from long-term contracts, which are generally on a fixed-price basis. Revenue on fixed-price contracts includes direct costs and allocated indirect costs incurred plus recognized profit. Revenue is recognized under fixed-price contracts on the percentage-of-completion basis. The percentage of completion of individual contracts includes management's best estimate of the amounts expected to be realized on the contracts. It is at least reasonably possible that the amounts the Company will ultimately realize could differ materially in the near term from the amounts estimated in arriving at the earned revenue and costs and estimated earnings in excess of billings on uncompleted contracts.

Contract costs include all direct material, direct labor and direct subcontract costs. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined. Changes in job performance, job conditions and estimated profitability, including those arising from contract revisions and final contract settlements, may result in revisions to costs and income and are recognized in the period in which the revisions occur.

The asset "costs and estimated earnings in excess of billings on uncompleted contracts" represents revenue recognized in excess of amounts billed to clients. The liability "billings in excess of costs and estimated earnings on uncompleted contracts" represents billings in excess of revenue recognized.

Cash equivalents

The Company considers all highly liquid instruments with original maturities of three months or less to be cash equivalents.

Inventory

Inventory consists of equipment and parts held for sale and is stated at the lower of cost or market, with cost being determined by the first-in, first-out method.

Property and equipment

Property and equipment is stated at cost less accumulated depreciation and amortization. Depreciation and amortization of property and equipment is computed using the straight-line method over the estimated useful lives of three to ten years. Amortization of leasehold improvements is computed using the straight-line method over the shorter of the estimated useful lives of the assets or the term of the related lease.

Income taxes

Income taxes have been recorded using the liability method. The income tax provision includes federal and state income taxes both currently payable and changes in deferred taxes due to differences between financial reporting and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. Deferred tax assets and liabilities are measured using the enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse.

Loss per share

The Company has adopted SFAS No. 128, "Earnings Per Share" (EPS), which requires public companies to present basic earnings per share and, if applicable, diluted earnings per share. Basic EPS is based on weighted-average number of shares outstanding without consideration of common stock equivalents. Diluted EPS is based on the weighted-average number of common and common equivalent shares outstanding. When dilutive, the calculation takes into account the shares that may be issued upon exercise of stock options and warrants, reduced by the shares that may be repurchased with the funds received from the exercise, based on the average price during the year.

Stock options and warrants have not been included in the calculation of dilutive earnings per share as their inclusion would be antidilutive.

NOTE 2 - OPERATIONS

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplates continuation of the Company as a going concern. However, the Company has sustained substantial operating losses in recent years. In addition, the Company has used substantial amounts of working capital in its operations, financed primarily through over-line borrowing from its line-of-credit with a financing company. Further, at December 31, 2001, current liabilities exceed current assets by $4,982,797, and total liabilities exceed total assets by $4,377,129.

In view of these matters, realization of a major portion of the assets in the accompanying balance sheets is dependent upon continued operations of the Company, which in turn is dependent upon the Company's ability to meet its financing requirements, and the success of its future operations. Management believes that actions presently being taken to revise the Company's operating and financial requirements provide the opportunity for the Company to continue as a going concern.

NOTE 3 - BUSINESS COMBINATION

On November 30, 2000, the Company acquired Security Systems Integration, Inc. (SSI) in a business combination accounted for as a pooling of interests. SSI became a wholly-owned subsidiary of the Company through the exchange of 1,650,000 in newly-issued shares and 350,000 in treasury shares of the Company's common stock for all of the outstanding stock of SSI. The accompanying financial statements for 2000 are based on the assumption that SFT and SSI were combined for the full year. Financial statements for prior years have been restated to give effect to the combination.

Prior to the merger, SSI paid cash dividends of $462,220 ($0.05 per share) in 2000. Per share amounts are based on the equivalent number of common shares that would have been outstanding during these years, after giving effect to the pooling of interest in 2000.

Summarized results of operation of the separate companies for the period for January 1, 2000 through September 30, 2000, the last completed quarter prior to the date of acquisition, are as follows:

	SFT	SSI
Net revenue	$ 11,864,407	$ 6,869,531
Net income	$ 365,636	$ 1,215,931

The summarized assets and liabilities of the separate companies on September 30, 2000, the last completed quarter prior to the date of acquisition, were as follows:

	SFT
Cash and cash equivalents	$ 228,52
Accounts receivable	4,237,96

Costs and estimated earnings in excess of billings on uncompleted contracts	3,608,96
Other current assets	937,55
Property and equipment, net	525,41
Other assets	78,06
Total assets	9,616,48
Current liabilities	(5,558,42
Noncurrent liabilities	(43,51
Stockholders' equity (deficit)	$ 4,014,54

NOTE 4 - COSTS AND ESTIMATED EARNINGS ON UNCOMPLETED CONTRACTS AND BILLINGS IN EXCESS OF COSTS AND ESTIMATED EARNINGS ON UNCOMPLETED CONTRACTS

Costs and estimated earnings in excess of billings on uncompleted contracts, as well as the related billings in excess of costs and estimated earnings on uncompleted contracts, represent revenue recognized on long-term fixed-price contracts based on the percentage-of-completion method less the related billings to date. Revenue recognized in excess of billing is included in the asset balance and billings in excess of recognized revenue is included in the liability balance.

NOTE 5 - PROPERTY AND EQUIPMENT

Property and equipment consist of the following at December 31:

	2001	2000
Office furniture and equipment	$ 632,348	$ 611,493
Computer equipment	449,100	441,857
Leasehold improvements	227,439	191,836
Vehicles	159,251	159,251
Computer software	65,519	63,694
	1,533,657	1,468,131
Less: accumulated depreciation and amortization	(1,049,753)	(792,218)
	$ 483,904	$ 675,913

Equipment purchased under capital leases approximated $342,000 at December 31, 2001 and 2000. Accumulated depreciation on those assets approximated $323,000 and $272,000 at December 31, 2001 and 2000, respectively.

Depreciation and amortization expense on property and equipment (including equipment under capital leases) was $257,535 and $280,228 for the years ended December 31, 2001 and 2000, respectively.

NOTE 6 - NOTE RECEIVABLE FROM STOCKHOLDER

The note receivable from stockholder (with an original balance of $490,000) is unsecured, with installments of principal and interest (at 7.0%) of $3,260 due monthly through September 2029. No principal payments have been received during the years ended December 31, 2001 or 2000. As such, the unpaid balance of $327,277 has been fully reserved.

NOTE 7 - BANK AND OTHER LINES-OF-CREDIT

Bank and other lines-of-credit consists of the following at December 31:

	2001
Line-of-credit with financing company (maximum amount of 80% of eligible accounts receivable), due on demand, with interest (computed as a discount on amounts factored and the duration that the factored amount is unpaid) due monthly. Discounts range from 2.5% - 4.5%. This line-of-credit is secured by accounts receivable and inventory. At December 31, 2001 total borrowings exceeded the allowable limit described above by $2,438,536.	$ 6,325,49
Bank line-of-credit (maximum amount of $450,000), due on demand with interest at the bank's prime rate (4.75% at December 31, 2001). The line-of-credit is secured by a certificate of deposit, and expires, if not renewed, on May 31, 2002.	
Bank line-of-credit (maximum amount of $100,000), due on demand, with interest at the bank's prime rate plus 1.75% (6.5% at December 31, 2001) due monthly. This line-of-credit is secured by equipment and machinery and expired on March 5, 2002.	
Total	$ 6,325,49

Interest expense related to the lines-of-credit, which approximated interest paid, aggregated $462,512 and $447,806 for the years ended December 31, 2001 and 2000, respectively.

NOTE 8 - NOTES PAYABLE TO STOCKHOLDERS

During April 1998, the Company's board of directors approved issuance of up to $2 million in convertible subordinated debentures in an effort to provide additional working capital. In 1998, the Company sold $1,850,000 of these debentures to related parties, with 185,000 warrants attached to purchase common stock of the Company at $2.50 per share. The debentures bear interest at 10 percent semiannually. The value of the warrants was $71,393 at issuance and was determined by the Company, using the Black-Scholes valuation model and was

recorded as additional paid-in capital. All 185,000 warrants were outstanding at December 31, 2000 and expired in April 2001.

NOTE 9 - ACCRUED EXPENSES

Accrued expenses are summarized as follows at December 31:

	2001	2000
Accrued payroll and related liabilities	$ 146,343	$ 228,669
Sales tax	94,795	111,666
Accrued interest and penalties	50,000	300,000
Legal judgment	0	262,290
Directors fees	0	17,500
Other	13,823	100,621
	$ 304,961	$ 1,020,746

NOTE 10 - RELATED PARTY TRANSACTIONS

During 2000, the Company sold 175,688 shares of common stock in a private placement at a price of $1.50 per share to one related party.

During 2000, the Company entered into a noncancelable lease agreement with a stockholder for office space in Springfield, Virginia. The lease agreement provides for payments of $10,000 per month through December 31, 2005 and has been included in the operating lease commitment schedule in Note 17.

During 2001, the Company issued warrants for the purchase of 400,000 shares of its common stock (Note 11) to its financing company (Note 7).

NOTE 11 - STOCK WARRANTS

In conjunction with its initial public offering in 1997, the Company issued to the underwriter, at a purchase price of $0.001 per warrant, warrants to purchase up to an aggregate of 140,000 shares of common stock at an exercise price of $13.18 per share, all of which were outstanding at December 31, 2000. These warrants expired on October 7, 2001.

During 2001, the Company issued to its financing company (Note 7) warrants to purchase 400,000 shares of common stock at a purchase price of $1 per share for the first 200,000 shares and $0.70 per share for the remaining 200,000 shares. The weighted average fair value of these warrants granted during 2001 is estimated at $0.85 on the date of the grant. These warrants are all outstanding at December 31, 2001 and, if not exercised, expire on December 31, 2002.

NOTE 12 - EMPLOYEE STOCK OPTIONS

In 1997, the board of directors approved the adoption of the 1997 Stock Option Plan. The 1997 Stock Option Plan provides for the grant of nonqualified options to purchase up to 500,000 shares of the Company's common stock and was amended to increase the grant of options up to 1,950,000 shares. Options may be granted to employees, officers, directors and consultants of the Company for the purchase of common stock of the Company at a price not less than the fair market value of the common stock on the date of the grant. The term of all options

granted is three years and one month, with vesting occurring ratably over three years.

The Company has elected to follow Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations in measuring compensation expense for its stock options. Under APB No. 25, because the exercise price of the Company's employee stock options is not less than the fair market value of the underlying stock on the date of grant, no compensation expense is recognized. However, SFAS No. 123, "Accounting for Stock-Based Compensation," requires presentation of pro forma net income and earnings per share as if the Company had accounted for its employee stock options, granted subsequent to December 31, 1994, under the fair value method of that statement. For purposes of pro forma disclosure, the estimated fair value of the options is amortized to expense over the vesting period. Under the fair value method, the Company's net loss in 2001 would have increased by $445,000 or $0.04 per share on a basic and diluted basis. Under the fair value method, the Company's net loss in 2000 would have increased by $225,000 or $0.02 per share on a basic and diluted basis.

The weighted-average fair value of the individual options granted during 2001 and 2000 is estimated as $0.70 and $1.61, respectively, on the date of grant. The fair values were determined using a Black-Scholes option-pricing model with the following assumptions:

	2001	2000
Dividend yield	0%	0%
Volatility	350%	140%
Risk-free interest rate	3.10%	5.50%
Expected life	3 years	3 years

Stock option activity during the years ended December 31, 2001 and 2000 is summarized below:

	Number of Shares	Weighted Average Exercise Price
Outstanding at January 1, 2000	1,163,000	$ 1.84
Granted	873,000	2.03
Exercised	(1,666)	1.88
Forfeited	(126,334)	2.48
Outstanding at December 31, 2000	1,908,000	1.92
Granted	895,000	0.70
Exercised	0	0.00
Forfeited	(898,666)	2.04
Outstanding at December 31, 2001	1,904,334	$ 1.29

The following table summarizes information concerning outstanding and exercisable options at December 31, 2001:

Exercise Price	Number Outstanding	Weighted-Average Remaining Contractual Life (Years)	Options Exercisable
$ 1.500	48,000	0.75	31,999
1.875	223,000	0.05	148,667
1.250	145,000	0.50	96,666
1.500	385,000	1.93	128,333
2.750	175,000	1.50	58,333
3.000	33,334	1.25	11,111
0.700	895,000	2.62	0

NOTE 13 - INCOME TAXES

The Company's provision for income taxes differs from the amount of income tax determined by applying the applicable federal and state statutory income tax rates to the (loss) income before income taxes due to the Company's merger with SSI, for which an income tax provision has been provided based on its income before income taxes, and to changes in SFT's valuation allowance, which has been established for the net operating loss carryforwards and temporary differences that are not presently considered likely to be realized. The benefit from income taxes at December 31, 2001 relates to a change of estimate concerning the SSI taxes payable, which was adjusted upon the completion of the related income tax returns.
The benefit from (provision for) income taxes consists of the following for the years ended December 31:

	2001	2000
Current income taxes		
Federal	$ 242,799	$ (806,000)
State	46,247	(153,000)
Deferred income taxes		
Federal	0	134,000
State	0	25,000
	$ 289,046	$ (800,000)

The deferred income tax asset results from differences in the bases for assets and liabilities presented in the financial statements and the amounts reported in the income tax returns. As of December 31, the differences are summarized as follows:

	2001
Current assets and liabilities	
Allowance for doubtful accounts	$ 420,000
Inventory allowance	160,000
Reserve for note receivable from stockholder	131,000
Accrued vacation pay and other	5,000
Provision for legal judgment	0

		716,000
Valuation allowance		(716,000)
Net current deferred tax asset (liability)	$	0
Noncurrent assets and liabilities		
Depreciation	$	(35,000)
Net operating loss carryforward		11,115,000
		11,080,000
Valuation allowance		(11,080,000)
Noncurrent deferred tax asset (liability)	$	0

During the years ended December 31, 2001 and 2000, the valuation allowance established for the net operating loss carryforwards and temporary differences that are not presently considered likely to be realized were increased by $3,121,000 and $453,000, respectively.

As of December 31, 2001, the Company has net operating loss carryforwards of approximately $27,800,000, which will expire, if not utilized, in various years through 2021. No income taxes were paid during the years ended December 31, 2001 and 2000.

The ability of the Company to utilize net operating losses of approximately $3.5 million, which were incurred prior to 1992, may be limited due to significant ownership changes that have occurred since these losses were created.

The Company's initial public offering (IPO) also created an ownership change. However, net operating losses of approximately $8.7 million incurred after 1992, but before the IPO, are expected to be utilized, if sufficient income is generated, before they expire.

NOTE 14 - RETIREMENT PLAN

The Company maintains a defined contribution 401(k) profit sharing plan (the Plan) for all employees who have attained the age of 21 and completed three months of service. Participants may make voluntary contributions to the Plan up to the maximum amount allowable by law, but not to exceed 15% of their annual compensation. The Company contributes an amount equal to 25% of the lesser of each participant's voluntary contribution or 5% of his or her annual compensation. Company contributions to the Plan vest to the participants ratably over a two year period. Company contributions to the Plan were $11,500 and $27,000, for the years ended December 31, 2001 and 2000, respectively.

NOTE 15 - EMPLOYMENT AND CONSULTING AGREEMENTS

The Company entered into a consulting agreement with its chairman (who is also managing partner of KuwAm Corporation) which provides for an annual consulting fee of $145,000 through March 31, 2002. As of February 1998, the annual consulting fee under this agreement was reduced by 10 percent.

NOTE 16 - SIGNIFICANT CLIENTS

During the year ended December 31, 2001, contracts with three clients accounted for approximately 33 percent, 6 percent and 4 percent of revenue. For the year ended December 31, 2000, contracts with three clients accounted for approximately 29 percent, 19 percent and 13 percent of revenue.

NOTE 17 - COMMITMENTS

The Company leases office space for its headquarters in Springfield, Virginia and satellite facilities under the terms of noncancelable operating leases, which expire at various dates through December 2005. The Company also leases equipment and automobiles under the terms of capital lease agreements, which expire at various dates through November 2002. The following is a schedule of the future minimum lease payments required under capital and operating leases that have initial or remaining terms in excess of one year as of December 31, 2001:

Years ending December 31,	Capital Leases
2002	$ 25,813
2003	0
2004	0
2005	0
Total minimum lease payments	25,813
Less: imputed interest	(3,198
Present value of minimum lease payments	22,615
Current portion of capital lease obligations	(22,615)
Noncurrent portion of capital lease obligations	$ 0

Rent expense aggregated $376,000 and $287,000 for the years ended December 31, 2001 and 2000, respectively.

STRATESEC INCORPORATED

SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS

YEARS ENDED DECEMBER 31, 2001 AND 2000

Description	Balance at Beginning of Period	Additions: Charged to Costs and Expenses	Additions: Charged to Other Accounts (describe)	Ded (de
Year ended December 31, 2001				
Allowance for doubtful accounts	$ 350,000	$ 2,489,860	$ 0	$ (2
Reserve for costs and estimated earnings in excess of billings on uncompleted contracts	$ 0	$ 300,000	$ 0	$
Inventory reserve	$ 70,000	$ 330,000	$ 0	$
Reserve on note receivable from stockholder	$ 0	$ 327,277	$ 0	$
Year ended December 31, 2000				
Allowance for doubtful accounts	$ 675,000	$ 245,000	$ 0	$
Inventory reserve	$ 40,000	$ 30,000	$ 0	$

(A) Write-off of uncollectible accounts.