

COMMAND SECURITY CORP
Form 10-Q
February 13, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended December 31, 2018

or

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

For the transition period from _____ to _____

Commission File Number 001-33525

COMMAND SECURITY CORPORATION

The number of outstanding shares of the registrant's common stock as of February 1, 2019 was 10,134,662.

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

	Three Months Ended		Nine Months Ended	
	December 31, 2018	December 31, 2017	December 31, 2018	December 31, 2017
Revenues	\$41,053,671	\$49,180,261	\$126,077,784	\$143,496,876
Cost of revenues	36,193,497	43,640,504	110,991,369	127,437,129
Gross profit	4,860,174	5,539,757	15,086,415	16,059,747
Operating expenses				
General and administrative	4,701,985	4,508,240	13,654,384	14,094,801
Provision for (recoveries of) doubtful accounts, net	8,665	(14,284)	37,348	(131,902)
	4,710,650	4,493,956	13,691,732	13,962,899
Operating income	149,524	1,045,801	1,394,683	2,096,848
Other expenses				
Interest expense	128,900	147,617	420,279	370,025
Income before income taxes and equity loss in minority investment of unconsolidated affiliate	20,624	898,184	974,404	1,726,823
Equity loss in minority investment of unconsolidated affiliate	-	(68,500)	-	(123,400)
Income before income taxes	20,624	829,684	974,404	1,603,423
Provision for income taxes	11,000	1,613,000	421,000	1,973,000
Net income (loss)	\$9,624	\$(783,316)	\$553,404	\$(369,577)

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Income (loss) per share of common stock					
Basic	\$0.00	\$(0.08) \$0.05	\$(0.04)
Diluted	\$0.00	\$(0.08) \$0.05	\$(0.04)
Weighted average number of common shares outstanding					
Basic	10,260,538	9,941,909	10,229,663	9,881,595	
Diluted	10,733,592	9,941,909	10,479,169	9,881,595	

See accompanying notes to condensed consolidated financial statements

COMMAND SECURITY CORPORATION**CONDENSED CONSOLIDATED BALANCE SHEETS**

	December 31, 2018 (Unaudited)	March 31, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,336,490	\$ 1,211,915
Accounts receivable, net of allowance for doubtful accounts of \$200,101 and \$335,192, respectively	29,976,239	36,831,394
Prepaid expenses	1,450,368	1,933,500
Other assets	2,080,880	3,321,345
Total current assets	34,843,977	43,298,154
Furniture and equipment at cost, net	705,144	559,976
Other assets:		
Intangible assets, net	895,258	921,902
Other assets	3,116,181	3,508,469
Total other assets	4,011,439	4,430,371
Total assets	\$ 39,560,560	\$ 48,288,501
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Checks issued in advance of deposits	\$ 423,947	\$ 1,167,097
Short-term borrowings	13,827,766	18,234,089
Accounts payable	1,509,003	1,354,817
Accrued and other liabilities	7,336,831	11,753,423
Total current liabilities	23,097,547	32,509,426
Insurance reserves	485,624	582,481
Other non-current liabilities	33,071	46,601
Total liabilities	23,616,242	33,138,508
Stockholders' equity:		
Preferred stock, convertible Series A, \$.0001 par value	-	-
Common stock, \$.0001 par value	1,172	1,172
Treasury stock, at cost, 1,579,646 shares and 1,584,418 shares, respectively	(2,599,610)	(2,609,881)
Additional paid-in capital	19,189,103	18,958,453
Accumulated deficit	(646,347)	(1,199,751)
Total stockholders' equity	15,944,318	15,149,993

Total liabilities and stockholders' equity	\$39,560,560	\$48,288,501
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See accompanying notes to condensed consolidated financial statements

COMMAND SECURITY CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(Unaudited)

	Preferred Stock	Common Stock	Treasury Stock	Additional Paid In Capital	Accumulated Earnings / (Deficit)	Total
Balance at March 31, 2017	-	1,160	(2,885,579)	18,535,051	231,950	15,882,582
Options exercised, net		12		173,150		173,162
Issuance of treasury stock			238,791	(17,191)		221,600
Stock compensation cost				235,576		235,576
Net loss					(369,577)	(369,577)
Balance at December 31, 2017	-	1,172	(2,646,788)	18,926,586	(137,627)	16,143,343
Issuance of shares in exchange for restricted stock units			36,907	(55,171)		(18,264)
Stock compensation cost				87,038		87,038
Net loss					(1,062,124)	(1,062,124)
Balance at March 31, 2018	-	1,172	(2,609,881)	18,958,453	(1,199,751)	15,149,993
Issuance of shares in exchange for restricted stock units			10,271	(22,747)		(12,476)
Stock compensation cost				253,397		253,397
Net income					553,404	553,404
Balance at December 31, 2018	\$ -	\$ 1,172	\$(2,599,610)	\$19,189,103	\$(646,347)	\$15,944,318

See accompanying notes to condensed consolidated financial statements

COMMAND SECURITY CORPORATION**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

	Nine Months Ended December 31,	
	2018	2017
Cash flows from operating activities:		
Net income (loss)	\$553,404	\$(369,577)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	187,224	164,006
Provision for (recoveries of) doubtful accounts	37,348	(131,902)
Equity loss in minority investment of unconsolidated affiliate	-	123,400
Rent expense	(34,967)	3,208
Stock based compensation costs	253,397	235,576
Insurance reserves	(96,857)	123,364
Deferred income taxes	400,000	1,850,322
Change in receivables, prepaid expenses and other current assets	8,533,692	(11,143,242)
Change in accounts payable and other liabilities	(4,227,439)	(815,438)
Change in other long term liabilities	(13,530)	51,110
Net cash provided by (used in) operating activities	5,592,272	(9,909,173)
Cash flows from investing activities:		
Purchases of equipment	(305,748)	(504,868)
Net cash used in investing activities	(305,748)	(504,868)
Cash flows from financing activities:		
Net (repayments) advances on short-term borrowings	(4,406,323)	9,310,174
Change in checks issued in advance of deposits	(743,150)	379,056
Proceeds from option exercises, net	-	394,761
Tax withholding related to net share settlements of restricted stock units	(12,476)	-
Net cash provided by (used in) financing activities	(5,161,949)	10,083,991
Net change in cash and cash equivalents	124,575	(330,050)
Cash and cash equivalents, beginning of period	1,211,915	1,042,291
Cash and cash equivalents, end of period	\$1,336,490	\$712,241

Supplemental Disclosures of Cash Flow Information

Cash paid during the nine months ended December 31 for:	2018	2017
Interest	\$436,546	\$329,086
Income taxes	3,128	7,802

See accompanying notes to condensed consolidated financial statements

COMMAND SECURITY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The accompanying condensed consolidated financial statements presented herein have not been audited, and have been prepared in accordance with the instructions to Form 10-Q which do not include all of the information and note disclosures required by generally accepted accounting principles in the United States. These financial statements should be read in conjunction with our consolidated financial statements and notes thereto as of and for the fiscal year ended March 31, 2018. In this discussion, the words “Company,” “we,” “our,” “us” and terms of similar import should be deemed to refer to Command Security Corporation and its consolidated subsidiaries.

The condensed consolidated financial statements for the interim period shown in this report are not necessarily indicative of our results to be expected for any period after the date hereof, including for the fiscal year ending March 31, 2019, or for any other subsequent period. The condensed consolidated financial statements include the consolidated accounts of the Company with all intercompany transactions eliminated. In the opinion of our management, the accompanying condensed consolidated financial statements reflect all adjustments, consisting of only normal recurring adjustments, considered necessary for a fair presentation of the financial statements included in this quarterly report. All such adjustments are of a normal recurring nature.

1. Agreement and Plan of Merger

On September 18, 2018, Command Security Corporation, a New York corporation (the “Company”), entered into an Agreement and Plan of Merger (the “Merger Agreement”) with Prosegur SIS (USA) Inc., a Delaware corporation (“Parent”), and Crescent Merger Sub, Inc., a New York corporation and a wholly owned subsidiary of Parent (“Merger Sub”). The Merger Agreement provides that, subject to the terms and conditions set forth therein, Merger Sub will merge with and into the Company (the “Merger”), with the Company surviving the Merger and becoming a wholly owned subsidiary of Parent.

Under the Merger Agreement, at the effective time of the Merger, each issued and outstanding share of the Company’s common stock (other than (i) shares owned by Parent, Merger Sub or any other direct or indirect wholly owned subsidiary of Parent or (ii) shares owned by any direct or indirect wholly owned subsidiary of the Company, and, in each case, not held on behalf of third parties) will be cancelled and automatically converted into the right to receive \$2.85 per share in cash (the “Merger Consideration”).

Under the Merger Agreement, at the effective time of the Merger, each outstanding option to purchase shares, outstanding restricted shares and outstanding restricted stock units, in each case, whether vested or unvested, will be cancelled. A holder of an outstanding option to purchase shares will be entitled to receive an amount in cash equal to (x) the total number of shares subject to such Company option, whether vested or unvested, immediately prior to the effective time of the Merger multiplied by (y) the excess, if any, of the Merger Consideration over the exercise price per share under each Company option, less applicable taxes. A holder of an outstanding restricted share or outstanding restricted stock unit will be entitled to receive an amount in cash equal to (x) the total number of such restricted shares and restricted stock units, whether vested or unvested, immediately prior to the effective time multiplied by (y) the Merger Consideration, less applicable taxes.

The Company has made customary representations, warranties and covenants in the Merger Agreement, including covenants not to, during the pendency of the Merger, solicit alternative transactions or, subject to certain exceptions, not to enter into discussions concerning, or provide confidential information in connection with, an alternative transaction. Each of Parent and Merger Sub also has made customary representations, warranties and covenants in the Merger Agreement.

COMMAND SECURITY CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Consummation of the Merger is subject to the satisfaction or waiver of customary closing conditions, including receipt of approval of the Committee on Foreign Investment in the United States (“CFIUS”). CFIUS approval has been delayed as a result of the recent U.S. federal government shutdown and remains pending as of the date of this report. The transaction is not subject to any financing condition.

The Merger Agreement contains certain customary termination rights for Parent and the Company, including a right to terminate the Merger Agreement if the Merger is not completed by March 18, 2019 (which may be automatically extended until June 18, 2019 in the event that CFIUS approval has not been obtained by March 18, 2019 and all other closing conditions have been satisfied), unless otherwise extended by mutual consent pursuant to the terms of the Merger Agreement. The Merger Agreement further provides that, upon termination of the Merger Agreement under certain specified circumstances relating to a breach of the Company’s agreement not to pursue an alternative transaction, the Company will be obligated to pay Parent a termination fee of approximately \$1.2 million.

The foregoing description of the Merger Agreement and the transactions contemplated thereby does not purport to be complete and is subject to, and qualified in its entirety by, the full text of the Merger Agreement, which is attached as Exhibit 2.1 to the Company’s Form 8-K filed with the U.S. Securities and Exchange Commission (the “SEC”) on September 24, 2018 and incorporated herein by reference. It is not intended to provide any other factual information about the Company, Parent or Merger Sub, their respective businesses, or the actual conduct of their respective businesses during the period prior to the consummation of the Merger. The representations, warranties and covenants contained in the Merger Agreement were made only for purposes of the Merger Agreement as of the specific dates therein, were solely for the benefit of the parties to the Merger Agreement, may be subject to limitations agreed upon by the contracting parties, including being qualified by confidential disclosures made for the purposes of allocating contractual risk between the parties to the Merger Agreement instead of establishing these matters as facts, and may be subject to standards of materiality applicable to the contracting parties that differ from those applicable to investors. Accordingly, the representations and warranties may not describe the actual state of affairs as of the date they were made or at any other time and investors should not rely on them as statements of fact.

On November 2, 2018, the Company filed a definitive proxy statement with the SEC relating to a special meeting of the Company’s shareholders held on December 4, 2018 (the “Special Meeting”), the purpose of which was to consider and vote on several proposals related to the Merger Agreement and certain other related matters. At the Special Meeting, our shareholders voted on and approved all the proposals.

2. Recently Issued Accounting Standards

In May 2014, the FASB and the International Accounting Standards Board (IASB) issued, ASU 2014-09 (*Topic 606 Revenue from Contracts with Customers*). The guidance substantially converges final standards on revenue recognition between the FASB and IASB providing a framework on addressing revenue recognition issues and, upon its effective date, replaces almost all existing revenue recognition guidance, including industry-specific guidance, in current U.S. generally accepted accounting principles. In July 2015, the FASB issued ASU No. 2015-14, “Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date”, which deferred the effective date of ASU No. 2014-09 by one year, making it effective for the Company’s fiscal year ending March 31, 2019. Subsequently, the FASB also issued a series of amendments to the new revenue standards. The new revenue standards may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of adoption. Based on the Company’s evaluation process and review of our contracts with customers, the timing and amount of revenue recognized based on ASU 2014-09 is consistent with our revenue recognition policy under previous guidance. We adopted the new standard effective April 1, 2018, using the modified retrospective approach and have expanded our consolidated financial statement disclosures in order to comply with the ASU.

In February 2016, the FASB issued ASU No. 2016-02, “*Leases (Topic 842)*”, which requires lessees to recognize a lease liability and a right-to-use asset on the balance sheet for all leases, except certain short-term leases. ASU 2016-02 is effective beginning with the Company’s fiscal year ending March 31, 2020, with early adoption permitted. Originally, entities were required to adopt ASU 2016-02 using a modified retrospective approach, which required prior periods to be presented under this new standard with certain practical expedients available. However, in July 2018, the FASB issued ASU 2018-11, “*Leases (Topic 842): Targeted Improvements*”, which amends Leases (Topic 842) to add an optional transition method that would permit entities to apply the new requirements by recognizing a cumulative-effect adjustment to the opening balance of retained earnings in the year of adoption. The Company is currently evaluating the impact of ASU 2016-02 on its consolidated financial statements. The adoption of this guidance is expected to result in a significant increase in assets and liabilities on the Company’s balance sheet, with no material impact on the statements of operations. However, the ultimate impact of adopting ASU 2016-02 will depend on the Company’s lease portfolio as of the adoption date.

COMMAND SECURITY CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

In August 2016, the FASB issued new guidance on cash flow statement presentation ASU 2016-15, *Statement of Cash Flows (Topic 230); Classification of Certain Cash Receipts and Cash Payments*. This ASU addresses diversity in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The new guidance is effective beginning with the Company's fiscal year ending March 31, 2019, with early adoption permitted. The adoption of ASU 2016-15 is not expected to have a material impact on the Company's consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04 "*Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*", which eliminates Step 2 from the goodwill impairment test. Instead, an entity should perform its annual or interim goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount and recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value, not to exceed the total amount of goodwill allocated to the reporting unit. ASU 2017-04 is effective for annual or any interim goodwill tests in fiscal years beginning after December 15, 2019. The adoption is not expected to have a material impact on the consolidated financial statements.

In July 2018, the FASB issued ASU 2018-09, "Codification Improvements." This guidance affects a wide variety of topics in the codification and represents changes to clarify, correct errors in, or make minor improvements to the codification. The amendments make the codification easier to understand and easier to apply by eliminating inconsistencies and providing clarifications. The amendments apply to all reporting entities within the scope of the affected accounting guidance. Some of the amendments in ASU 2018-09 do not require transition guidance and will be effective upon issuance. However, many of the amendments do have transition guidance with effective dates for annual periods beginning after December 15, 2018 for public business entities. We are currently evaluating the impact ASU 2018-09 may have on our consolidated financial statements.

COMMAND SECURITY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

3. Revenue Recognition

Adoption of New Accounting Guidance on Revenue Recognition

Effective April 1, 2018, we adopted the new accounting guidance on revenue recognition using the modified retrospective approach. Based on the Company's evaluation process and review of our contracts with customers, the timing and amount of revenue recognized under the new guidance is consistent with our revenue recognition policy under previous guidance. The new guidance has not had a material impact on our results of operations, cash flows or financial condition.

Our customer contracts generally include payment terms which vary by the type of customer and services offered. Customer payments are generally due within 30 to 45 days upon receipt of invoice. The timing between satisfaction of a given performance obligation and invoicing is not significant. In certain situations we may require payment prior to delivery of services to the customer, in which cases deferred revenue is recorded. Deferred revenue was not material as of December 31, 2018.

Revenue Recognition and Service Types

We provide armed and unarmed uniformed security personnel for access control, loss prevention, mobile patrols, traffic control, security console or system operators and fire safety directors, as well as provide personnel for reception, concierge and front desk or doorman operations. We also provide aviation security services and aviation passenger services such as passenger and cargo screening, baggage screening, wheelchair escort services, special escort services in secured areas as required and skycap services. Our contracts contain single performance obligations. We recognize revenue from these performance obligations over time, as services are performed, in amounts that reflect the consideration we expect to be entitled to receive in exchange for the services we provide, net of applicable taxes. Generally, revenues from all services rendered are based on contractual rates per hour or a specific cost per defined unit of activity.

We generally determine standalone selling prices based on the prices included in the customer contracts. The price as specified in our customer contracts is generally considered the standalone selling price.

Practical Expedients and Exemptions

We recognize revenue based on contractual rates over time for which we have the right to invoice for services performed. As allowed under the new guidance, we are not required to disclose the amount of unsatisfied performance obligations.

Disaggregation of Revenues

The following table presents revenue disaggregated by service type, substantially all of which represents services that are transferred to customers over time:

Service Types	Nine Months Ended December 31, 2018		
	Security Division	Aviation Division	Total
Security services	\$76,095,180	\$31,991,545	\$108,086,725
Aviation passenger services	-	17,991,059	17,991,059
	\$76,095,180	\$49,982,604	\$126,077,784

COMMAND SECURITY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Accounts Receivable, Contract Assets and Contract Liabilities

We record accounts receivable when our right to consideration becomes unconditional. We record contract liabilities (deferred revenue) when payments are received prior to the satisfaction of the related performance obligations. The current portion of our contract liabilities is included in accrued liabilities in our Consolidated Balance Sheets. We did not have any material contract assets or long-term contract liabilities as of December 31, 2018.

4. Short-Term Borrowings:

On February 12, 2009, we entered into a credit facility (the “Credit Agreement”) with Wells Fargo Bank, National Association (“Wells Fargo”). This credit facility, which was most recently amended in March 2018 (see below) and matures March 31, 2020, contains customary affirmative and negative covenants, including, among other things, covenants requiring us to maintain certain financial ratios and is collateralized by customer accounts receivable and certain other assets of the Company as defined in the Credit Agreement.

The Credit Agreement provides for a letter of credit sub-line in an aggregate amount of up to \$1.5 million. The Credit Agreement also provides for interest to be calculated on the outstanding principal balance of the revolving loans at the floating 90 day LIBOR rate plus 1.75%. For LIBOR loans, interest will be calculated on the outstanding principal balance of the LIBOR loans at the 30 day LIBOR rate plus 1.75%.

On March 14, 2018, we entered into a ninth amendment (the “Ninth Amendment”) to our Credit Agreement. The Ninth Amendment increased the revolving line of credit from \$27.5 million to \$35.0 million.

The Company is currently negotiating with Wells Fargo to amend the Credit Agreement which will, among other things, increase the interest rate and amend certain of the financial covenants. The Company expects the amendment to be finalized during the quarter ended March 31, 2019.

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Under the Credit Agreement, as of December 31, 2018, the interest rate was 4.125% for LIBOR loans and 4.625% for revolving loans, an increase of 1.0% and 1.125%, respectively, as compared with December 31, 2017. At December 31, 2018, we had approximately \$1.3 million of cash on hand, \$7.0 million of LIBOR loans outstanding, \$6.8 million of revolving loans outstanding and \$0.5 million outstanding under our letters of credit sub-line under the Credit Agreement, representing approximately 64% of the maximum borrowing capacity under the Credit Agreement based on our “eligible accounts receivable” (as defined in the Credit Agreement) as of such date. As of the close of business January 31, 2019, we had total short term borrowings, net of cash, of approximately \$13.8 million, representing approximately 73% of the maximum borrowing capacity under the Credit Agreement based on our “eligible accounts receivable” (as defined in the Credit Agreement) as of such date.

We rely on our revolving loan from Wells Fargo which contains a fixed charge covenant and various other financial and non-financial covenants. If we breach a covenant, Wells Fargo has the right to immediately request the repayment in full of all borrowings under the Credit Agreement, unless Wells Fargo waives the breach. For the nine months ended December 31, 2018, we were in compliance with all covenants under the Credit Agreement.

5. Other Assets:

	December 31, 2018	March 31, 2018
Workers’ compensation insurance	\$2,080,880	\$3,321,345
Deferred tax asset	2,982,041	3,382,041
Security deposits	131,140	126,428
	5,197,061	6,829,814
Current portion	(2,080,880)	(3,321,345)
Total non-current portion	\$3,116,181	\$3,508,469

The other asset workers’ compensation insurance represents the net amount of the payments made to cover the workers’ compensation insurance premium against the actual premium due as well as the difference in the amount deposited to the loss fund less the estimated workers’ compensation claims and reserves related to the historical loss claims as well as the estimates related to claims incurred but not reported. There is no offsetting claim liability reported as the Company has determined that there is a sufficient amount deposited into the loss funds to cover the estimated claims reserve as well as the estimate related to claims incurred but not reported.

COMMAND SECURITY CORPORATION**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****6. Accrued Expenses and Other Liabilities:**

	December 31, 2018	March 31, 2018
Payroll and related expenses	\$5,835,488	\$10,117,671
Taxes and fees payable	152,889	324,823
Accrued interest payable	47,135	63,401
Other	1,301,319	1,247,528
Total	\$7,336,831	\$11,753,423

7. Insurance Reserves:

We have insurance policies covering workers' compensation claims in states where we perform services. Estimated accrued liabilities are based on our historical loss experience and the ratio of claims paid to our historical pay-out profiles. Charges for estimated workers' compensation related losses incurred and included in cost of sales were \$86,425 and \$403,002 for the three months ended December 31, 2018 and 2017, respectively, and \$867,069 and \$1,646,824 for the nine months ended December 31, 2018 and 2017, respectively. The decrease in workers' compensation costs during the nine months ended December 31, 2018 was primarily due to favorable reserve adjustments on certain legacy claims including some claims that were settled at values less than previously estimated reserves.

The nature of our business also subjects us to claims or litigation alleging that we are liable for damages as a result of the conduct of our employees or others. We insure against such claims and suits through general liability policies with third-party insurance companies.

Our insurance coverage limits are currently \$1.0 million per occurrence for non-aviation related business (with additional first and second layer excess liability policies of \$5.0 million and \$10.0 million, respectively) and \$30.0 million per occurrence for aviation related business. We retain the risk for the first \$25,000 of general liability non-aviation related operations. The aviation related deductible is \$5,000 per occurrence, with the exception of \$50,000 for airport wheelchair and electric cart operations, \$25,000 for damage to aircraft and \$100,000 for skycap operations. Estimated accrued liabilities are based on specific reserves in connection with existing claims as

determined by third party risk management consultants and actuarial factors and the timing of reported claims. These are all factored into estimated losses incurred but not yet reported to us.

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

Workers' compensation annual costs are comprised of premiums as well as incurred losses as determined at the end of the coverage period, subject to minimum and maximum amounts. Workers' compensation insurance claims and reserves include accruals of estimated settlements for known claims, as well as accruals of estimates for claims incurred but not yet reported. In estimating these accruals, we consider historical loss experience and make judgments about the expected levels of costs per claim. We believe our estimates of future liability are reasonable based upon our methodology; however, changes in health care costs, accident frequency and severity and other factors could materially affect these estimates. The Company continually monitors changes in claim type and incident and evaluates the workers' compensation insurance accrual, making necessary adjustments based on the evaluation of these qualitative data points.

COMMAND SECURITY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

8. Income Taxes

On December 22, 2017, the United States government (“U.S.”) enacted significant changes to the U.S. tax law following the passage and signing of H.R.1, “An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018” (the “Tax Act”) (previously known as “The Tax Cuts and Jobs Act”). The Tax Act included significant changes to existing tax law, including a permanent reduction to the U.S. federal corporate income tax rate from 34% to 21%, a one-time repatriation tax on deferred foreign income, deductions, credits and business related exclusions.

On December 22, 2017, the SEC issued Staff Accounting Bulletin 118 (“SAB 118”). SAB 118 expresses views of the SEC regarding ASC Topic 740, Income Taxes (“ASC 740”) in the reporting period that includes the enactment date of the Tax Act. The SEC staff issuing SAB 118 (the “Staff”) recognized that a registrant’s review of certain income tax effects of the Tax Act may be incomplete at the time financial statements are issued for the reporting period that includes the enactment date, including interim periods therein. If a company does not have the necessary information available, prepared or analyzed for certain income tax effects of the Tax Act, SAB 118 allows a company to report provisional numbers and adjust those amounts during the measurement period not to extend beyond one year.

COMMAND SECURITY CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

In accordance with SAB 118, the provisional estimates recorded represent reasonable estimates of the effects of the Tax Act as of December 31, 2018. We have not made any measurement period adjustments related to these items during the nine months ended December 31, 2018. The Company finalized its provisional estimates during the quarter ended December 31, 2018.

The following table sets forth the effective tax rates for the Company for the nine months ended December 31, 2018 and 2017.

	Nine months ended December 31,		
	2018	2017	
Statutory federal income tax rate	21.0 %	30.8 %	
State and local income taxes	8.1 %	7.1 %	
Permanent differences	13.3 %	-6.0 %	
Minority investment in unconsolidated affiliate	-	2.8 %	
Remeasurement of deferred tax assets	-	84.2 %	
Other	0.8 %	4.1 %	
Effective tax rate	43.2 %	123.0 %	

The decrease in the effective tax rate for the nine months ended December 31, 2018 as compared with the nine months ended December 31, 2017 was primarily attributable to the absence of the \$1.35 million charge related to the permanent U.S. federal corporate income tax rate change from 34% to 21% and the related impact on the Company's deferred tax assets in December 2017, partly offset by the reversal of deferred tax credits related to previously issued stock options that have since expired in fiscal year 2019, the cost of which is no longer deductible.

9. Earnings per Share:

Under the requirements of FASB ASC 260-10, *Earnings Per Share*, the dilutive effect of our common shares that have not been issued, but that may be issued upon the exercise or conversion, as the case may be, of rights or options to acquire such common shares, is excluded from the calculation for basic earnings per share. Diluted earnings per

share reflects the additional dilution that would result from the issuance of our common shares if such rights or options were exercised or converted, as the case may be, and is presented for the three and nine months ended December 31, 2018.

For the three and nine months ended December 31, 2017, the Company reported a net loss and, accordingly, potential common shares that would cause dilution, such as employee stock options and restricted stock units (“RSUs”), have been excluded from the diluted share count because their inclusion would have been anti-dilutive. For the three and nine months ended December 31, 2017, the fully diluted shares would have been 10,540,256 and 10,476,975, respectively.

10. Contingencies:

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

We have been named or could be named as a defendant in uninsured employment related claims including claims related to wages and related benefits that are pending before various courts, the Equal Employment Opportunities Commission or various state and local agencies. We have instituted policies to minimize these occurrences and monitor those that do occur. At this time, we are unable to determine the impact on the financial position and results of operations that these claims may have, should the investigations conclude that such claims are valid. The impact of these claims could have a material adverse effect on the Company’s financial position or results of operations.

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

Approximately 50% of our workforce is not subject to a labor union. The remaining 50% of our workforce, including in particular, a number of employees based in our New York City security services office and at our airport offices at John F. Kennedy International and LaGuardia airports are subject to collective bargaining agreements. Three of the agreements, covering approximately 9% of our employees, expired on March 31, 2017, June 28, 2017 and September 30, 2018. We are currently involved in negotiations to renew the expired agreements. The remaining eight agreements are set to expire in June 2019 and thereafter.

On November 5, 2018, a putative class action was filed in the Supreme Court of the State of New York for New York County captioned *Franchi v. Command Security Corporation, et al.*, Index No. 655494/2018 (the “Merger Litigation”). The complaint, which was filed by a purported Company shareholder, alleged breaches of fiduciary duty by the Company’s Board of Directors, and aiding and abetting such breaches by the Company, in connection with the Merger. Among other things, the complaint asserts that (a) the preliminary proxy statement that the Company filed with the SEC on October 5, 2018 in connection with the Merger omitted certain purportedly material information, (b) the process leading to the Merger was flawed, (c) the agreed-upon deal protection measures are unduly restrictive, and (d) the merger price is inadequate. The complaint contains demands for, among other things, declaratory and mandatory injunctive relief, attorneys’ fees and costs and “enjoinment of the Proposed Transaction” or rescission of the Merger if consummated. The Company believes that the claims asserted in the Merger Litigation are without merit. On February 6, 2019, the parties in the Merger Litigation stipulated to voluntary discontinuance of the Merger Litigation with prejudice as to Plaintiff only, and without prejudice as to the putative class. The Company expects the stipulation to become effective subject to a court order approving the discontinuance.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following Management’s Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with our condensed consolidated financial statements and the related notes contained in this quarterly report. In this discussion, the words “Company,” “we,” “our,” “us” and terms of similar import should be deemed to refer to Command Security Corporation and its consolidated subsidiaries.

Forward Looking Statements

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

As provided for under the Private Securities Litigation Reform Act of 1995, we wish to caution shareholders and investors that the important factors under the heading “Risk Factors” in our Annual Report on Form 10-K filed with the Securities and Exchange Commission with respect to our fiscal year ended March 31, 2018, could cause our actual financial condition and results from operations to differ materially from our anticipated results or other expectations expressed in our forward-looking statements in this quarterly report.

Critical Accounting Policies and Estimates

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

Principles of Consolidation

The consolidated financial statements include the accounts of Command Security Corporation and its consolidated subsidiaries. All intercompany balances and transactions are eliminated upon consolidation. The Company's revenues and expenses transacted in foreign currencies are translated based on the monthly average exchange rate for the month in which each transaction occurred. Realized gains and losses on foreign currency transactions are recorded in general and administrative expenses on the Company's consolidated statements of operations. Amounts recorded as foreign currency exchange gains and losses were not material for the nine months ended December 31, 2018. Assets and liabilities of the Company denominated in foreign currencies are translated at the exchange rate in effect as of the balance sheet date. Amounts recorded as a result of translation adjustments are not material as of December 31, 2018 and therefore we did not present the translation adjustments as a separate component of accumulated other comprehensive income in the stockholders' equity section of the consolidated balance sheets.

Revenue Recognition

We record revenues as services are provided to our customers. Revenues consist primarily of aviation and security services, which are typically billed at hourly rates. These rates may vary depending on base, overtime and holiday time worked. Revenue is reported net of applicable taxes.

Accounts Receivable

We periodically evaluate the requirement for providing for billing adjustments and/or reflect the extent to which we will be able to collect our accounts receivable. We provide for billing adjustments where management determines that there is a likelihood of a significant adjustment for disputed billings. Criteria used by management to evaluate the

adequacy of the allowance for doubtful accounts include, among others, the creditworthiness of the customer, current trends, prior payment performance, the age of the receivables and our overall historical loss experience. Individual accounts are charged off against the allowance as management deems them to be uncollectible.

Intangible Assets

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

Insurance Reserves

Estimated accrued liabilities related to our general liability claims are calculated on an undiscounted basis and are based on actual claim data and estimates of incurred but unreported claims developed utilizing historical claim trends. Projected settlements and incurred but unreported claims are estimated based on pending claims, historical trends and related data.

Workers' compensation annual costs are comprised of premiums as well as incurred losses as determined at the end of the coverage period, subject to minimum and maximum amounts. Workers' compensation insurance claims and reserves include accruals of estimated settlements for known claims, as well as accruals of estimates for claims incurred but not yet reported as provided by a third party. In estimating these accruals, we consider historical loss experience and make judgments about the expected levels of costs per claim. We believe our estimates of future liability are reasonable based upon our methodology; however, changes in health care costs, accident frequency and severity and other factors could materially affect the estimate for these liabilities. The Company continually monitors changes in claim type and incident and evaluates the workers' compensation insurance accrual, making necessary adjustments based on the evaluation of these qualitative data points.

Income Taxes

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

We recognize the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. In the event that interest and/or penalties are assessed in connection with our tax filings, interest will be recorded as interest expense and penalties will be recorded as selling, general and administrative expense. We did not have any unrecognized tax benefits as of December 31, 2018 and 2017.

Stock Based Compensation

FASB ASC 718, Stock Compensation, requires all share-based payments to employees, including grants of stock options and restricted stock units (“RSUs”) to be recognized in the financial statements based on their fair values at grant date and the recognition of the related expense over the period in which the share-based compensation vests. Non-cash charges for stock based compensation of \$91,203 and \$92,475 have been recorded in the three months ended December 31, 2018 and 2017, respectively, and \$253,397 and \$235,576 have been recorded in the nine months ended December 31, 2018 and 2017, respectively.

Reclassifications

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

Overview

We principally provide uniformed security officers and aviation services to commercial, residential, financial, industrial, aviation and governmental customers through approximately 18 offices throughout the United States. In conjunction with providing these services, we assume responsibility for a variety of functions, including recruiting, hiring, training and supervising all operating personnel as well as paying such personnel and providing them with uniforms, fringe benefits and workers' compensation insurance.

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

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

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

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

As previously disclosed, on September 18, 2018, the Company entered into an Agreement and Plan of Merger (the “Merger Agreement”) with Prosegur SIS (USA) Inc., a Florida corporation (“Parent”), and Crescent Merger Sub, Inc., a New York corporation and a wholly owned subsidiary of Parent (“Merger Sub”). The Merger Agreement provides that, subject to the terms and conditions set forth therein, Merger Sub will merge with and into the Company (the “Merger”), with the Company surviving the Merger and becoming a wholly owned subsidiary of Parent.

Under the Merger Agreement, at the effective time of the Merger, each issued and outstanding share of the Company’s common stock (other than (i) shares owned by Parent, Merger Sub or any other direct or indirect wholly owned subsidiary of Parent or (ii) shares owned by any direct or indirect wholly owned subsidiary of the Company, and, in each case, not held on behalf of third parties) will be cancelled and automatically converted into the right to receive \$2.85 per share in cash (the “Merger Consideration”).

Under the Merger Agreement, at the effective time of the Merger, each outstanding option to purchase shares, outstanding restricted shares and outstanding restricted stock units, in each case, whether vested or unvested, will be cancelled. A holder of an outstanding option to purchase shares will be entitled to receive an amount in cash equal to (x) the total number of shares subject to such Company option, whether vested or unvested, immediately prior to the effective time of the Merger multiplied by (y) the excess, if any, of the Merger Consideration over the exercise price per share under each Company option, less applicable taxes. A holder of an outstanding restricted share or outstanding restricted stock unit will be entitled to receive an amount in cash equal to (x) the total number of such restricted shares and restricted stock units, whether vested or unvested, immediately prior to the effective time multiplied by (y) the Merger Consideration, less applicable taxes.

The Company has made customary representations, warranties and covenants in the Merger Agreement, including covenants not to, during the pendency of the Merger, solicit alternative transactions or, subject to certain exceptions, not to enter into discussions concerning, or provide confidential information in connection with, an alternative transaction. Each of Parent and Merger Sub also has made customary representations, warranties and covenants in the Merger Agreement.

Consummation of the Merger is subject to the satisfaction or waiver of customary closing conditions, including receipt of the Committee on Foreign Investment in the United States (“CFIUS”) approval. CFIUS approval has been delayed as a result of the recent U.S. federal government shutdown and remains pending as of the date of this report. The transaction is not subject to any financing condition.

The Merger Agreement contains certain customary termination rights for Parent and the Company, including a right to terminate the Merger Agreement if the Merger is not completed by March 18, 2019 (which may be automatically extended until June 18, 2019 in the event that CFIUS approval has not been obtained by March 18, 2019 and all other closing conditions have been satisfied), unless otherwise extended by mutual consent pursuant to the terms of the Merger Agreement. The Merger Agreement further provides that, upon termination of the Merger Agreement under certain specified circumstances relating to a breach of the Company’s agreement not to pursue an alternative transaction, the Company will be obligated to pay Parent a termination fee of approximately \$1.2 million.

On November 2, 2018, the Company filed a definitive proxy statement with the U.S. Securities and Exchange Commission (the “SEC”) relating to a special meeting of the Company’s shareholders held on December 4, 2018 (the “Special Meeting”), the purpose of which was to consider and vote on several proposals related to the Merger Agreement and certain other related matters. At the Special Meeting, our shareholders voted on and approved all the proposals.

Results of Operations

Revenues

Our revenues decreased by \$8.1 million, or 16.5%, to \$41.1 million for the three months ended December 31, 2018, from \$49.2 million in the corresponding period of the prior year. The decrease in revenues was due mainly to the cessation of services at fulfillment centers of a large on-line retailer. The decrease was partly offset by the commencement of work for LaGuardia Gateway Partners at LaGuardia Airport’s new central terminal building in June 2018, an increase in security services with the web services division of a large on-line retailer, the commencement of work under a new contract with the United States Department of State at the U.S. Mission Tegucigalpa, Honduras in

February 2018 and an increase in services with various airlines.

Our revenues decreased by \$17.4 million, or 12.1%, to \$126.1 million for the nine months ended December 31, 2018, from \$143.5 million in the corresponding period of the prior year. The decrease in revenues was due mainly to the cessation of services with the fulfillment centers division of a large on-line retailer and reductions in revenues from a major transportation company following the Company's decision to terminate its relationship with this customer effective August 31, 2017. These decreases were partly offset by an increase in security services with the web services division of a large on-line retailer, the commencement of work under a new contract with LaGuardia Gateway Partners for LaGuardia airport's new central terminal in June 2018, the commencement of work under a new contract with the United States Department of State at the U.S. Mission Tegucigalpa, Honduras in February 2018, an increase in services with various airlines and an increase in services with the U.S. Postal Service.

Gross Profit

Our gross profit decreased by \$0.7 million, or 12.3%, to \$4.9 million (11.8% of revenues) for the three months ended December 31, 2018, from \$5.5 million (11.3% of revenues) in the corresponding period of the prior year. The decrease in gross profit was due mainly to the above-mentioned changes in revenue and certain start-up costs incurred in connection with new business and lower workers' compensation expense.

Our gross profit decreased by \$1.0 million, or 6.1%, to \$15.1 million (12.0% of revenues) for the nine months ended December 31, 2018, from \$16.1 million (11.2% of revenues) in the corresponding period of the prior year. The decrease in gross profit was due mainly to the above-mentioned changes in revenue, certain start-up costs incurred in connection with new business and lower workers' compensation expense.

General and Administrative Expenses

Our general and administrative expenses increased by \$0.2 million, or 4.3%, to \$4.7 million (11.5% of revenues) for the three months ended December 31, 2018, from \$4.5 million (9.2% of revenues) in the corresponding period of the prior year. The increase in general and administrative expenses was driven primarily by legal and other merger related costs of approximately \$0.5 million, partly offset by lower employee compensation and benefits.

Our general and administrative expenses decreased by \$0.4 million, or 3.1%, to \$13.7 million (10.8% of revenues) for the nine months ended December 31, 2018, from \$14.1 million (9.8% of revenues) in the corresponding period of the prior year. The decrease in general and administrative expenses was driven primarily by lower employee compensation and benefits as a result of the reductions in revenue noted above, partly offset by legal and other merger related costs of approximately \$0.8 million.

Provision for Doubtful Accounts

The provision for doubtful accounts for the three months ended December 31, 2018, net of recoveries, increased by \$22,949 to \$8,665 as compared with net recoveries of \$14,284 in the corresponding period of the prior year. The increase in the net provision for doubtful accounts was primarily due to a decrease in recoveries of specific accounts previously deemed uncollectible and an increase in reserves for specific accounts considered uncollectible.

The provision for doubtful accounts for the nine months ended December 31, 2018, net of recoveries, increased by \$169,250 to \$37,348 as compared with net recoveries of \$131,902 in the corresponding period of the prior year. The increase in the net provision for doubtful accounts was primarily due to a decrease in recoveries of specific accounts previously deemed uncollectible and an increase in reserves for specific accounts considered uncollectible.

We periodically evaluate the requirement to provide for billing adjustments and/or credit losses on our accounts receivable. We provide for billing adjustments in cases where our management determines that there is a likelihood of a significant adjustment for disputed billings. Criteria used by management to evaluate the adequacy of the allowance for doubtful accounts include, among others, the creditworthiness of the customer, current trends, prior payment performance, the age of the receivables and our overall historical loss experience. Individual accounts are charged off against the allowance for doubtful accounts as our management deems them to be uncollectible. We do not know if bad debts will increase in future periods.

Interest Expense

Interest expense decreased by \$18,717, or 12.7%, to \$128,900 for the three months ended December 31, 2018, from \$147,617 in the corresponding period of the prior year. The decrease in interest expense for the three months ended December 31, 2018 was due mainly to lower average outstanding borrowings partly offset by higher average interest rates under our credit agreement with Wells Fargo, described below.

Interest expense increased by \$50,254, or 13.6%, to \$420,279 for the nine months ended December 31, 2018, from \$370,025 in the corresponding period of the prior year. The increase in interest expense for the nine months ended December 31, 2018 was due to higher average interest rates under our credit agreement with Wells Fargo, described below, partly offset by lower average outstanding borrowings.

Provision for income taxes

The provision for income taxes decreased by \$1,602,000 to \$11,000 for the three months ended December 31, 2018, compared with \$1,613,000 in the corresponding period of the prior year. The Company's effective tax rate decreased to 53.3% for the three months ended December 31, 2018 compared with 194.4% in the corresponding period of the prior year. The difference between the Company's effective tax rate of 53.3% for the three months ended December 31, 2018 and the Company's statutory tax rate of approximately 29% is primarily attributable to the reversal of deferred tax credits related to previously issued stock options that have since expired, the cost of which is no longer deductible.

The provision for income taxes decreased by \$1,552,000 to \$421,000 for the nine months ended December 31, 2018, compared with \$1,973,000 in the corresponding period of the prior year. The Company's effective tax rate decreased to 43.2% for the nine months ended December 31, 2018 compared with 123.0% in the corresponding period of the prior year. The difference between the Company's effective tax rate of 43.2% for the nine months ended December 31, 2018 and the Company's statutory tax rate of approximately 29% is primarily attributable to certain expenses related to the expiration of stock options that are not deductible for income tax purposes.

Liquidity and Capital Resources

We pay approximately 80% of our employees on a bi-weekly basis and we pay the remaining employees on a weekly basis, while customers pay for services generally within 45 to 60 days from the invoice date. We maintain a commercial revolving loan arrangement, currently with Wells Fargo Bank, National Association ("Wells Fargo"). We fund our payroll and operations primarily through borrowings under our \$35.0 million credit facility with Wells Fargo (as amended, the "Credit Agreement"), described below under "Short Term Borrowings."

We principally use short-term borrowings under our Credit Agreement to fund our accounts receivable. We intend to continue to use short-term borrowings to support our working capital requirements.

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

Short-Term Borrowings:

On February 12, 2009, we entered into a credit facility (the “Credit Agreement”) with Wells Fargo Bank, National Association (“Wells Fargo”). This credit facility, which was most recently amended in March 2018 (see below) and matures March 31, 2020, contains customary affirmative and negative covenants, including, among other things, covenants requiring us to maintain certain financial ratios and is collateralized by customer accounts receivable and certain other assets of the Company as defined in the Credit Agreement.

The Credit Agreement provides for a letter of credit sub-line in an aggregate amount of up to \$1.5 million. The Credit Agreement also provides for interest to be calculated on the outstanding principal balance of the revolving loans at the floating 90 day LIBOR rate plus 1.75%. For LIBOR loans, interest will be calculated on the outstanding principal balance of the LIBOR loans at the 30 day LIBOR rate plus 1.75%.

On March 14, 2018, we entered into a ninth amendment (the “Ninth Amendment”) to our Credit Agreement. The Ninth Amendment increased the revolving line of credit from \$27.5 million to \$35.0 million.

The Company is currently negotiating with Wells Fargo to amend the Credit Agreement which will, among other things, increase the interest rate and amend certain of the financial covenants. The Company expects the amendment to be finalized during the quarter ended March 31, 2019.

Under the Credit Agreement, as of December 31, 2018, the interest rate was 4.125% for LIBOR loans and 4.625% for revolving loans. At December 31, 2018 we had approximately \$1.3 million of cash on hand, \$7.0 million of LIBOR loans outstanding, \$6.8 million of revolving loans outstanding and \$0.5 million outstanding under our letters of credit sub-line under the Credit Agreement, representing approximately 64% of the maximum borrowing capacity under the Credit Agreement based on our “eligible accounts receivable” (as defined in the Credit Agreement) as of such date. As of the close of business January 31, 2019, we had total short term borrowings, net of cash, of approximately \$13.8 million, representing approximately 73% of the maximum borrowing capacity under the Credit Agreement based on our “eligible accounts receivable” (as defined in the Credit Agreement) as of such date.

We rely on our revolving loan from Wells Fargo which contains a fixed charge covenant and various other financial and non-financial covenants. If we breach a covenant, Wells Fargo has the right to immediately request the repayment in full of all borrowings under the Credit Agreement, unless Wells Fargo waives the breach. For the nine months ended December 31, 2018, we were in compliance with all covenants under the Credit Agreement.

Investments and Capital Expenditures

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

Working Capital

Our working capital increased by approximately \$1.0 million, or 8.9%, to \$11.7 million as of December 31, 2018, from \$10.8 million as of March 31, 2018.

We had checks drawn in advance of future deposits of \$0.4 million at December 31, 2018 and \$1.2 million at March 31, 2018. Cash balances, book overdrafts and payroll and related expenses can fluctuate materially from day to day depending on such factors as collections and timing of payroll payments.

Outlook

Operating Initiatives

During the last few years the Company has pursued several initiatives to improve our competitive and strategic position. Significant progress has been made in rebuilding and strengthening our management team and improving the efficiency and functional effectiveness of our organization, systems and processes. The Company re-entered the U.S. federal government market with the commencement of work for the U.S. Postal Service (“USPS”) and in February 2018, we commenced work on an armed security contract for the U.S. Embassy in Honduras. More recently, on December 1, 2018, we commenced security services for the U.S. Embassy in Hong Kong. With the contract to provide physical security for data centers for the web services segment of the major on-line retailer, we have expanded our strategic focus to include the data center market space. Our Aviation division has also expanded to include the addition of cargo screening for a major domestic airline. Despite the recent loss of a significant scope of work with a major customer, we expect to continue to pursue similar large opportunities in multiple end markets. These large service agreements provide significant opportunities to leverage operating and administrative costs.

With a strong foundation and a more effective organization, the Company remains engaged in a corporate-wide campaign with four basic focus areas:

Improved performance through better systems, procedures and training;

Profitable top line revenue growth through identification of larger bid and proposal opportunities including new federal and international opportunities, the inclusion of a broad range of technology offerings to augment manned guarding and potential strategic opportunities;

Dedicated marketing and sales efforts in specific industry sectors that complement our core capabilities, geographic presence and operational expertise; and,

Attention to details and discipline that will drive operating efficiencies, and enhance enterprise value.

These strategic initiatives may result in future costs related to new business development, severance and other employee-related matters, litigation risks and expenses, and other costs. At this time we are unable to determine the scope of these potential costs.

Financial Results

Our future revenues will largely depend on our ability to gain additional business from new and existing customers in our security officer and aviation services divisions at acceptable margins, while minimizing terminations of contracts with existing customers. We may pursue complementary acquisition opportunities to leverage our management structure and deliver accretive earnings with acceptable collection terms. Our focus on larger, long-term service agreements provides another path to add significant additional revenue similar to that of the U.S. Postal Service contract and other commercial and federal contract opportunities. Our ability to complete future acquisitions will depend on our ability to identify suitable acquisition candidates, negotiate acceptable terms for their acquisition and, if necessary, finance those acquisitions. Our current focus is on increasing our revenues, as our sales and marketing teams and branch managers work to develop new business and retain profitable contracts. Also, intense competition from other security services companies impacts our ability to gain or maintain sales, gross margins and employees. During recent years, the Department of Homeland Security and the Transportation Security Administration have implemented numerous security measures that affect airline operations, including expanded cargo and baggage screening, and are likely to implement additional measures in the future. Additional measures taken to enhance either passenger or cargo security procedures in the future may increase the airline industry's demand for third party services provided by us. Additionally, our aviation services division is continually subject to such government regulation, which has adversely affected us in the past with the federalization of the pre-board screening services and the document verification process at several of our domestic airport locations.

Our gross profit margin increased during the nine months ended December 31, 2018 to 12.0% of revenues, compared with 11.2% during the corresponding period in the prior year. We expect gross profit to remain under pressure due primarily to continued price competition, including competition from companies that have substantially greater financial and other resources than we have. However, we expect these effects will be moderated by continued operational efficiencies resulting from better management and leveraging of our cost structures, workflow process efficiencies associated with our integrated financial software system and higher contributions from our continuing new business development.

For the nine months ended December 31, 2018, our security services division generated approximately \$76 million or 60% of our total revenues and our aviation services division generated approximately \$50 million or 40% of our total revenues.

In the nine months ended December 31, 2018, the Company had five customers, who represented approximately 53% of the Company's total revenues. These five customers included one domestic and one international airline, the USPS, an online retailer and web services provider and a northeast U.S. based healthcare facility. Two of these six customers represented 17% and 15% of total revenue, respectively, for the nine months ended December 31, 2018. The scope of work with the large online retailer representing 5% of total revenues was terminated effective May 31, 2018. Total revenues from the remaining four largest customers represent approximately 38% of the Company's total revenues for the nine months ended December 31, 2018.

As noted earlier, on February 12, 2009, we entered into a Credit Agreement with Wells Fargo, which was most recently amended in March 2018, as described above. As of the close of business January 31, 2019, we had total short term borrowings, net of cash, of approximately \$13.8 million, representing approximately 73% of the maximum

borrowing capacity under the Credit Agreement based on our “eligible accounts receivable” (as defined in the Credit Agreement) as of such date, which we believe is sufficient to meet our needs for the foreseeable future barring any increase in reserves imposed by Wells Fargo. We believe that existing funds, cash generated from operations, and existing sources of and access to financing are adequate to satisfy our working capital, planned capital expenditures and debt service requirements for the foreseeable future, barring any increase in reserves imposed by Wells Fargo. However, we cannot assure you that this will be the case, and we may be required to obtain alternative or additional financing to maintain and expand our existing operations through the sale of our securities, an increase in the amount of available borrowings under our Credit Agreement, obtaining additional financing from other financial institutions or otherwise. The financial markets generally, and the credit markets in particular, continue to be volatile, both in the United States and in other markets worldwide. The current market situation has resulted generally in substantial reductions in available loans to a broad spectrum of businesses, increased scrutiny by lenders of the credit-worthiness of borrowers, more restrictive covenants imposed by lenders upon borrowers under credit and similar agreements and, in some cases, increased interest rates under commercial and other loans. If we require alternative or additional financing at this or any other time, we cannot assure you that such financing will be available upon commercially acceptable terms or at all. If we fail to obtain additional financing when and if required by us, our business, financial condition and results of operations would be materially adversely affected.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

During the nine months ended December 31, 2018, we did not hold a portfolio of securities instruments for either trading or speculative purposes. Periodically, we hold securities instruments for other than trading purposes. Due to the short-term nature of our investments, we believe that we have no material exposure to changes in the fair value as a result of market fluctuations.

We are exposed to market risk in connection with changes in interest rates, primarily in connection with outstanding balances under our revolving line of credit with Wells Fargo, which was entered into for purposes other than trading purposes. Based on our average outstanding balances during the nine months ended December 31, 2018, a 1% change in the prime and/or LIBOR lending rates could impact our financial position and results of operations by approximately \$32,000 over the remainder of our fiscal year ending March 31, 2019. For additional information on the revolving line of credit with Wells Fargo, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources – Short Term Borrowings.”

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

Item 4. Controls and Procedures

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

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

An evaluation was performed under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation and subject to the foregoing, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of December 31, 2018. There have been no changes in our internal control over financial reporting that occurred during the quarter ended December 31, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

See our discussion under Note 10 “Contingencies” to the Notes to Condensed Consolidated Financial Statements included in Item 1 of Part I of this Quarterly Report on Form 10-Q.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. “Risk Factors” in our Annual Report on Form 10-K for fiscal year 2018, as filed with the SEC on June 11, 2018, which could materially affect our business, financial condition, and future operating results. The risks described in our Annual Report on Form 10-K for fiscal year 2018, as filed with the SEC on June 11, 2018, are not the only risks that we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition, and operating results. There have been no material changes to the risk factors set forth in our Annual Report on Form 10-K for fiscal year 2018, as filed with the SEC on June 11, 2018, except for the additional risks related to the Merger as noted below.

Risks Related to the Merger

Completion of the Merger is subject to certain conditions and if these conditions are not satisfied or waived, the Merger will not be completed. Failure to complete the Merger could negatively impact our financial condition, results of operations and stock price.

Consummation of the Merger is subject to the satisfaction or waiver of customary closing conditions, including receipt of the Committee on Foreign Investment in the United States (CFIUS) approval. The Merger Agreement contains certain customary termination rights for Parent and the Company, including a right to terminate the Merger Agreement if the Merger is not completed by March 18, 2019, unless otherwise extended pursuant to the terms of the Merger Agreement. The Merger Agreement further provides that, upon termination of the Merger Agreement under certain specified circumstances, the Company will be obligated to pay Parent a termination fee of approximately \$1.2 million. There can be no assurance that the conditions to the closing of the Merger will be satisfied or waived or that the Merger will be completed in a timely manner or at all. If the Merger is not completed, we will have incurred substantial expenses for which we will have received little or no benefit, which could negatively impact our financial condition, results of operations and stock price.

The proposed Merger could divert management’s attention and disrupt our relationships with third parties and employees, which could negatively impact our operating results and ongoing business.

We have expended, and continue to expend, significant management time and resources in an effort to complete the Merger, which may have a negative impact on our ongoing business. Further, the Merger Agreement restricts us from taking certain actions without consent while the Merger is pending. These restrictions will or may, among other matters, prevent us from paying dividends, pursuing otherwise attractive business opportunities, making certain investments or acquisitions, selling assets, investing in capital expenditures in excess of certain agreed limits, incurring certain indebtedness or making certain other changes to our business pending the closing of the Merger. Uncertainty regarding the outcome of the Merger and our future could adversely affect our ability to recruit and retain key personnel and other employees, and disrupt our business relationships with our existing and potential customers, suppliers, vendors, and other business partners, who may attempt to negotiate changes in existing business relationships or consider entering into business relationships with parties other than us. These restrictions and disruptions could have a material and adverse effect on our business, financial condition, and results of operations, which could be exacerbated by a delay in the consummation of the Merger or failure to consummate the Merger.

Item
6. Exhibits

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

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

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

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

Exhibit 101* The following materials from our Quarterly Report on Form 10-Q for the quarter ended December 31, 2018 are formatted in eXtensible Business Reporting Language (XBRL): (i) Condensed Consolidated Statements of Income for the three and nine months ended December 31, 2018 and December 31, 2017, (ii) Condensed Consolidated Balance Sheets as of December 31, 2018 and March 31, 2018, (iii) Condensed Consolidated Statements of Changes in Stockholders’ Equity for the nine months ended December 31, 2018 and December 31, 2017, (iv) Condensed Consolidated Statements of Cash Flows for the nine months ended December 31, 2018 and December 31, 2017, and (v) Notes to the Unaudited Condensed Consolidated Financial Statements.

*Filed herewith

**Furnished herewith

SIGNATURES

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

COMMAND SECURITY CORPORATION

Date: February 13, 2019 By: */s/ Craig P. Coy*

Craig P. Coy
Chief Executive Officer
(Principal Executive Officer)

/s/ N. Paul Brost

N. Paul Brost
Chief Financial Officer
(Principal Financial and Accounting Officer)

