- failure to properly comply with foreign laws and regulations applicable to our foreign activities including, without limitation, software localization requirements;
- compliance with multiple and potentially conflicting regulations in Europe, Australia and North America, including export requirements, tariffs, import duties and other trade barriers, as well as intellectual property requirements;
- difficulties in managing foreign operations and appropriate levels of staffing;
- longer collection cycles;
- seasonal reductions in business activities, particularly throughout Europe;
- reduced protection for intellectual property rights in some countries;
- proper compliance with local tax laws, which can be complex and may result in unintended adverse tax consequences;
- anti-American sentiment due to the wars in Iraq and Afghanistan and other American policies that may be unpopular in certain countries;
- difficulties in enforcing agreements through foreign legal systems;
- fluctuations in exchange rates may affect product demand and may adversely affect the profitability in U.S. dollars of products and services provided by us in foreign markets where payment for our products and services is made in the local currency;
- changes in general economic and political conditions in countries where we operate; and
- restrictions on downsizing operations in Europe and expenses and delays associated with any such activities.

Regulatory Risks

The FCC is currently reviewing challenges and alternatives to the rates applicable to interstate inmate telecommunications service that, if implemented, could have an adverse effect on our business.

The FCC has opened several rulemaking proceedings that question whether the current regulatory regime applicable to the rates for interstate inmate telecommunications services is responsive to the needs of correctional facilities, inmate telecommunications service providers, the inmates and their families. Parties participating in these proceedings generally include prison inmates and their families, parties receiving calls from inmates, several national inmate advocacy organizations such as Citizens United for the Rehabilitation of Errants and providers of inmate telecommunications services. In general, the position of those challenging the current regulatory regime is that inmate telecommunications service rates are excessive due to compensation paid to correctional facilities in the form of "commissions" and that the FCC should establish rate caps, prohibit commissions to correctional facilities and mandate the offering by inmate telecommunications service providers of inmate debit or prepaid card alternatives to collect calling. Such a regime would require a new and complex set of federal regulations that, if adopted, could reduce our revenues derived from existing contracts and could lead to increased costs associated with regulatory compliance. Moreover, if implementation of these regulations leads to technological or structural changes in the industry, it could diminish the value of our intellectual property and our customer relationships and lead to a reduction in profitability of calls originating from correctional facilities.

We operate in a highly regulated industry, and are subject to restrictions in the manner in which we conduct our business and a variety of claims relating to such regulation.

Our operations are subject to federal regulation, and we must comply with the Communications Act of 1934, as amended, and FCC regulations promulgated there under. We are also subject to the applicable laws and regulations of various states and other state agencies, including regulation by public utility commissions. Federal laws and FCC regulations generally apply to interstate telecommunications (including international telecommunications that originate or terminate in the United States), while state regulatory authorities generally have jurisdiction over telecommunications that originate and terminate within the same state. Generally, we must obtain and maintain prior authorization from and/or register with, regulatory bodies in most states where we offer intrastate services and must obtain or submit prior regulatory approval of rates, terms and conditions for our intrastate services in many of these jurisdictions. We are also in some cases required, along with other telecommunications providers, to contribute to federal and state funds established for universal service, number portability, payphone compensation and related purposes. Laws and regulations in this industry such as those identified above, and others including those regulating call recording and call rate announcements, and billing, collection, customer collection management, and solicitation practices are all highly complex and burdensome, making it difficult to be in complete compliance. The difficulty is sometimes exacerbated by technology issues. Although we actively seek to comply with all laws and regulations and remedy areas in which we become aware of inadvertent non-compliance, we may not always be in full compliance with all regulations applicable to us. Once non-compliance is identified, remedies are sought and implemented as quickly as possible. Failure to comply with these requirements can result in potentially significant fines, penalties, regulatory sanctions and claims for substantial damages. Claims may be widespread, as in the case of class actions commenced on behalf of inmates or the called parties of inmates. Significant fines, penalties, regulatory sanctions and damage claims could be material to our business, operating results and financial condition. Additionally, regulation of the telecommunications industry is changing rapidly, and the regulatory environment varies substantially from state to state. Future regulatory, judicial or legislative activities may have an adverse effect on our operations or financial condition, and domestic or international regulators or third parties may raise material issues with regard to our compliance or non-compliance with applicable regulations.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our principal executive office is located in, and a portion of our operations are conducted from, leased premises located at 14651 Dallas Parkway, Suite 600, Dallas, Texas 75254-8815. We also lease additional regional facilities located in Carrollton, Texas, from which we conduct our technical support operations, in-sourced call center, and warehouse operations, and our data centers located in Allen and Dallas, Texas and Atlanta, Georgia. We have offices in Richmond, British Columbia and London, United Kingdom. We believe that our facilities are suitable and the space contained by them adequate for their respective operations.

ITEM 3. LEGAL PROCEEDINGS

We have been, and expect to continue to be, subject to various legal and administrative proceedings or various claims in the normal course of business. We believe the ultimate disposition of these matters will not have a material effect on our financial condition, liquidity, or results of operations.

From time to time, inmate telecommunications providers, including the Company, are parties to judicial and regulatory complaints and proceedings initiated by inmates, consumer protection advocates or individual called parties alleging, among other things, that excessive rates are being charged with respect to inmate collect calls, that commissions paid by inmate telephone service providers to the correctional facilities are too high, that a call was wrongfully disconnected, that security notices played during the call disrupt the call, that the billed party did not accept the collect calls for which they were billed or that rate disclosure was not provided or was inadequate. On occasion, we are also the subject of regulatory complaints regarding our compliance with various matters including tariffing, access charges, payphone compensation requirements and rate disclosure issues. In March 2007, the FCC asked for public comment on a proposal from an inmate advocacy group to impose a federal rate cap on interstate inmate calls. This proceeding could have a significant impact on the rates that we and other companies in the inmate telecommunications industry may charge. Similar proposals have been pending before the FCC for more than four years without action by the agency. This newest proceeding remains under review by the FCC and has received strong opposition from the inmate telecommunications industry. In August 2008, a group of inmate telephone service providers provided the FCC with an "industry wide" cost of service study for their consideration. That proceeding remains ongoing and we have no information as to when, if ever, it will be resolved. We cannot predict the outcome at this time.

In June 2000, T-Netix was named, along with AT&T, in a lawsuit in the Superior Court of King County, Washington, in which two private citizens allege violations of state rules requiring pre-connect audible disclosure of rates as required by Washington statutes and regulations. T-Netix and other defendants successfully obtained dismissal and a "primary jurisdiction" referral in 2002. In 2005, after several years of inactivity before the Washington Utilities and Transportation Commission ("WUTC"), the state telecommunications regulatory agency, T-Netix prevailed at the trial court in securing an order entering summary judgment on grounds of lack of standing, but that decision was reversed by an intermediate Washington state appellate court in December 2006. T-Netix's subsequent petition for review by the Washington Supreme Court was denied in January 2008, entitling plaintiffs to continue to pursue their claims against T-Netix and AT&T. This matter was referred to the WUTC on the grounds of primary jurisdiction, in order for the WUTC to determine various regulatory issues. On May 22, 2008, AT&T filed with the trial court a cross-claim against T-Netix seeking indemnification. T-Netix moved to dismiss AT&T's cross-claim, but the court denied that motion and deferred resolution of whether AT&T's belated indemnification claim is within the statute of limitations for summary judgment. Motions by both T-Netix and AT&T for summary determination were briefed to the WUTC in September 2009 and remain pending before an administrative law judge. As merits and damages discovery are not completed, however, we cannot estimate the Company's potential exposure or predict the outcome of this dispute.

In July 2009, Evercom filed a complaint against Combined Public Communications, Inc. ("CPC"), alleging tortious interference with Evercom's contracts for the provision of telecommunications services with correctional facilities in the Commonwealth of Kentucky and the State of Indiana. Evercom claims CPC has misrepresented that the correctional facility has a statutory right to terminate its contract with Evercom upon the election of a new Sheriff. Accordingly, Evercom seeks a declaration that under Kentucky law its contracts with its customers are not personal services contracts and that under both Indiana and Kentucky law, its contracts with correctional facilities are not void for not being terminable within thirty days, as well as an award of compensatory and punitive damages. On July 29, 2009, CPC filed a motion to dismiss for failure to state a claim. On August 14, 2009, Evercom filed its response in opposition to dismiss, and on September 9, 2009, the court denied CPC's motion to dismiss. On January 8, 2009, the court entered a scheduling order setting forth the pre-trial deadlines. This matter is in its early stages and we cannot predict the outcome at this time.

In July 2009, the Company filed a petition with the Federal Communications Commission ("FCC") seeking affirmation of the Company's right to block attempts by inmates to use services, which the Company calls "call diversion schemes," designed to circumvent its secure calling platforms. These illicit services are not permitted to carry calls from any correctional facility, and the Company has received strong support from its correctional authority clients to stop this activity. The FCC has long-standing precedent that permits inmate telecommunications service providers to block such attempts. The FCC had asked that interested parties file comments to the Company's petition by August 31, 2009; and thereafter, the Company filed reply comments. This matter is in its early stages and we cannot predict the outcome at this time.

In September 2009, T-Netix filed suit against Combined Public Communications, Inc. in the United States Federal District Court for the Western District of Kentucky, for patent infringement of various T-Netix patents. The court has scheduled a Rule 26(f) scheduling conference for February 10, 2010 and the parties are negotiating an agreed discovery plan to present at the hearing. This matter is in its early stages and we cannot predict the outcome at this time.

In October 2009, T-Netix filed suit in the United States Federal District Court for the Eastern District of Texas against Pinnacle Public Services, LLC for patent infringement of various T-Netix patents. Pinnacle has served its answer and filed a motion to transfer venue to the Northern District of Texas. This matter is in its early stages and we cannot predict the outcome at this time.

In October 2009, the Company, along with Evercom and T-Netix, and one of the Company's competitors were sued in the Federal District Court for the Southern District of Florida by Millicorp d/b/a ConsCallHome. Millicorp, a proprietor of what the Company has described to the FCC as a call diverter, has sued these companies under the Communications Act of 1934, alleging that the companies have no right to block attempts by inmates to use the call diversion scheme. The FCC has permitted inmate telecommunications service providers to block such attempts since 1991, and the Company had sought re-affirmance of that permission in the petition for declaratory ruling described above. All defendants have filed motions to dismiss all claims with prejudice. Discovery has not yet commenced. This matter is in its early stages and we cannot predict the outcome at this time.

In October 2009, the Company filed suit in the District Court of Dallas County, Texas, against Lattice Incorporated ("Lattice", formerly known as Science Dynamics Corporation) alleging breach of contract, tortious interference, unfair competition, damage to goodwill and injunctive relief as a result of Lattice's breach of certain provisions of a December 2003 asset purchase agreement between Evercom and Science Dynamics Corporation. On October 2, 2009, the court issued a temporary restraining order against Lattice, and ordered Lattice to immediately cease and desist from, among other things, (i) renewing any customer contracts in the law enforcement industry; (ii) marketing, selling or soliciting, directly or indirectly, any of its products and/or services to any customers in the law enforcement industry; and (iii) interfering with any of the

Company's business relationships in the law enforcement industry in the United States. On January 4, 2010, the parties entered into a settlement agreement and mutual release, and a patent license agreement wherein Lattice was granted a license to use one (1) of the Company's patents.

In January 2010, T-Netix and Evercom filed suit in the United States Federal District Court for the Eastern District of Texas against Legacy Long Distance International, Inc. dba Legacy International, Inc. and Legacy Inmate Communications for patent infringement of various T-Netix's and Evercom's patents. This matter is in its early stages and we cannot predict the outcome at this time.

ITEM 4. RESERVED

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information. Our common stock is not registered and there is currently no established public trading market for our issued and outstanding equity securities.

Holders of Record. As of March 1, 2010, we had three holders of Series A Redeemable Convertible Preferred Stock, seven holders of Class A Common Stock and twenty-two holders of Class B Common Stock. In December 2007, we effected a 1 for 1,000 reverse stock split for our Class A Common Stock and Class B Common Stock in connection with the issuance of the Series A Redeemable Convertible Preferred Stock.

Dividends. We have never declared or paid any cash dividends on our Common Stock. Our Series A Redeemable Convertible Preferred Stock accrues dividends at 12.5% annually. We currently intend to retain earnings, if any, to support our business strategy and do not anticipate paying cash dividends in the foreseeable future. Payment of future dividends, if any, will be at the sole discretion of our board of directors after taking into account various factors, including restrictions on our ability to pay dividends, our financial condition, operating results, capital requirements and any plans for expansion. Our revolving credit facility, the indenture governing our Second-priority Senior Secured Notes, and the note purchase agreement governing our senior subordinated notes contain certain negative covenants that restrict our ability to declare dividends. See "Management's Discussion and Analysis of Financial Conditions and Results of Operations—Debt and Other Obligations."

Securities Authorized for Issuance Under Equity Compensation Plans. The following table provides information about the securities authorized for issuance under our equity compensation plans as of December 31, 2009:

	Equity Compensation Plan Information		
	(a)	(b)	(c)
Plan category	**Number of securities to be issued upon exercise of outstanding options, warrants and rights (1)**	**Weighted-average exercise price of outstanding Options, warrants and rights**	**Number of Securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))**
Equity compensation plans approved by security holders(2)	126,660	$ .01	48,340
Equity compensation plans not approved by security holders	-	-	-
Total	126,660	$ .01	48,340

(1) Includes 126,660 shares of restricted stock issued under the 2004 Restricted Stock Plan.
(2) In March 2009, the Company filed a Fourth Amendment and Restated Certificate of Incorporation which 1,685,000 shares of stock were authorized, of which 10,000 shares are designated Preferred Stock, $.001 par value per share (the "Preferred Stock"), 1,500,000 shares are designated Common Stock, $.001 par value per share (the "Common Stock"), and 175,000 shares are designated Class B Common Stock, $.001 par value per share (the "Class B Common Stock").

Unregistered Sales of Equity Securities. As of December 31, 2009, we had sold to certain members of management and our board of directors a total of 126,660 restricted shares of Class B Common Stock at a purchase price of $.01 per share pursuant to the 2004 Restricted Stock Plan. In 2009, we issued 4,566 shares and 2,000 shares of Class B Common Stock on February 19, 2009 and March 1, 2009, respectively. The shares are subject to certain contractual limitations, including provisions regarding forfeiture and disposition, as provided in each executive's restricted stock purchase agreement and the 2004 Restricted Stock Plan. The restricted period ends upon the occurrence of certain events or the lapse of time. The sale of the Class B Common Stock was made pursuant to the exemption set forth in Section 4(2) of the Securities Act of 1933 for transactions not involving a public offering, and regulations promulgated thereunder.

On March 25, 2009, the Company filed a Fourth Amended and Restated Certificate of Incorporation, which authorized 1,685,000 shares of capital stock. Additionally, the Board of Directors issued a unanimous resolution to adopt a Fourth Amendment to the 2004 Restricted Stock Plan which increased the number of shares of Class B Common Stock authorized for issuance thereunder from 165,000 to 175,000 shares. The Fourth Amended and Restated Certificate of Incorporation designated 1,500,000 shares as Class A Common Stock, 10,000 shares as Preferred Stock, of which 5,100 were designated as Series A Convertible Preferred Stock, and 175,000 shares as Class B Common Stock. All issued shares of Common Stock are entitled to vote on a one share/one vote basis.

ITEM 6. SELECTED FINANCIAL DATA

The following selected consolidated historical financial data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and the related notes thereto appearing elsewhere in this Form 10-K. The selected historical consolidated financial and other data presented below for the fiscal years ended December 31, 2007, 2008 and 2009 have been derived from our audited consolidated financial statements.

	For the Year Ended December 31,				
	2005	2006	2007	2008	2009
Consolidated Statement of Operations					
Operating revenues (1)	$ 377.4	$ 401.9	$ 391.9	$ 388.6	$ 363.4
Cost of service (1)	279.7	293.1	286.8	271.9	247.2
Selling, general and administrative expenses (1)	57.9	69.4	74.4	74.7	66.1
Depreciation and amortization	23.9	30.3	37.1	34.4	31.4
Other operating expenses (2)	0.6	-	0.6	0.2	-
Operating income (loss)	15.3	9.1	(7.0)	7.4	18.7
Other Income Expense:					
Interest and other expenses, net	(26.6)	(27.8)	(31.5)	(41.9)	(39.1)
Loss before income taxes	(11.3)	(18.7)	(38.5)	(34.5)	(20.4)
Income tax expense (benefit)	(2.2)	1.4	1.9	(0.5)	0.7
Net loss	(9.1)	(20.1)	(40.4)	(34.0)	(21.1)
Accrued dividends on preferred stock	-	-	-	(1.4)	(1.5)
Net loss available to common stockholders	$ (9.1)	$ (20.1)	$ (40.4)	$ (35.4)	$ (22.6)
Other Financial Data:					
Direct provisioning revenues (1)	$ 303.3	$ 341.2	$ 338.7	$ 333.6	$ 312.6
Wholesale services revenues (1)	74.1	60.7	45.2	29.9	28.1
Offender management software	-	-	7.9	25.1	22.7

	For the Year Ended December 31,				
	2005	2006	2007	2008	2009
Other Data:					
Deficiency of earnings to fixed charges	$ 9.1	$ 20.1	$ 40.4	$ 35.4	$ 22.6
Consolidated Cash Flow Data:					
Cash flows from operating activities	$ 29.8	$ 19.1	$ 20.5	$ 17.4	$ 26.8
Cash flows from investing activities	(26.3)	(27.1)	(64.0)	(17.0)	(16.3)
Cash flows from financing activities (3)	(2.8)	6.0	46.5	1.1	(12.3)
Capital Expenditures	26.3	27.2	21.4	17.0	16.5
Balance Sheet Data (End of Period)					
Cash and cash equivalents and restricted cash	$ 4.0	$ 2.0	$ 3.6	$ 8.2	$ 4.0
Total current assets (4)	80.7	76.4	62.9	61.6	51.7
Net property and equipment	43.9	46.4	40.8	35.4	28.8
Total assets	266.9	259.6	292.1	259.0	240.1
Total long-term debt (including current portion)	198.0	210.6	263.3	288.3	287.8
Stockholders' deficit	$ (31.9)	$ (51.9)	$ (88.9)	$ (128.8)	$ (148.2)

(1) Includes reclassification of certain amounts in prior years to conform with current period presentation. No impact on operating income (loss), net loss, cash flows or the financial position of the Company for the prior periods presented.
(2) Includes gain on sale of assets, compensation expense on employee restricted stock, severance and restructuring costs.
(3) The 2007 amount reflects $40 million of indebtedness incurred through the issuance of additional Second-priority Senior Secured Notes in connection with our acquisition of Syscon.
(4) Current assets decreased in 2007, 2008, and 2009 primarily as a result of a decline in receivables due to a significant increase in prepaid revenues as a percentage of total revenues, coupled with a decline in overall direct call provisioning and wholesale services revenues.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following information should be read in conjunction with our historical consolidated financial statements and related notes, our audited consolidated financial data and related notes and other financial information included elsewhere in this Form 10-K.

Overview

We are one of the largest independent providers of inmate telecommunications services to correctional facilities operated by city, county, state and federal authorities and other types of confinement facilities such as juvenile detention centers and private jails in the United States and Canada. As of December 31, 2009, we provided service to approximately 2,400 correctional facilities.

Our core business consists of installing, operating, servicing and maintaining sophisticated call processing systems in correctional facilities and providing related services. We enter into multi-year agreements (generally three to five years) directly with the correctional facilities in which we serve as the exclusive provider of telecommunications services to inmates. In exchange for the exclusive service rights, we pay a negotiated commission to the correctional facility based upon revenues generated by actual inmate telephone use. In addition, on a limited basis we may partner with other telecommunications companies whereby we provide our equipment and, as needed, back office support including validation, billing and collections services, and charge a fee for such services. Based on the particular needs of the corrections industry and the requirements of the individual correctional facility, we also sell platforms and specialized equipment and services such as law enforcement management systems, call activity reporting and call blocking.

Our subsidiary Syscon is an enterprise software development company for the correctional facility industry. Syscon's core product is a sophisticated and comprehensive software system utilized by correctional facilities and law enforcement agencies for complete offender management. Syscon's system provides correctional facilities with the ability to manage and monitor inmate parole and probation activity and development at a sophisticated level.

Certain amounts in the prior periods' consolidated financial statements have been reclassified to conform to the current period presentation. We believe this reclassification will result in a clearer presentation of our results of operations. As a result, we have revised our Management's Discussion and Analysis of Financial Condition and Results of Operations for prior periods to reflect this reclassification.

Revenues

We derived approximately 86% of our revenues for each of the years ended December 31, 2008 and 2009 from our direct operation of inmate telecommunication systems and the provision of related services located in correctional facilities within 43 states and the District of Columbia. We enter into multi-year agreements under direct or "prime" contracts with the correctional facilities, pursuant to which we serve as the exclusive provider of telecommunications services to inmates within each facility. In exchange for the exclusive service rights, we pay a commission to the correctional facility based upon inmate telephone use. We install and generally retain ownership of the telephones and the associated equipment and provide additional services tailored to the specialized needs of the corrections industry and to the requirements of each individual correctional facility, such as call activity recording and call blocking. In our direct call provisioning business, we earn the full retail value of the call and pay corresponding line charges and commissions.

We derived approximately 6% of our revenues from our offender management software business for each of the years ended December 31, 2008 and December 31, 2009. Offender management systems are platforms that allow facilities managers and law enforcement personnel to analyze data to reduce costs, prevent and solve crimes and facilitate rehabilitation through a single user interface. Revenue related to the offender management software business is recognized using the residual method when the fair value of vendor specific objective evidence ("VSOE") of the undelivered element is determined. If the VSOE of fair value cannot be determined for any undelivered element or any undelivered element is essential to the functionality of the delivered element, revenue is deferred until such criteria are met or recognized as the last element is delivered. Under the residual method, the fair value of the undelivered elements is deferred and the difference between the total arrangement fee and the amount recorded as deferred revenue for the undelivered elements is recognized as revenue related to the delivered elements.

We derived approximately 8% of our revenues for each of the years ended December 31, 2008 and 2009 from the wholesale services business. We derive this revenue through (1) validation, uncollectible account management and billing services (solutions services), (2) providing equipment, security enhanced call processing, call validation and service and support through the primary inmate telecommunications providers (telecommunications services), and (3) the sale of equipment to other telecommunications companies as customers or service partners.

In our direct call provisioning and wholesale services business, we accumulate call activity data from our various installations and bill our revenues related to this call activity against prepaid customer accounts or through direct billing agreements with local exchange carrier ("LEC") billing agents, or in some cases through billing aggregators that bill end users. We receive payment on a prepaid basis for the majority of our services and record deferred revenue until the prepaid balances are used. In each case, we recognize revenue when the calls are completed and record the related telecommunication costs for validating, transmitting, billing and collection, bad debt, and line and long-distance charges, along with commissions payable to the facilities. In our wholesale services business, our service partner may bill the called party and we either share the revenues with our service partner or receive a prescribed fee for each call completed. We also charge fees for additional services such as customer support and advanced validation.

Cost of Service

Our principal cost of service for our direct call provisioning business consists of commissions paid to correctional facilities, which are typically expressed as a percentage of either gross or net direct call provisioning revenues and are typically fixed for the term of the agreements. Our cost of service for direct call provisioning also includes (1) bad debt expense from uncollectible accounts; (2) billing and collection charges; (3) telecommunication costs such as telephone line access, long distance and other charges; (4) call validation costs; and (5) field operations and maintenance costs for service on our installed base of inmate telephones. We pay monthly line and usage charges to Regional Bell Operating Companies ("RBOCs") and other LECs for interconnection to local networks to complete local calls. We also pay fees to interexchange and long distance carriers for long distance calls completed. Third-party billing charges consist of payments to LECs and other billing service providers for billing and collecting revenues from called parties.

Cost of service associated with our offender management software business primarily includes salaries and related costs of employees and contractors that provide technological services to develop, customize or enhance the software for our clients.

Cost of service for our wholesale service business includes billing and collection, call validation, bad debt expense and service costs for correctional facilities, including salaries and related personnel expenses, inmate calling systems repair and maintenance expenses and the cost of equipment sold to service partners.

Facility Commissions. In our direct call provisioning business, we pay a facility commission typically based on a percentage of our billed revenues from such facility. Commissions are set at the beginning of each facility contract.

Bad Debt. We account for bad debt as a direct cost of providing telecommunications services. We accrue the related telecommunications cost charges along with an allowance for uncollectible calls, based on historical experience. We use a proprietary, specialized billing and bad-debt management system to integrate our billing with our call blocking, validation and customer inquiry procedures. We seek to manage our higher risk revenues by proactively requiring certain billed parties to prepay collect calls or be directly billed by us. This system utilizes multi-variable algorithms to minimize bad debt expense by adjusting our credit policies and billing. For example, when unemployment rates are high, we may decrease credit to less creditworthy-billed parties or require them to purchase prepaid calling time in order to receive inmate calls.

Bad debt expense tends to rise with higher unemployment rates and as the economy worsens, and is subject to other factors, some of which may not be known. To the extent our bad debt management system overcompensates for bad debt exposure by limiting credit to billed parties, our revenues and profitability may decline as fewer calls are permitted to be made. In 2008, we tightened our credit policy to reduce our risk of loss from bad debts. Consequently, billed minutes and associated revenues may have been negatively impacted in the latter part of 2008 and in 2009. Since our bad debt visibility is delayed an average of six to nine months, risk exists that future write-offs may be incurred.

Field Operations and Maintenance Costs. Field operations and maintenance costs consist of service administration costs for correctional facilities. These costs include salaries and related personnel expenses, communication costs, and inmate calling systems repair and maintenance expenses.

Selling, General & Administrative Expenses

Selling, general and administrative ("SG&A") expenses consist of corporate overhead and selling expenses, including accounting, marketing, legal, regulatory, and research and development costs.

Industry Trends

The corrections industry, which includes the inmate calling and offender management software markets, is and can be expected to remain highly competitive. We compete directly with numerous other suppliers of inmate call processing systems and other corrections-related products (including our own wholesale service provider customers) that market their products to our same customer base. Contracts to service correctional facilities are typically subject to competitive bidding, and as we seek to secure inmate telecommunications contracts with larger county and state departments of corrections, we may be required to provide surety bonds or significant up-front payments such as signing bonuses and guaranteed commissions, as well as incur the cost of equipment and installation costs. We provide our wholesale products and services to inmate telecommunications service providers, such as Global Tel*Link, Embarq, AT&T, and FSH Communications.

Our offender management software business has been affected by the poor economy and government budget shortfalls. As corrections agencies have increased the amount of time they take to evaluate proposals, process contracts and change orders, and in some cases have deferred or cancelled orders for the purchase of technology solutions. Agencies are being extremely careful, as all purchases are under increased scrutiny and many require additional steps before approval. The U.S. federal government economic stimulus programs have provided some relief domestically. The global nature of the downturn is having a similar impact overseas.

Results of Operations for the Year Ended December31, 2009 Compared to December 31, 2008

The following table sets forth the primary components of revenue for 2008 and 2009.

	For the Twelve Months Ended			
	December 31, 2008	December 31, 2009	Variance	% Change
(Dollars in thousands)				
Direct call provisioning	$ 333,564	$ 312,614	$ (20,950)	(6.3)%
Offender management software	25,137	22,698	(2,439)	(9.7)
Wholesale services	29,902	28,124	(1,778)	(5.9)
Total revenue	$ 388,603	$ 363,436	$ (25,167)	(6.5)%

Revenues

Compared to the year ended December 31, 2008, consolidated revenues decreased for the year ended December 31, 2009 by $25.2 million, or 6.5 %, to $363.4 million. The primary components of the decrease in revenues are discussed below:

Direct call provisioning revenues decreased $21.0 million, or 6.3%, to $312.6 million resulting primarily from lower call volumes and revenues per call due primarily to the economic recession. Additionally, in 2009 we experienced a change in revenue recognition from a partnering arrangement that reduced our revenues by approximately $8.2 million from the prior year. In 2008, inmate calls were processed on our platforms and revenues and expenses were recorded on a gross basis. The new equipment owned and managed by our partner was installed at the various sites and, accordingly, our share of revenue is now recorded net of expenses. This change in revenue recognition from a gross to net basis will continue to affect revenues over the term of the underlying facility contract.

Offender management software revenues decreased $2.4 million, or 9.7%, to $22.7 million. The majority of our offender management revenues have been associated with the implementation of our software for Her Majesty's Prison Service in the United Kingdom through a sub-contracting agreement with HP Enterprise Services (formerly EDS). The implementation phase of this contract was successfully completed during the second quarter of 2009 causing the expected decline in revenues. During the fourth quarter of 2009, we started to generate revenues from new contracts in the United States as well as extended our work in the United Kingdom and Australia, and we continually seek to win new contracts. We were impacted by the global economic recession in 2009 which has affected government budgets causing corrections agencies to delay or defer technology spending or cancel orders altogether, which, in turn, made it more difficult to generate new contracts during this recessionary period. In connection with the acquisition of Syscon we valued the existing customer contracts and related deferred revenues at fair value, which impacted the amount of revenue and profit recognized on the acquired contracts. Our 2008 offender management software revenues and operating profits were $3.5 million lower than what would have been reported resulting from the amortization of acquired customer contracts, as required by purchase accounting. 2009 revenues and operating profits were not significantly impacted by the amortization of acquired customer contracts.

Wholesale services revenues decreased by $1.8 million, or 5.9%, due to the ongoing trend of our wholesale partners, who also compete directly with us, not renewing our services as their underlying facility contracts expire. This revenue attrition was partially offset by a $7.1 million increase in revenues related to installation and project management services associated with the Texas Department of Criminal Justice (TDCJ) contract. With the exception of the TDCJ contract, we expect our wholesale services revenues to continue to decline in the future as wholesale contracts expire.

Cost of Service. Total cost of service for the year ended December 31, 2009 decreased by $24.7 million, or 9.1%, from the year ended December 31, 2008 due to lower direct call provisioning and offender management software revenues and the implementation of direct cost reduction initiatives. A comparison of the components of our business segment gross margins is provided below (dollars in thousands):

	Year Ended December 31,					
	2008			2009		
Direct Call Provisioning						
Revenue	$	333,564		$	312,614	
Cost of service		243,807	73.1%		221,572	70.9%
Segment gross margin	$	89,757	26.9%	$	91,042	29.1%
Offender Management Software						
Revenue	$	25,137		$	22,698	
Cost of service		13,540	53.9%		9,624	42.4%
Segment gross margin	$	11,597	46.1%	$	13,074	57.6%
Wholesale Services						
Revenue	$	29,902		$	28,124	
Cost of service		14,543	48.6%		16,032	57.0%
Segment gross margin	$	15,359	51.4%	$	12,092	43.0%

Cost of service in our direct call provisioning segment decreased as a percentage of revenue to 70.9% from 73.1% due to efficiencies gained from our packet-based architecture, cost savings initiatives implemented during 2008 and 2009, as well as our strategy to shift customers to our prepaid products, which carry a higher gross margin since bad debt risk is greatly reduced. In 2008, approximately 46% of our direct call provisioning revenues were prepaid while 55% of our direct call provisioning revenues were prepaid in 2009, generating an improvement in bad debt expense as a percentage of revenues even in the current recessionary environment. Because our bad debt visibility is delayed an average of six to nine months, risk exists that we may incur future write-offs.

Cost of service in our offender management software segment as a percentage of revenue decreased to 42.4 % from 53.9%. Excluding the impact of the amortization of acquired contracts on revenues in the prior year, cost of service as a percentage of revenues would have been 47.3% of revenues in 2008. The cost improvement in 2009 is primarily due to more efficient utilization of personnel coupled with the completion and delivery of several older projects that had yielded lower margins. Cost of service for the offender software segment primarily represents salaries and related costs of employees and contractors, who provide technological services to develop, customize or enhance the software for our clients.

Cost of service in our wholesale services segment as a percentage of our revenue increased to 57.0% from 48.6% as a result of low margins for project management and installation labor revenues associated with the TDCJ contract. The wholesale services cost structure currently includes a mix of field service costs resulting from implementation of the TDCJ sites. Margins related to the TDCJ contract are expected to improve in 2010 as we generate a higher mix of billing and collection revenues from this contract.

SG&A. SG&A expenses of $66.1 million were $8.6 million, or 11.5%, lower than the prior year primarily due to cost reduction initiatives implemented beginning in the third quarter of 2008 that have allowed us to reduce our administrative expenses by over $7.4 million in 2009. Both 2008 and 2009 include non-recurring executive reorganization costs of $1.2 million and $0.5 million, respectively. Proceeds from favorable intellectual property dispute settlements were recorded against SG&A expense in both 2008 and 2009 as we had previously incurred substantial legal and other professional service fees related to these settlements.

Depreciation and Amortization Expenses. Depreciation and amortization expenses were $31.3 million for the year ended December 31, 2009, a decrease of $3.1 million, or 9%, from the year ended December 31, 2008. The decrease is primarily attributable to assets that became fully depreciated or amortized as well as lower capital spending in 2008 and 2009 versus previous years.

Interest and Other Expenses, net. Interest and other expenses, net of $39.1 million decreased by $2.8 million, or 7%, from the prior year due to foreign exchange gains of $2.3 million in 2009 compared to foreign exchange losses of $3.8 million in 2008. Offsetting this gain was an increase in interest expense of $3.4 million due primarily to the increasing principal on the Senior Subordinated Notes from paid-in-kind interest accumulation.

Income Tax Expense. Income tax expense for the year ended December 31, 2009 was $0.7 million compared to a benefit of $0.5 million for the year ended December 31, 2008 and principally arose from changes in valuation allowances on our deferred tax assets. The Company's net operating losses are fully reserved by valuation allowances since the Company has a history of generating net losses.

Results of Operations for the Year Ended December31, 2008 Compared to December 31, 2007

The following table sets forth the primary components of revenue for 2007 and 2008

	For the Twelve Months Ended			
	December 31, 2007	December 31, 2008	Variance	% Change
(Dollars in thousands)				
Direct call provisioning	$ 338,703	$ 333,564	$ (5,139)	(1.5)%
Offender management software	7,933	25,137	17,204	216.9
Wholesale services	45,214	29,902	(15,312)	(33.9)
Total revenue	$ 391,850	$ 388,603	$ (3,247)	(0.8)%

Revenues

Compared to the year ended December 31, 2007, consolidated revenues decreased for the year ended December 31, 2008 by $3.2 million, or 0.8 %, to $388.6 million. The primary components of the decrease in revenues are discussed below:

Direct call provisioning revenues decreased $5.1 million, or 1.5%, to $333.6 million. This resulted from a decrease of $20 million due primarily to the loss of direct business contracts with several departments of corrections that expired during the second half of 2007, combined with the lower revenues due to the worsening economy, which caused us to tighten credit controls in an effort to reduce our bad debt exposure. In addition, in 2008 we sought to improve our margins in bidding for new state and county contracts, which resulted in the loss of some contracts that did not meet acceptable profitability standards. We monitor contracts coming up for renewal on the same basis. The decrease in revenue was partially offset by $14.9 million of revenues from department of corrections and mega-county contracts won from competitors, net of accounts not renewed. Large accounts installed in 2008 generated $7.3 million in 2008, and are expected to generate $16 million annually over the term of the contracts.

Offender management software revenues increased $17.2 million or 216.9% to $25.1 million primarily due to only two quarters of operations in 2007 compared to a full year in 2008. The majority of our offender management revenues were associated with the implementation of our software for Her Majesty's Prison Service in the United Kingdom, through a sub-contracting agreement with Electronic Data Systems, Inc. In connection with the Syscon acquisition, we valued Syscon's existing customer contracts and related deferred revenues at fair value, which impacted the amount of revenue and profit we recognized. As a result, for the years ended December 31, 2008 and 2007, respectively, our offender management software revenues and operating profits were reduced by $3.5 million and $1.4 million related to the amortization of acquired customer contracts, as required by purchase accounting.

Wholesale services revenues decreased by $15.3 million, or 33.9%, primarily due to terminations of service by AT&T and Global Tel*Link as their underlying facility contracts expire.

Cost of Service. Total cost of service for the year ended December 31, 2008 decreased by $14.9 million over cost of service for the year ended December 31, 2007, or 5.2%, to $271.9 million.

Cost of service in our direct call provisioning segment decreased as a percentage of revenue to 73.1% from 75.8% due to lower bad debt, commission and field operations expenses, offset slightly by higher billing and collection fees and network costs. Bad debt expense declined 31.5%, from 11.2 % to 7.8% as a percentage of direct call provisioning revenues, as a result of our shift to selling products on our prepaid platforms, further tightening of our credit policies due to the deteriorating economy, and the impact of a one-time write-off of $1.7 million in 2007 related to complications arising from our billing system conversion. Historically, our bad debt has been highly correlated to unemployment rates; however, we have developed statistical methods to identify high risk customers who we require to prepay for services. In 2007, approximately 35% of our direct provision revenues were prepaid, while 46% of our direct provisioning revenues were prepaid in 2008. Field operations expense declined $0.9 million year over year due to efficiencies gained from our packet-based architecture.

Cost of service in our offender management software segment as a percentage of revenue decreased to 53.9 % from 77.0% mainly due to more efficient utilization of personnel in 2008. Cost of service for the offender software segment primarily represents salaries and related costs of employees and contractors who provide technological services to develop, customize or enhance the software for our clients. Time incurred for research and development or administrative activities by these employees is classified as SG&A expense in 2008.

Cost of service in our wholesale services segment as a percentage of our revenue decreased to 48.6% from 53.3% as a result of our bad debt savings initiatives discussed above. Cost of service is a more volatile component of wholesale services relative to our direct call provisioning business because most of the cost is comprised of bad debt expense. Therefore, a rise in unemployment rates may cause a significant erosion of wholesale profitability should bad debt results deteriorate.

SG&A. SG&A expenses of $74.7 million were $0.4 million, or 0.5%, higher than the year ended December 31, 2007. The increase was due primarily to $6.3 million in additional SG&A expenses in our offender management software segment as 2007 results included only two quarters of Syscon expenses compared to a full reporting year in 2008. Additionally, we incurred $1.2 million related to the reorganization of the executive team of the Company. These increases were offset by a decrease of approximately $1.0 million related to one-time costs incurred in 2007 for bonuses tied to the closing of the Syscon acquisition, severance and death benefits paid to the family of an executive and lease exit costs. Legal fees were lower in 2008 as a result of settling several intellectual property lawsuits during the third quarter of 2008. Proceeds from the intellectual property settlements were recorded against SG&A costs, as we had incurred substantial legal and other professional service fees related to these settlements in SG&A expense since the fourth quarter of 2006. In the third quarter of 2008, we implemented cost cutting initiatives which lowered administrative costs by approximately $0.7 million during the last six months of 2008.

Restructuring Costs. During 2008, we incurred $0.2 million related to the realignment of our field service organization because of efficiencies gained from our packet-based architecture, which we began to install in 2006 and will continue to install as customer contracts are renewed. In 2007, restructuring charges of $0.6 million were incurred related to the consolidation of our customer care function into the Dallas office, comprised of $0.2 million of severance expense and $0.4 million of facility exit costs for the Selma, Alabama location.

Depreciation and Amortization Expenses. Depreciation and amortization expenses were $34.4 million for the year ended December 31, 2008, a decrease of $2.6 million or 7.1% over the year ended December 31, 2007. The decrease was primarily attributable to lower amortization of intangibles related to the Evercom acquisition that became fully amortized in 2007. This was partially offset by an increase in amortization of new software development and purchases and four quarters of depreciation and amortization related to Syscon verses two quarters in 2007.

Interest and Other Expenses, net. Interest and other expenses, net, of $41.9 million for the year ended December 31, 2008, increased by $10.4 million or 33.1% over the year ended December 31, 2007. The increase relates primarily to the increasing principal on the Senior Subordinated Notes due to the accumulation of interest being paid-in-kind and additional interest expense on the $40 million 11% Second-priority Senior Secured Notes due 2011 issued on June 29, 2007. Additionally, we experienced a foreign exchange transaction loss of $3.8 million during the year ended December 31, 2008 compared to a gain of $1.5 million in 2007.

Income Tax Expense. We had an income tax benefit of $0.5 million for the year ended December 31, 2008 and an expense of $1.9 million for the year ended December 31, 2007. In 2007, we generated tax expense as a result of changes in valuation allowances on our deferred tax assets. In 2008, a tax benefit of $2.5 million was recorded related to our foreign operations, offset by $2.0 million in expense as a result of changes in valuation allowances on deferred tax assets in the United States.

Accrued Dividends on Redeemable Preferred Stock. Dividends accrue on the Series A Redeemable Preferred Stock issued in December 2007. Each share of the preferred stock has a stated value of $2,000 and accrues dividends annually at 12.5% of the stated value. As of December 31, 2008, the Company had accrued dividends of $1.3 million for the Series A Preferred Stock.

Liquidity and Capital Resources

General

Our principal liquidity requirements are to service and repay debt and meet our capital expenditure and operating needs. We are significantly leveraged. Our ability to make payments on and to refinance indebtedness and to fund planned capital expenditures will depend on our ability to generate cash in the future and our ability to maintain compliance with covenants in our credit facilities, which, to a certain extent, is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control. Based on our current and expected level of operations, we believe our cash flow from operations, available cash and available borrowings under our $30.0 million revolving credit facility will be adequate to make required capital expenditures, service our indebtedness and meet our other working capital needs for at least twelve months from our balance sheet dated December 31, 2009. However, due to the economy and other uncertainties referred to above, there are no assurances that our available sources of cash will be sufficient to enable us to make such capital expenditures, service our indebtedness or to fund our other working capital needs. Further, in the event we wish to make additional acquisitions, we may need to seek additional financing. We are continuing to evaluate alternatives to refinance our existing debt arrangements in an effort to provide greater flexibility to meet long-term capital requirements, reduce interest expense and extend maturity dates.

As of December 31, 2009, we had a total stockholders' deficit of $148.2 million and $291.4 million in total debt outstanding before considering $1.6 million of original issue discount on our Second-Priority Senior Secured Notes and $2.0 million of fair value attributable to warrants issued in connection with our Senior Subordinated debt financing, both of which are reflected as discounts to outstanding long-term debt in our consolidated financial statements (see additional information on our long and short-term debt under "Debt and Other Obligations" below). As of December 31, 2009, we had availability of $30 million under our working capital facility (See Note 4).

Cash Flows

The following table provides our cash flow data for the years ended December 31, 2007, 2008 and 2009 (in thousands):

	For the Year Ended December 31,		
	2007	**2008**	**2009**
Net cash provided by operating activities	$ 20,459	$ 17,406	$ 26,752
Net cash used in investing activities	$ (64,000)	$ (17,046)	$ (16,253)
Net cash provided by (used in) financing activities	$ 46,506	$ 1,094	$ (12,313)

Net cash provided by operating activities was $20.5 million, $17.4 million, and $26.8 million for the years ended December 31, 2007, 2008 and 2009, respectively. Net cash provided by operating activities of $26.8 million consisted of operating income of $50.1 million before considering non-cash expenses, such as depreciation and amortization of $31.3 million, offset by $22.8 million of cash paid for interest and $0.5 million of working capital use. In 2008, lower wholesale services volumes caused the payable to our partners to decline, thus using working capital. In 2009, we experienced a reduction in receivables and accrued liabilities arising from an increased percentage of calls made on a prepaid basis, lower call volumes and differences in the timing of cash payments made.

Net cash used in investing activities was $64.0 million, $17.0 million and $16.3 million for the years ended December 31, 2007, 2008 and 2009, respectively. The $16.3 million spending in 2009 was utilized primarily for investments in infrastructure technology, equipment and intangibles to maintain and grow the direct call provisioning business. The decline in spending from 2008 was principally due to less tangible equipment installed at customer sites and improved management oversight of our capital spending.

Net cash provided by financing activities was $46.5 million and $1.1 million for the years ended December 31, 2007 and 2008, respectively, and net cash used in financing activities was $12.3 million for the year ended December 31, 2009. The 2009 use of $12.3 million primarily related to $16.5 million in net payments on the Company's revolving credit facility, offset partially by a $4.3 million benefit from a timing difference in outstanding checks. In 2008, $11.5 million in net advances on the revolver funded cash used to pay outstanding checks and repay a loan to Syscon's former stockholder. As of March 10, *2010, there were no borrowings and $30.0 million of availability under the revolving credit facility.*

Debt and other Obligations

Revolving Credit Facility — On September 30, 2008, we and certain of our subsidiaries entered into a senior credit agreement with a lending institution and the other lenders party thereto (the "Credit Agreement") to refinance our existing revolving credit facility. The Credit Agreement provides us with a $10.0 million letter of credit facility and a revolving facility of up to the lesser of (i) $30.0 million and (ii) 125% of consolidated EBITDA (as defined in the Credit Agreement) for the preceding 12 months less the face amount of outstanding letters of credit. The Credit Agreement expires on June 9, 2011. Advances bear interest at an annual rate of our option equal to either: (a) LIBOR plus 4.0%, or (b) a rate equal to the Base Rate plus 3.0%. The Base Rate is the greater of (i) 5%, (ii) the Federal Funds rate plus 0.5%, or (iii) the prime rate (as defined in the Credit Agreement), which was 3.25% as of December 31, 2009. Interest is payable in arrears on the first day of each month. The unused availability under the Credit Agreement is subject to a fee based on a per annum rate of 0.375% due monthly. Borrowings under the Credit Agreement are secured by a first lien on substantially all of our and certain of our subsidiaries' assets. We draw from the available credit under the Credit Agreement to cover normal business cash requirements. As of December 31, 2009, we had $30.0 million of borrowing availability under the Credit Agreement.

Second-priority Senior Secured Notes — We have $194.0 million of the 11% Second-priority Senior Secured Notes outstanding. These notes were issued at a discount of $4.5 million, or 97.651% of face value. The Second-priority Senior Secured Notes are secured by a second lien on substantially all of our and certain of the subsidiaries' assets other than accounts receivable, inventory and real property.

All $194.0 million of principal is due September 9, 2011. To the extent we generate excess cash flow (as defined in the indenture) in any calendar year, we are required by the Second-priority Senior Secured Notes to offer to repay principal equal to 75% of such excess cash flow at a rate of 102.75% of face value through September 1, 2010 and 100.00% therafter. No excess cash flow payment was due for the year ended December 31, 2009, because an Excess Cash Flow Amount (as defined in the Indenture governing the terms of the Second-priority Senior Secured Notes) was not generated. In the event we determine that the Excess Cash Flow Amount is likely to exceed $5.0 million in 2010, we may purchase Second-priority Senior Secured Notes in the open market, by negotiated private transactions or otherwise, to reduce the aggregate Excess Cash Flow Amount to less than $5.0 million. We and our affiliates may from time to time seek to retire or purchase our outstanding debt, including the Notes, through cash purchases and/or exchanges, in open market purchases, privately negotiated transactions or otherwise. Such repurchases or exchanges, if any, will depend on prevailing market conditions, our liquidity requirements, contractual restrictions and other factors. The amounts involved may be material. Interest is payable semiannually on March 1 and September 1. The effective interest rate is 11.3% on the Second-priority Senior Secured Notes.

The fair values associated with our Senior Secured Notes were quoted as of December 31, 2009, at trading prices of $96.00 and $80.00, increases of 80.3% and 22.1%, respectively, from the quoted values at December 31, 2008. We believe the increase in fair values was due to our improved operating performance and an improvement in the credit markets in 2009.

Senior Subordinated Notes — We have outstanding $97.4 million of Senior Subordinated Notes that are unsecured and subordinate to the revolving credit facility, and bear interest at an annual rate of 17%. Interest is payable at the end of each calendar quarter, or, as restricted by our revolving credit facility, is paid-in-kind by adding accrued interest to the principal balance of the Senior Subordinated Notes. All outstanding principal, including interest paid-in-kind, is due on September 9, 2014 and a mandatory prepayment equal to $20.0 million plus 50% of all outstanding interest paid-in-kind is due on September 9, 2013. In connection with the issuance of the Senior Subordinated Notes, we issued warrants to acquire 51.01 shares of our common stock at an exercise price of $10 per share to the Senior Subordinated Noteholders. As a result, we discounted the face value of the Senior Subordinated Notes by $2.9 million, representing the estimated fair value of the warrants at the time of issuance. For the twelve months ended December 31, 2009, $14.9 million of paid-in-kind interest was added to the principal balance of the Senior Subordinated Notes. The effective interest rate is 18.5% on the Senior Subordinated Notes.

All of our domestic subsidiaries and certain of our foreign subsidiaries (the "Subsidiary Guarantors") are jointly and severally liable for the working capital facility, Senior Subordinated Notes and Second-priority Senior Secured Notes. The Subsidiary Guarantors are wholly-owned. We have not included separate financial statements of our subsidiaries because (a) our aggregate assets, liabilities, earnings and equity are presented on a consolidated basis, and (b) we believe that separate financial statements and other disclosures concerning subsidiaries are not material to investors.

Our credit facilities contain financial and operating covenants that require the maintenance of certain financial ratios, including specified fixed interest coverage ratios, maintenance of minimum levels of operating cash flows and maximum capital expenditure limitations. These covenants also limit our ability to incur additional indebtedness, make certain payments including dividends to shareholders, invest and divest company assets, and sell or otherwise dispose of capital stock. In the event that we fail to comply with the covenants and restrictions, as specified in the credit agreements, we may be in default, at which time payment of the long term debt and unpaid interest may be accelerated and become immediately due and payable. As of December 31, 2009, we were in compliance with all covenants associated with our credit facilities.

Capital Requirements

As of December 31, 2009, our contractual obligations and commitments on an aggregate basis were as follows:

	Payments by Period					
	2010	**2011**	**2012**	**2013**	**2014**	**Thereafter**
Long-term debt (1)	$ -	$ 194,000	$ -	$ 48,714	$ 48,713	$ -
Unrecognized tax benefits	-	-	-	-	-	357
Operating leases	3,518	2,144	2,016	1,779	1,794	450
Minimum commission payments	3,367	720	488	98	-	-
Minimum purchase guarantees	2,087	155	-	-	-	-
Other long-term liabilities	290	290	290	240	540	-
Total contractual cash obligations and commitments	$ 9,262	$ 197,309	$ 2,794	$ 50,831	$ 51,047	$ 807

(1) Does not include any amounts that may be drawn under our Credit Agreement, which expires on June 9, 2011, or accrued interest under our long-term debt. Assumes no repurchases of second-priority senior secured notes or senior subordinated notes during such period whether or not mandatory.

Critical Accounting Policies

A "critical accounting policy" is one that is both important to the portrayal of a company's financial condition and results and requires management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Our financial statements prepared in accordance with generally accepted accounting principles in the United States, or GAAP. The process of preparing financial statements in conformity with GAAP requires us to use estimates and assumptions to determine certain of our assets, liabilities, revenues and expenses. We base these determinations upon the best information available to us during the period in which we are accounting for our results. Our estimates and assumptions could change materially as conditions within and beyond our control change or as further information becomes available. Further, these estimates and assumptions are affected by management's application of accounting policies. Changes in our estimates are recorded in the period the change occurs. Our critical accounting policies include, among others:

- Revenue recognition and bad debt reserve estimates;
- goodwill and other intangible assets;
- accounting for income taxes; and
- capitalization of internally developed software costs.

The following is a discussion of our critical accounting policies and the related management estimates and assumptions necessary for determining the value of related assets or liabilities.

Revenue Recognition and Bad Debt Reserve Estimates

Revenues related to collect and prepaid calling services generated by the direct call provisioning segment are recognized during the period in which the calls are made. In addition, during the same period, we accrue the related telecommunication costs for validating, transmitting, billing and collection, and line and long distance charges, along with commissions payable to the facilities and allowances for uncollectible calls, based on historical experience.

Revenues related to the wholesale services segments are recognized in the period in which the calls are processed through the billing system, or when equipment and software is sold. During the same period, we accrue the related telecommunications costs for validating, transmitting, and billing and collection costs, along with allowances for uncollectible calls, as applicable, based on historical experience.

We record call revenues related to the wholesale services segment at the net amount since we are acting as an agent on behalf of another provider. For records processed through our billing system, this is the amount charged to the end user customer less the amount paid to the inmate telecommunications provider.

Revenues associated with multiple-deliverable arrangements are recognized using the residual method when the fair value of vendor specific objective evidence ("VSOE") of the undelivered element is determined. If the VSOE of fair value cannot be determined for any undelivered element or any undelivered element is essential to the functionality of the delivered element, revenue is deferred until such criteria are met or recognized as the last element is delivered. Under the residual method, the fair value of the undelivered elements is deferred and the difference between the total arrangement fee and the amount recorded as deferred revenue for the undelivered elements is recognized as revenue related to the delivered elements.

Services related to the implementation, customization, and modification of software are not separable and are essential to the functionality for the customer. Accordingly, we account for the combined upfront software license fee and customization revenue under contract accounting, recognizing revenue and related costs using the percentage-of-completion method. The percentage of completion is calculated using hours incurred to date compared to total estimated hours to complete the project. Our estimates are based upon the knowledge and experience of project managers and other personnel, who review each project to assess the contract's schedule, performance, technical matters and estimated hours to complete. When the total cost estimate exceeds revenue, the estimated project loss is recognized immediately. Support contracts, which require our ongoing involvement, are billed in advance and recorded as deferred revenue and amortized over the term of the contract, typically one year.

In evaluating the collectibility of our trade receivables, we assess a number of factors including historical cash reserves held by our LEC billing agents, collection rates with our billing agents and a specific customer's ability to meet the financial obligations to us, as well as general factors, such as the length of time the receivables are past due, historical collection experience and economic conditions including unemployment rates. Based on these assessments, we record reserves for uncollectible receivables to reduce the related receivables to the amount we ultimately expect to collect from our customers.

If circumstances related to specific customers change or economic conditions worsen such that our past collection experience is no longer relevant, our estimate of the recoverability of our trade receivables could be further reduced or increased from the levels provided for in our financial statements. Because the majority of our receivables are collected through our LEC billing agents and such agents typically do not provide us with visibility as to collection results for an average six to nine month period, our bad debt reserves are estimated and may be subject to substantial variation.

Goodwill and Other Intangible Assets

The calculation of amortization expense is based on the cost and estimated economic useful lives of the underlying intangible assets, intellectual property assets, capitalized computer software, and patent license rights. Goodwill represents the excess of costs over fair value of assets of businesses acquired. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead tested for impairment at least annually. Intangible assets with estimable useful lives are amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment. We review our unamortized intangible assets whenever events or changes in circumstances indicate that the carrying amount may not be recoverable or the estimated useful life has been reduced. We estimate the future cash flows expected to result from operations, and if the sum of the expected undiscounted future cash flows is less than the carrying amount of the intangible asset, we recognize an impairment loss by reducing the unamortized cost of the long-lived asset to its estimated fair value.

We perform an annual impairment test of goodwill and other intangible assets with indefinite useful lives as of the last day of each fiscal year. The goodwill test is a two-step process and requires goodwill to be allocated to our reporting units. Reporting units are defined by us to be the same as the reportable segments (see Note 5). In the first step, the fair value of the reporting unit is compared with the carrying value of the reporting unit. If the fair value of the reporting unit is less than the carrying value, a goodwill impairment may exist and the second step of the test is performed. In the second step, the implied fair value of the goodwill is compared with the carrying value of the goodwill. An impairment loss is recognized to the extent that the carrying value of the goodwill exceeds the implied fair value of the goodwill. An impairment loss is recognized by reducing the carrying value of the asset to its estimated fair value.

Accounting for Income Taxes

We recognize deferred tax assets and liabilities for the expected future tax consequences of transactions and events. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. If necessary, deferred tax assets are reduced by a valuation allowance to an amount that is determined to be more likely than not recoverable. We must make significant estimates and assumptions about future taxable income and future tax consequences when determining the amount of the valuation allowance.

We account for the uncertainty in income taxes on the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. The tax benefit from an uncertain tax position may be recognized only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities. The determination is based on the technical merits of the position and presumes that each uncertain tax position will be examined by the relevant taxing authority that has full knowledge of all relevant information.

Capitalization of Internally Developed Software Costs

We capitalize labor associated with software developed for internal use. Software is considered for internal use if acquired, internally developed or modified solely to meet the entity's internal needs and if during the software's development or modification, no plan exists to market the software externally. Costs incurred during the application development stage are capitalized. Capitalization of cost begins when the preliminary project stage is completed and management with the relevant authority authorizes and commits to funding a computer software project and believes that it is probable that the project will be completed and the software will be used to perform the function intended. Capitalization ceases when the project is complete or it is no longer probable that the project will be completed.

Financial Reporting Changes

See Note 1, paragraph (v) of the Consolidated Financial Statements for information about recent accounting pronouncements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

We are exposed to market rate risk for changes in interest rates related to our revolving line of credit. Our market risks as of December 31, 2009 were substantially equivalent, in all material aspects, to the market risks we faced in 2008. Interest expense on our floating rate debt will increase if interest rates rise. Our $30.0 million revolving line of credit bears an interest rate equal to one of the following, at our option: (a) LIBOR plus 4.0%, or (b) a rate equal to the Base Rate plus 3.0%. The Base Rate is the greater of (i) 5%, (ii) the Federal Funds rate plus 0.5%, or (iii) the prime rate (as defined in the Credit Agreement). The effect of a 10% fluctuation in the interest rate on our revolving line of credit would have had a negligible impact on our interest expense for the twelve months ended December 31, 2008 and 2009. There were no borrowings *outstanding at December 31, 2009 related to our variable rate debt.*

We are exposed to foreign currency exchange rates on the earnings, cash flows and financial position of our international operations. We are not able to project the possible effect of these fluctuations on translated amounts or future earnings due to our constantly changing exposure to various currencies, the fact that all foreign currencies do not react in the same manner in relation to the U.S. dollar and each other, and the number of currencies involved; however we do not believe the effect of this exposure would materially impact our financial position. Our most significant exposure is to the British pound.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders
Securus Technologies, Inc.

We have audited the accompanying consolidated balance sheet of Securus Technologies, Inc. and Subsidiaries as of December 31, 2009, and the related consolidated statements of operations, stockholders' deficit and comprehensive loss, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Securus Technologies, Inc. and Subsidiaries as of December 31, 2009, and the results of their operations and their cash flows for the year then ended, in conformity with United States generally accepted accounting principles.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Securus Technologies, Inc. and Subsidiaries' internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 15, 2010 expressed an unqualified opinion on the effectiveness of Securus Technologies, Inc. and Subsidiaries' internal control over financial reporting.

McGladrey & Pullen, LLP
Dallas, Texas
March 15, 2010

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Securus Technologies, Inc.:

We have audited the accompanying consolidated balance sheet of Securus Technologies, Inc. and subsidiaries as of December 31, 2008 and the related consolidated statements of operations, stockholders' deficit and comprehensive loss, and cash flows for each of the years in the two-year period ended December 31, 2008. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Securus Technologies, Inc. and subsidiaries as of December 31, 2008, and the results of their operations and their cash flows for each of the years in the two-year period ended December 31, 2008, in conformity with U.S. generally accepted accounting principles.

KPMG LLP
Dallas, Texas
March 27, 2009

ITEM 8. CONSOLIDATED FINANCIAL STATEMENTS

SECURUS TECHNOLOGIES, INC.AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except per share amounts)

	December 31, 2008	December 31, 2009
ASSETS		
Cash and cash equivalents	$ 6,576	$ 2,668
Restricted cash	1,599	1,366
Accounts receivable, net	45,316	40,010
Prepaid expenses	6,116	6,183
Current deferred income taxes	1,973	1,487
Total current assets	61,580	51,714
Property and equipment, net	35,364	28,767
Intangibles and other assets, net	98,550	92,207
Goodwill	63,468	67,386
Total assets	$ 258,962	$ 240,074
LIABILITIES, REDEEMABLE CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS' DEFICIT		
Accounts payable	$ 14,743	$ 19,010
Accrued liabilities	44,371	38,285
Deferred revenue and customer advances	15,069	14,755
Current deferred income taxes	817	893
Total current liabilities	75,000	72,943
Deferred income taxes	10,893	11,306
Long-term debt	288,341	287,802
Other long-term liabilities	2,238	3,357
Total liabilities	376,472	375,408
Commitments and contingencies		
Series A redeemable convertible preferred stock, stated value $2,253 and $2,534 at December 31, 2008 and December 31, 2009; total redemption value $11,489 and $12,925 at December 31, 2008 and December 31, 2009; 5,100 shares authorized and outstanding at December 31, 2008 and 2009.	11,321	12,820
Stockholders' deficit:		
Common stock, $0.001 stated value; 1,355,000 and 1,675,000 shares authorized at December 31, 2008 and 2009; 161,037 and 140,792 shares issued and outstanding at December 31, 2008 and 2009, respectively.	8	8
Additional paid-in capital	34,304	32,806
Accumulated other comprehensive income (loss)	(2,701)	560
Accumulated deficit	(160,442)	(181,528)
Total stockholders' deficit	(128,831)	(148,154)
Total liabilities, redeemable convertible preferred stock and stockholders' deficit	$ 258,962	$ 240,074

See accompanying notes to consolidated financial statements.

SECURUS TECHNOLOGIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
For the Years Ended December31, 2007, 2008 and 2009
(Dollars in thousands)

	For the Year Ended December 31,		
	2007	2008	2009
Revenue:			
Direct call provisioning	$ 338,703	$ 333,564	$ 312,614
Offender management software	7,933	25,137	22,698
Wholesale services	45,214	29,902	28,124
Total revenue	391,850	388,603	363,436
Cost of service (exclusive of depreciation and amortization shown separately below):			
Direct call provisioning, exclusive of bad debt expense	218,824	217,918	197,713
Direct call provisioning bad debt expense	37,776	25,889	23,859
Offender management software expense	6,110	13,540	9,624
Wholesale services expense	24,104	14,543	16,032
Total cost of service	286,814	271,890	247,228
Selling, general and administrative expenses	74,369	74,721	66,128
Restructuring costs	614	224	-
Depreciation and amortization	37,048	34,400	31,333
Total operating costs and expenses	398,845	381,235	344,689
Operating income (loss)	(6,995)	7,368	18,747
Interest and other expenses, net	31,487	41,896	39,114
Loss before income taxes	(38,482)	(34,528)	(20,367)
Income tax expense (benefit)	1,922	(509)	719
Net loss	(40,404)	(34,019)	(21,086)
Accrued dividends on redeemable convertible preferred stock	-	(1,351)	(1,499)
Net loss available to common stockholders	$ (40,404)	$ (35,370)	$ (22,585)

See accompanying notes to consolidated financial statements.

SECURUS TECHNOLOGIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT
AND COMPREHENSIVE LOSS
For the Years Ended December31, 2007, 2008 and 2009
(Dollars in thousands)

	Common Shares	Amount	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Deficit
Balance at December 31, 2006	610	$ 6	$ 34,140	$ (86,019)	$ -	$ (51,873)
Issuance of common stock in conjunction with Syscon acquisition	45	1	1,413	-	-	1,414
Stock based compensation	-	-	67	-	-	67
Exercise of warrants	14	-	-	-	-	-
Restricted stock grants	11	-	-	-	-	-
Forfeitures of restricted stock	(3)	-	-	-	-	-
Foreign currency translation	-	-	-	-	1,935	1,935
Net loss	-	-	-	(40,404)	-	(40,404)
Total comprehensive loss						(38,469)
Balance at December 31, 2007	677	$ 7	$ 35,620	$ (126,423)	$ 1,935	$ (88,861)
Stock based compensation	-	-	35	-	-	35
Restricted stock grants	160,364	1	-	-	-	1
Forfeitures of restricted stock	(2)	-	-	-	-	-
Purchase of common stock	(2)					-
Accrued dividends on preferred stock	-	-	(1,351)	-	-	(1,351)
Foreign currency translation	-	-	-	-	(4,636)	(4,636)
Net loss	-	-	-	(34,019)	-	(34,019)
Total comprehensive loss						(38,655)
Balance at December 31, 2008	161,037	$ 8	$ 34,304	$ (160,442)	$ (2,701)	$ (128,831)
Stock based compensation	-	-	1	-	-	1
Restricted stock grants	6,566	-	-	-	-	-
Forfeitures of restricted stock	(40,341)	-	-	-	-	-
Issuance of common stock	13,576	-	-	-	-	-
Purchase of common stock	(46)	-	-	-	-	-
Accrued dividends on preferred stock	-	-	(1,499)	-	-	(1,499)
Foreign currency translation	-	-	-	-	3,261	3,261
Net loss	-	-	-	(21,086)	-	(21,086)
Total comprehensive loss						(17,825)
Balance at December 31, 2009	140,792	$ 8	$ 32,806	$ (181,528)	$ 560	$ (148,154)

See accompanying notes to consolidated financial statements.

SECURUS TECHNOLOGIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended December31, 2007, 2008 and 2009
(Dollars in thousands)

	For the Year Ended		
	2007	2008	2009
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net loss	$ (40,404)	$ (34,019)	$ (21,086)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Depreciation and amortization	37,048	34,400	31,333
Amortization of fair value of contracts acquired	1,360	3,489	-
Deferred income taxes	922	(2,365)	323
Conversion of interest paid "in kind" to secured subordinated notes	10,678	12,650	14,943
Amortization of deferred financing costs and debt discounts	2,251	3,542	4,170
Other operating activities, net	169	(25)	(49)
Changes in operating assets and liabilities, net of effects of acquisitions:			
Restricted cash	(74)	(68)	237
Accounts receivable	20,459	3,813	5,988
Prepaid expenses and other current assets	191	(862)	4
Other assets	376	654	(2,885)
Accounts payable	(11,251)	(9,057)	(210)
Accrued liabilities	(1,266)	5,254	(6,016)
Net cash provided by operating activities	$ 20,459	$ 17,406	$ 26,752
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of property and equipment and intangible assets	$ (21,356)	$ (17,046)	$ (16,453)
Cash consideration paid for acquired business	(43,717)	-	-
Proceeds from sale of asset	-	-	200
Proceeds from sale of unconsolidated affiliate	985	-	-
Property insurance proceeds	88	-	-
Net cash used in investing activities	$ (64,000)	$ (17,046)	$ (16,253)

See accompanying notes to consolidated financial statements.

SECURUS TECHNOLOGIES, INC.AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS — (Continued)
For the Years Ended December 31, 2007, 2008 and 2009
(Dollars in thousands)

	For the Year Ended December 31,		
	2007	2008	2009
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from issuance of second-priority senior secured notes	$ 39,060	$ -	$ -
Cash overdraft	(3,958)	(4,151)	4,275
Net advances (payments) on revolving credit facility	1,775	11,511	(16,511)
Debt issuance costs	(4,853)	(1,757)	(77)
Proceeds (payments) related to loan payable to related party, net	4,510	(4,510)	-
Proceeds from issuance of common stock	1	1	-
Proceeds from issuance of Series A preferred stock	10,200	-	-
Series A preferred stock issuance costs	(229)	-	-
Net cash provided by (used in) financing activities	$ 46,506	$ 1,094	$ (12,313)
Effect of exchange rates on cash and cash equivalents	(1,451)	3,050	(2,094)
Increase (decrease) in cash and equivalents	$ 1,514	$ 4,504	$ (3,908)
Cash and cash equivalents at beginning of year	558	2,072	6,576
Cash and cash equivalents at end of year	$ 2,072	$ 6,576	$ 2,668
SUPPLEMENTAL DISCLOSURES:			
Cash paid during the period for:			
Interest	$ 18,715	$ 22,207	$ 22,797
Income taxes	$ 239	$ 846	$ 1,228
NONCASH FINANCING AND INVESTING ACTIVITIES:			
Non-cash consent fee	$ 400	$ -	$ -
Leasehold improvements	$ -	$ 710	$ 155

See accompanying notes to consolidated financial statements.

SECURUS TECHNOLOGIES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Securus Technologies, Inc. and its subsidiaries ("Securus" or the "Company") provide inmate telecommunications services and software solutions to correctional facilities operated by city, county, state and federal authorities and other types of confinement facilities in 43 states and the District of Columbia. Securus also provides offender management and other software solutions to U.S. and foreign correctional facilities and law enforcement agencies. The Company was incorporated in Delaware on January 12, 2004, and on March 3, 2004 and September 9, 2004, the Company acquired all of the outstanding equity interests of T-Netix, Inc. ("T-Netix") and Evercom Holdings, Inc. ("Evercom"), respectively. On June 29, 2007, the Company acquired Syscon Holdings, Ltd. and certain of its affiliates ("Syscon").

(a)Basis of Presentation

The Company has three reportable segments: direct call provisioning, offender management software and wholesale services. These segments are the determinants for how management makes operating decisions, assesses performance and allocates resources. These three segments each demonstrate similar economic characteristics and are similar in the nature, class of customer, distribution methods, and regulatory environment for their products and services.

In the direct call provisioning segment, the Company bills call revenue to established prepaid accounts of end users, or bills through major local exchange carriers ("LECs") or through third-party billing services for smaller volume LECs. The Company performs ongoing customer credit evaluations and maintains allowances for uncollectible amounts based on historical experience, changes in economic conditions including unemployment rates and other factors. Over half of direct call provisioning revenue is paid for on a prepaid basis. Deferred revenue is recorded for customer prepayments prior to usage.

In the offender management software segment, the Company provides platform systems that allow facility managers and law enforcement personnel to analyze data to reduce costs, prevent and solve crimes, and facilitate rehabilitation through a single user interface. The system provides correctional facilities and law enforcement with the ability to manage and monitor inmate parole and probation activity and development at a sophisticated level. The Company generates revenues through license fees, software implementation and consulting fees, and software maintenance and support.

In the wholesale services segment, the Company provides both solutions and billing services (validation, fraud management and billing and collection services) and telecommunications services (equipment, security enhanced call processing, validation and customer service and support) to corrections facilities through contracts with other inmate telecommunications providers.

(b)Reclassification

Certain amounts in the prior periods' consolidated financial statements have been reclassified to conform to the current period presentation. This reclassification had no impact on operating income (loss), net loss, cash flows or the financial position of the Company for the prior periods presented.

(c)Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Securus Technologies, Inc. and its wholly-owned subsidiaries, T-Netix, Inc., Evercom Holdings, Inc., and Syscon Holdings, Ltd. All significant intercompany accounts and transactions have been eliminated in consolidation.

(d)Liquidity

The Company's principal liquidity requirements are to service and repay debt and meet the Company's capital expenditure and operating needs. The Company's ability to make payments on and to refinance indebtedness, and to fund planned capital expenditures will depend on the Company's ability to generate cash in the future and its ability to maintain compliance with covenants in its credit facilities, which, to a certain extent, is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond the Company's control. Based on the current and expected level of operations, management believes the Company's cash flow from operations, available cash and available borrowings under the $30.0 million revolving credit facility will be adequate to make required capital expenditures, service indebtedness and meet the Company's other working capital needs for at least twelve months from the balance sheet dated December 31, 2009. However, due to the economy and other uncertainties referred to above, there are no assurances that available sources of cash will be sufficient to enable the Company to make such capital expenditures, service indebtedness or to fund other working capital needs. If the Company cannot meet covenants, debt service and repayment obligations, the debt would be in default under the governing terms of the agreements, which would allow the lenders under the credit facilities to declare all borrowings outstanding to be due and payable, which would in turn, trigger an event of default under the indenture agreement and the agreement governing the Company's senior subordinated debt. In the event that cash in excess of the amounts generated from on-going business operations and available under the credit facilities or through equity contributions from stockholders is required to fund operations, the Company may be required to reduce or eliminate discretionary selling, general and administrative costs, and sell or close certain operations.

(e)Accounting Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Significant items subject to such estimates include the valuation allowances for receivables, the recoverability of property and equipment, goodwill, intangible and other assets, and deferred income taxes.

Management evaluates its estimates and assumptions on an ongoing basis using historical experience and other factors, including the current economic environment, which management believes to be reasonable under the circumstances. Management adjust such estimates and assumptions when facts and circumstances dictate. As future events and their effects cannot be determined with precision, actual results could differ significantly from these estimates. Changes in those estimates resulting from continuing changes in the economic environment will be reflected in the financial statements in future periods.

(f)Risks and Uncertainties

The Company generated approximately 20% of its revenues from its five largest customers during the year ended December 31, 2009. If the Company loses one or more significant customers, revenues and our ability to comply with our debt covenants could be adversely affected.

The majority of offender management revenues have been associated with the implementation of software for one major customer. The implementation phase of this contract was completed during the second quarter of 2009, causing a subsequent decline in revenue. Revenues are currently being generated from new contracts with other customers; however, we will need to continue to generate new contracts to compensate for the loss of this revenue.

(g)Cash and Cash Equivalents and Restricted Cash

Cash equivalents consist of highly liquid investments, such as certificates of deposits, money market funds and short term treasury instruments, with original maturities of 90 days or less. Restricted cash accounts hold amounts established for the benefit of certain customers in the event the Company does not perform under the provisions of the respective underlying contract with these customers. Restricted cash was $1.6 million and $1.4 million at December 31, 2008 and December 31, 2009, respectively.

(h)Trade Accounts Receivable

Trade accounts receivable are recorded at the invoice amount and do not bear interest. The majority of trade accounts receivable represent amounts billed or that will be billed for calls placed through the Company's telephone systems. The majority of these receivables are billed using various LECs or third-party billing services and are reported net of an allowance for uncollectible calls for estimated chargebacks to be made by the LECs and clearinghouses. The Company maintains an allowance for doubtful accounts for estimated losses resulting from a customer's inability to make payments on accounts, and this allowance is net of amounts held by the LECs for estimated charge backs. The Company analyzes the collectibility of a majority of its accounts receivable based on a 12-month average of historical collections. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in its existing accounts receivable. The Company's policy is to write-off accounts after 180 days from invoice date, or after all collection efforts have failed.

The following table includes the activity related to the Company's allowance for doubtful accounts (in thousands):

	For the Year Ended December 31,		
	2007	2008	2009
Balance beginning of period	$ 15,045	$ 11,506	$ 5,180
Opening balance of acquired business	115	-	-
Additions charged to expense	52,062	33,094	29,676
Accounts written-off	(55,716)	(39,420)	(29,115)
Balance at end of period	$ 11,506	$ 5,180	$ 5,741

(i)Fair Value of Financial Instruments

The Company is required to include certain disclosures regarding the fair value of financial instruments. Cash and cash equivalents, receivables, accounts payable, and accrued liabilities approximate fair value due to their short maturities. Carrying amounts and estimated fair value of debt are presented in Note 4.

(j)Concentrations of Credit Risk

Financial instruments, which potentially expose the Company to concentrations of credit risk, consist primarily of cash and cash equivalents and accounts receivable. The Company's revenues are primarily concentrated in the United States in the telecommunications industry. The Company had trade accounts receivable from two customers that, when combined, comprised 29.7% (two telecommunications companies) of all trade accounts receivable at December 31, 2009. The Company does not require collateral on accounts receivable balances and provides allowances for potential credit losses.

The Company has significant revenue contracts denominated in US dollars and UK pounds. Syscon uses the Canadian dollar as its functional currency. Fluctuations in exchange rates between these currencies and the Canadian dollar could have an effect on the Company's financial condition and results of operations. The Company has not entered into any derivative contracts to mitigate the impact of foreign currency fluctuations.

(k)Property and Equipment

Property and equipment is stated at cost and includes costs necessary to place such property and equipment in service. Major renewals and improvements that extend an asset's useful life are capitalized, while repairs and maintenance are charged to operations as incurred. Construction in progress represents the cost of material purchases and construction costs for telecommunications hardware systems in various stages of completion.

Depreciation is computed by the straight-line basis using estimated useful lives of 3 to 5 years for telecommunications equipment, office and computer equipment and furniture and fixtures. No depreciation is recorded on construction in progress until the asset is placed in service.

(l)Goodwill and Intangible and Other Assets

Goodwill represents the excess of the purchase price over the fair value of identifiable net assets acquired in business combinations accounted for as purchases. Intangible and other assets include acquired operating contracts and customer agreements, capitalized computer software, patents and license rights, patent application costs, trademarks, trade names and other intellectual property, capitalized loan costs, deposits and long-term prepayments and other intangible assets. The Company capitalizes interest costs associated with internally developed software based on the effective interest rate on aggregate borrowings. The Company capitalized interest in the amount of $0.2 million for each of the years ended December 31, 2007, 2008 and 2009, respectively. The Company capitalizes contract acquisition costs representing up-front payments required by customers as part of the competitive process to award a contract. These capitalized costs are included in operating contracts and customer agreements within the balance sheet caption "Intangibles and other assets, net" and are commonly referred to as signing bonuses in the industry.

The Company performs an annual impairment test of goodwill and other intangible assets with indefinite useful lives as of the last day of each fiscal year. The goodwill test is a two-step process and requires goodwill to be allocated to the Company's reporting units. Reporting units are defined by the Company to be the same as the reportable segments (see Note 5). In the first step, the fair value of the reporting unit is compared with the carrying value of the reporting unit. If the fair value of the reporting unit is less than the carrying value, a goodwill impairment may exist and the second step of the test is performed. In the second step, the implied fair value of the goodwill is compared with the carrying value of the goodwill. An impairment loss is recognized to the extent that the carrying value of the goodwill exceeds the implied fair value of the goodwill. An impairment loss is recognized by reducing the carrying value of the asset to its implied fair value.

Other intangible assets with indefinite useful lives are tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset may be impaired. For this impairment test, the carrying value of the intangible asset is compared to its fair value. If the carrying value exceeds the fair value, an impairment loss is recognized by reducing the carrying value of the intangible asset to its fair value.

Amortization is computed on the straight-line basis over 3 to 12 years for operating contracts and customer agreements and patents and license rights. The weighted average amortization period for all of the intangible assets, which are subject to amortization as of the year ended December 31, 2009, is approximately ten years. Amortization expense was $18.9 million, $16.7 million and $17.5 million for the years ended December 31, 2007, 2008 and 2009, respectively.

(m)Impairment of Long-Lived Assets

Long-lived assets, such as property, equipment and purchased intangibles subject to amortization, are grouped with other assets producing the same cash flow streams and are reviewed for impairment as a group whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying value of the assets to the estimated undiscounted future cash flows expected to be generated by the assets. If the carrying value of the assets exceed their estimated future cash flows, an impairment charge is recognized by the amount by which the carrying value of the assets exceed the fair value of the assets.

(n)401(k) Plan

The Company sponsors 401(k) savings plans for the benefit of eligible full-time employees in the United States, Canada and the United Kingdom. The U.S. plan is a qualified benefit plan in accordance with the Employee Retirement Income Security Act. Employees participating in the plans can generally make contributions to the plan of up to 15% of their compensation, with the exception of employees in Canada, which jurisdiction does not have a maximum on the total amount of contributions. In the U.S., the 401(k) plan provides for the Company to make discretionary matching contributions of up to 50% of an eligible employee's contribution for up to 6% of their salary. In Canada and the United Kingdom, the Company makes discretionary matching contributions up to 5% of an eligible employee's contributions, dependent on the employees' tenure with the Company. Matching contributions and plan expenses were $0.6 million, $0.7 million, and $0.8 million for the years ended December 31, 2007, 2008 and 2009, respectively.

(o)Income Taxes

The Company records deferred tax assets and liabilities at an amount equal to the expected future tax consequences of transaction and events. Deferred tax assets and liabilities are determined based on the future tax consequences attributable to the differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted income tax rates expected to apply to taxable income in the years in which those differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in income tax rates is recognized in the results of operations in the period that includes the enactment date.

(p)Stock-Based Compensation

The Company accounts for its restricted stock plan based on the grant date estimated fair value of each award, net of estimated forfeitures or cancellations, over the employee's requisite service period, which is generally the vesting period of the equity grant. The Company recorded compensation expense of less than $0.1 million for each of the years ended December 31, 2007, 2008, and 2009 related to purchases of restricted stock by certain executives and members of the board of directors (See Note 8).

(q)Revenue Recognition

Revenues related to collect and prepaid calling services generated by the direct call provisioning segment are recognized during the period in which the calls are made. In addition, during the same period, the Company records the related telecommunication costs for validating, transmitting, billing and collection, and line and long distance charges, along with commissions payable to the facilities and allowances for uncollectible calls, based on historical experience.

Revenues related to the wholesale services segment are recognized in the period in which the calls are processed through the billing system, or when equipment and software is sold. During the same period, the Company records the related telecommunications costs for validating, transmitting, and billing and collection costs, along with allowances for uncollectible calls, as applicable, based on historical experience.

The Company records call revenues related to the wholesale services segment at the net amount since the Company is acting as an agent on behalf of another provider. For records processed through the billing system, this is the amount charged to the end user customer less the amount paid to the inmate telecommunications provider.

Revenues related to the offender management software segment are recognized using the residual method when the fair value of vendor specific objective evidence ("VSOE") of the undelivered elements is determined. If the VSOE of fair value cannot be determined for any undelivered element or any undelivered element is essential to the functionality of the delivered element, the arrangement fee is deferred until such criteria are met or recognized as the last element is delivered. Under the residual method, the fair value of the undelivered elements is recorded as deferred and the difference between the total arrangement fee and the amount recorded as deferred revenue for the undelivered elements is recognized as revenue related to the delivered elements.

Services related to the implementation, customization, and modification of software are not separable and are essential to the functionality for the customer. Accordingly, the Company accounts for the combined upfront software license fee and customization revenue under contract accounting, recognizing revenue and related costs using the percentage-of-completion method. The percentage of completion is calculated using hours incurred to date compared to total estimated hours to complete the project. The Company's estimates are based upon the knowledge and experience of its project managers and other personnel, who review each project at each reporting date to assess the contract's schedule, performance, technical matters and estimated hours to complete. When the total cost estimate exceeds revenue, the estimated project loss is recognized immediately. Support contracts, which require our ongoing involvement, are billed in advance and recorded as deferred revenue and amortized to revenue over the terms of the contract, typically one year.

The Company accounts for multiple deliverables for arrangements under which it will perform multiple revenue-generating activities. In an arrangement with multiple deliverables, the delivered items are considered a separate unit of accounting. These arrangements are evaluated to ensure they add standalone value to the customer, there is objective and reliable evidence of the fair value of the undelivered items, and the arrangements include only a general right of return relative to the delivered items and the delivery of the undelivered items is probable and substantially controlled by the vendor. The arrangement considerations are then allocated to the separate units of accounting based on the relative fair value.

(r)Capitalization of Internal Software Development Costs

We capitalize labor associated with software developed for internal use. Software is considered for internal use if acquired, internally developed or modified solely to meet the entity's internal needs and if during the software's development or modification, no plan exists to market the software externally. Costs incurred during the application development stage are capitalized. Capitalization of cost begins when the preliminary project stage is completed and management with the relevant authority authorizes and commits to funding a computer software project and believes that it is probable that the project will be completed and the software will be used to perform the function intended. Capitalization ceases when the project is complete or it is no longer probable that the project will be completed.

(s)Foreign Currency Translation and Transaction Gains and Losses

Assets and liabilities of a non-U.S. subsidiary whose functional currency is not the U.S. dollar are translated at current exchange rates. Revenue and expense accounts are translated using an average rate for the period. Translation gains and losses are not included in determining net income (loss), but are reflected in the comprehensive income (loss) component of shareholders' deficit.

The Company has transactions in currencies other than its functional currency. Transaction gains and losses are recorded in the consolidated statement of operations relating to the recurring remeasurement and settlement of such transactions. Included in "Interest and other expenses, net" on the Company's consolidated statement of operations was a $1.5 million gain, $3.8 million loss and $2.3 million gain related to foreign currency transactions for the years ended December 31, 2007, 2008 and 2009, respectively.

(t)Comprehensive Income/Loss

Reporting comprehensive income/loss requires that certain items such as foreign currency translation adjustments be presented as separate component of shareholders' equity. Total comprehensive loss for the years ended December 31, 2007, 2008 and 2009 was $38.5 million, $38.7 million, and $17.8 million, respectively. Other comprehensive income or loss includes a $1.9 million foreign currency translation gain, $4.6 million foreign currency translation loss and $3.3 million foreign currency translation gain in 2007, 2008 and 2009, respectively.

(u)Commitments and Contingencies

Liabilities for loss contingencies arising from claims, assessments, litigation, fines, and penalties and other sources are recorded when it is probable that a liability has been incurred and the amount of the assessment and/or remediation can be reasonably estimated. Legal fees related to loss contingencies are expensed as services are received.

(v)Recently Issued Accounting Pronouncements

In May 2009, the Financial Accounting Standards Board ("FASB") issued guidance which established general standards of accounting disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The FASB requires entities to disclose the date through which subsequent events were evaluated as well as the rationale for why that date was selected. The guidance was effective for interim and annual periods ending after June 15, 2009. Accordingly, the Company adopted the provision; however, the adoption had no material impact on the Company's consolidated financial condition, results of operations, cash flows, or disclosures.

In July 2009, the FASB issued new guidance on the Accounting Standards Codification ("Codification"). With the issuance of this new guidance, the FASB Codification becomes the single source of authoritative U.S. accounting and reporting standards applicable for all nongovernmental entities, with the exception of guidance issued by the U.S. Securities and Exchange Commission. The Codification does not change current GAAP, but changes the referencing of financial standards, and is intended to simplify user access to authoritative GAAP by providing all the authoritative literature related to a particular topic in one place. The Codification is effective for interim and annual periods ending after September 15, 2009. The Company adopted the provision; however, the adoption had no material impact on the Company's consolidated financial condition, results of operations or cash flows.

In September 2009, the FASB issued new accounting guidance related to the revenue recognition of multiple element arrangements. The new guidance states that if vendor specific objective evidence or third party evidence for deliverables in an arrangement cannot be determined, companies will be required to develop a best estimate of the selling price to separate deliverables and allocate arrangement consideration using the relative selling price method. The accounting guidance will be applied prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is allowed. We are currently evaluating the impact of this accounting guidance on our consolidated financial statements.

In September 2009, the FASB issued new accounting guidance related to certain revenue arrangements that include software elements. Previously, companies that sold tangible products with "more than incidental" software were required to apply software revenue recognition guidance. This guidance often delayed revenue recognition for the delivery of the tangible product. Under the new guidance, tangible products that have software components that are "essential to the functionality" of the tangible product will be excluded from the software revenue recognition guidance. The new guidance will include factors to help companies determine what is "essential to the functionality." Software-enabled products will now be subject to other revenue guidance and will likely follow the guidance for multiple deliverable arrangements issued by the FASB in September 2009. The new guidance is to be applied on a prospective basis for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with earlier application permitted. The adoption of this accounting guidance will not have an impact on our consolidated financial statements.

(2)BALANCE SHEET COMPONENTS

Accounts receivables, net consist of the following at December 31 (in thousands):

	2008	2009
Accounts receivable, net:		
Trade accounts receivable	$ 50,129	$ 44,564
Other receivables	367	1,187
	50,496	45,751
Less: Allowance for doubtful accounts	(5,180)	(5,741)
	$ 45,316	$ 40,010

Direct call provisioning bad debt expense for the year ended December 31, 2007 was $37.8 million or 11.2% of direct call provisioning revenue of $338.7 million. For the year ended December 31, 2008, direct call provisioning bad debt expense was $25.9 million or 7.8% of direct call provisioning revenue of $333.6 million. Direct call provisioning bad debt expense for the year ended December 31, 2009 was $23.9 million or 7.6% of direct call provisioning revenue of $312.6 million.

Property and equipment, net consists of the following at December 31 (in thousands):

	2008	2009
Property and equipment, net:		
Telecommunications equipment	$ 60,291	$ 59,418
Leasehold improvements	3,860	4,445
Construction in progress	3,348	1,660
Office equipment	19,215	23,275
	86,714	88,798
Less: Accumulated depreciation and amortization	(51,350)	(60,031)
	$ 35,364	$ 28,767

Intangibles and other assets, net consist of the following at December 31 (in thousands):

2008	Gross Carrying Value	Accumulated Amortization	Net	Weighted Average Life
Patents and trademarks	$ 24,129	$ (8,351)	$ 15,778	9.8
Deferred financing costs	15,308	(5,499)	9,809	5.8
Capitalized software development costs	25,964	(13,495)	12,469	4.5
Custom software development costs	6,698	(1,060)	5,638	10.0
Acquired contract rights	96,714	(44,645)	52,069	9.9
Deposits and other long-term assets	1,846	-	1,846	-
Non-compete and employment agreements	1,540	(599)	941	4.3
	$ 172,199	$ (73,649)	$ 98,550	

2009	Gross Carrying Value	Accumulated Amortization	Net	Weighted Average Life
Patents and trademarks	$ 24,706	$ (10,041)	$ 14,665	9.8
Deferred financing costs	15,385	(8,640)	6,745	5.8
Capitalized software development costs	32,931	(17,273)	15,658	4.6
Custom software development costs	7,885	(2,063)	5,822	10.0
Acquired contract rights	98,312	(54,387)	43,925	9.8
Deposits and other long-term assets	4,758	-	4,758	-
Non-compete and employment agreements	1,802	(1,168)	634	4.3
	$ 185,779	$ (93,572)	$ 92,207	

At December 31, 2008 and December 31, 2009, the carrying amount of trademarks assigned to patents and trademarks that were not subject to amortization was $2.7 million.

Amortization of intangibles and other assets for the year ended December 31, 2007 was $21.8 million (of which $1.5 million was included in interest expense and $1.4 million was amortized against revenue). Amortization of intangibles and other assets for the year ended December 31, 2008 was $22.7 million (of which $2.5 million was included in interest expense and $3.5 million was amortized against revenue). Amortization of intangibles and other assets for the year ended December 31, 2009 was $20.6 million (of which $3.1 million was included in interest expense). Estimated amortization expense related to intangibles, excluding deferred financing costs and other assets, as of December 31, 2009 and for each of the next five years through December 31, 2014 and thereafter is summarized as follows (in thousands):

Year Ended December 31:		
2010	$	18,151
2011		15,331
2012		13,256
2013		8,248
2014		7,557
Thereafter		15,461
	$	78,004

Accrued liabilities consist of the following at December 31 (in thousands):

		2008		2009
Accrued liabilities:				
Accrued expenses	$	26,433	$	21,904
Accrued compensation		6,287		4,569
Accrued severance and facility exit costs		207		150
Accrued taxes		4,187		4,512
Accrued interest and other		7,257		7,150
	$	44,371	$	38,285

The Company incurred restructuring charges of $0.2 million during the first quarter of 2008 related to the realignment of the field service organization because of efficiencies gained from our packet-based architecture. In July 2008, the Company entered into a separation agreement with an executive and, in 2009, the Company entered into separation agreements with two executives. For the twelve months ended December 31, 2008 and 2009, the Company accrued approximately $0.2 million and $0.4 million and paid $0.2 million and $0.3 million in severance costs, respectively.

(3)GOODWILL

The Company performed annual impairment tests as of each balance sheet date. No impairment was recorded as a result of the testing performed at December 31, 2007, 2008 and 2009.

Goodwill allocated to our reportable segments is summarized as follows (in thousands):

		Direct Call Provisioning		Offender Management Software		Total
Balance at December 31, 2007	$	37,936	$	31,099	$	69,035
Foreign currency translation		-		(5,567)		(5,567)
Balance at December 31, 2008	$	37,936	$	25,532	$	63,468
Foreign currency translation		-		3,918		3,918
Balance at December 31, 2009	$	37,936	$	29,450	$	67,386

(4)DEBT

Debt consists of the following at December 31 (in thousands):

	2008	2009
Revolving credit facility	$ 16,511	$ -
Second-priority senior secured notes	194,000	194,000
Senior subordinated notes	82,484	97,427
	292,995	291,427
Less unamortized discount on senior secured notes and senior subordinated notes	(4,654)	(3,625)
	288,341	287,802
Less current portion of long-term debt	-	-
	$ 288,341	$ 287,802

Revolving Credit Facility — On September 30, 2008, the Company and certain of its subsidiaries entered into a senior credit agreement with a lending institution and the other lenders party thereto (the "Credit Agreement") to refinance its existing revolving credit facility. The Credit Agreement provides the Company with a $10.0 million letter of credit facility and a revolving facility of up to the lesser of (i) $30.0 million and (ii) 125% of the Company's consolidated EBITDA (as defined in the Credit Agreement) for the preceding 12 months less the face amount of outstanding letters of credit. The Credit Agreement expires on June 9, 2011. Advances bear interest at an annual rate of the Company's option equal to either: (a) LIBOR plus 4.0%, or (b) a rate equal to the Base Rate plus 3.0%. The Base Rate is the greater of (i) 5%, (ii) the Federal Funds rate plus 0.5%, or (iii) the prime rate (as defined in the Credit Agreement), which was 3.25% as of December 31, 2009. Interest is payable in arrears on the first day of each month. The unused availability under the Credit Agreement is subject to a fee based on a per annum rate of 0.375% due monthly. Borrowings under the Credit Agreement are secured by a first lien on substantially all of the Company's and certain of the Company's subsidiaries' assets. The Company draws from the available credit under the Credit Agreement to cover normal business cash requirements. As of December 31, 2008 and December 31, 2009, the Company had $13.5 million and $30.0 million, respectively, of borrowing availability under the Credit Agreement.

Second-Priority Senior Secured Notes — The Company has $194.0 million of 11% Second-priority Senior Secured Notes outstanding. These notes were issued at a discount of $4.5 million, or 97.651% of face value. The Second-priority Senior Secured Notes are secured by a second lien on substantially all of the Company's and certain of the Company's subsidiaries' assets other than accounts receivable, inventory and real property.

All $194.0 million of principal is due September 9, 2011. To the extent the Company generates excess cash flow (as defined in the indenture) in any calendar year, the Company is required by the Second-priority Senior Secured Notes to offer to repay principal equal to 75% of such excess cash flow at a rate of 102.75% of face value through September 1, 2010 and 100.00% thereafter. No excess cash flow payment was due for the year ended December 31, 2009 because an Excess Cash Flow Amount (as defined in the Indenture governing the terms of the Second-priority Senior Secured Notes) was not generated. In the event we determine that the Excess Cash Flow Amount is likely to exceed $5.0 million in 2010, we may purchase Second-priority Senior Secured Notes in the open market, by negotiated private transactions or otherwise, to reduce the aggregate Excess Cash Flow Amount to less than $5.0 million. The Company and its affiliates may from time to time seek to retire or purchase the outstanding debt, including the notes, through cash purchases and/or exchanges, in open market purchases, privately negotiated transactions or otherwise. Such repurchases or exchanges, if any, will depend on prevailing market conditions, our liquidity requirements, contractual restrictions and other factors. The amounts involved may be material. Interest is payable semiannually on March 1 and September 1. The effective interest rate is 11.3% on the Second-priority Senior Secured Notes.

Senior Subordinated Notes —The Company has outstanding $97.4 million of Senior Subordinated Notes, unsecured and subordinate to the revolving credit facility, that bear interest at an annual rate of 17%. Interest is payable at the end of each calendar quarter, or, as restricted by the revolving credit facility, is paid-in-kind by adding accrued interest to the principal balance of the Senior Subordinated Notes. All outstanding principal, including interest paid-in-kind, is due on September 9, 2014 and a mandatory prepayment equal to $20.0 million plus 50% of all outstanding interest paid-in-kind is due on September 9, 2013. In connection with the issuance of the Senior Subordinated Notes, the Company issued warrants to acquire 51.01 shares of its common stock at an exercise price of $10 per share to the Senior Subordinated Noteholders. As a result, the Company discounted the face value of the Senior Subordinated Notes by $2.9 million representing the estimated fair value of the warrants at the time of issuance. For the twelve months ended December 31, 2007, 2008 and 2009 respectively, $10.7 million, $12.6 million and $14.9 million of paid-in-kind interest was added to the principal balance of the Senior Subordinated Notes. The effective interest rate is 18.5% on the Senior Subordinated Notes.

All of the Company's domestic subsidiaries and certain of its foreign subsidiaries (collectively, the "Subsidiary Guarantors") are fully, unconditionally, and jointly and severally liable for the revolving credit facility, Senior Subordinated Notes and Second-priority Senior Secured Notes. The Subsidiary Guarantors are wholly-owned. The Company has not included separate financial statements of guarantors because (a) their aggregate assets, liabilities, earnings and equity are presented on a consolidated basis and (b) the Company believes that separate financial statements and other disclosures concerning subsidiaries are not material to investors.

The Company's credit facilities contain financial and operating covenants that require the maintenance of certain financial ratios, including specified fixed charge interest coverage ratios, maintenance of minimum levels of operating cash flows and maximum capital expenditure limitations. These covenants also limit the Company's ability to incur additional indebtedness, make certain payments including dividends to shareholders, invest and divest company assets, and sell or otherwise dispose of capital stock. In the event that the Company fails to comply with these covenants and restrictions, it may be in default, at which time payment of the long term debt and unpaid interest may be accelerated by the Company's lenders and become immediately due and payable.

Based on the Company's current and expected levels of operations, cash flow from operations, available cash and available borrowings under the $30.0 million revolving credit facility will be adequate to continue to operate for at least twelve months from the Company's balance sheet dated December 31, 2009.

The fair value of our debt instruments is as follows (in thousands):

	December 31, 2008	December 31, 2009
Revolving Credit Facility	$ 16,511	$ -
Second-priority Senior Secured Notes	108,205	179,840
Senior Subordinated Notes	82,484	97,427
	$ 207,200	$ 277,267

The fair value of the revolving credit facility is equal to its carrying value and is considered a Level 2 fair value measurement (defined as inputs other than quoted prices in active markets that are either directly or indirectly observable) due to the variable nature of its interest rate. The fair values associated with the Second-priority Senior Secured Notes were quoted as of December 31, 2009 at trading prices of $96.00 and $80.00, increases of 80.3% and 22.1%, respectively, from the quoted values at December 31, 2008. The fair value of the Second-priority Senior Secured Notes is considered a Level 2 fair value measurement (defined as inputs other than quoted prices in active markets that are either directly or indirectly observable) of the fair value hierarchy determined on their quoted market value. The fair value of the Senior Subordinated Notes is based on their book value since these notes are not publicly traded and it is not practical to measure their fair value. These notes would be valued within Level 3 on the fair value hierarchy as little or no market data exists related to these notes.

Future maturities of debt for each of the following five years and thereafter are as follows (in thousands):

Year Ended December 31:	
2010	$ -
2011	194,000
2012	-
2013	48,714
2014	48,713
Thereafter	-
	$ 291,427

(5)SEGMENT INFORMATION

The Company organizes its segments around differences in products and services and has three reportable segments: direct call provisioning, offender management software and wholesale services. Through these segments, the Company provides inmate telecommunications products and services for correctional facilities, including security enhanced call processing, call validation and billing services for inmate calling, and software solutions to manage and monitor inmate, parole and probation activity. Depending upon the contractual relationship at the site and the type of customer, the Company provides these products and services primarily through direct contracts between the Company and correctional facilities. A smaller portion of the business is provided through wholesale service agreements with other telecommunications service providers and system sales to certain telecommunications providers. The Company's foreign operations, revenues and long-lived assets are reported in the offender management software segment.

The Company evaluates performance of each segment based on operating results. Total assets are those owned by or allocated to each segment. Assets included in the "Corporate & Other" column of the following table include all assets not specifically allocated to a segment. There are no intersegment sales. The Company's reportable segments are specific business units that offer different products and services and have varying operating costs associated with such products. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies. The Company uses estimates to allocate certain direct costs and selling, general and administrative costs, as well as for depreciation and amortization, goodwill, and capital expenditures. Estimation is required in these cases because the Company does not have the capability to specifically attribute such costs to a particular segment. The estimation is based on relevant factors such as proportionate share of revenue of each segment to the total business.

Segment information for the twelve months ended December 31, 2007 is as follows (in thousands):

	Direct Call Provisioning	Offender Management Software	Wholesale Services	Corporate & Other	Total
Revenue from external customers	$ 338,703	$ 7,933	$ 45,214	$ -	$ 391,850
Segment gross margin	$ 82,103	$ 1,823	$ 21,110	$ -	$ 105,036
Depreciation and amortization	33,137	1,908	1,880	123	37,048
Other operating costs and expenses	19,624	2,555	5,513	47,291	74,983
Operating income (loss)	$ 29,342	$ (2,640)	$ 13,717	$ (47,414)	$ (6,995)
Interest and other expenses, net				31,487	31,487
Segment loss before income taxes					(38,482)
Capital expenditures	$ 21,231	$ 20	$ -	$ 105	$ 21,356
December 31, 2007:					
Total assets	$ 199,071	$ 63,626	$ 15,767	$ 13,661	$ 292,125
Goodwill	$ 37,936	$ 31,099	$ -	$ -	$ 69,035

Segment information for the twelve months ended December 31, 2008 is as follows (in thousands):

	Direct Call Provisioning	Offender Management Software	Wholesale Services	Corporate & Other	Total
Revenue from external customers	$ 333,564	$ 25,137	$ 29,902	$ -	$ 388,603
Segment gross margin	$ 89,757	$ 11,597	$ 15,359	$ -	$ 116,713
Depreciation and amortization	26,736	3,679	3,862	123	34,400
Other operating costs and expenses	20,617	8,820	4,109	41,399	74,945
Operating income (loss)	$ 42,404	$ (902)	$ 7,388	$ (41,522)	$ 7,368
Interest and other expenses, net				41,896	41,896
Segment loss before income taxes					(34,528)
Capital expenditures	$ 15,522	$ 90	$ 100	$ 1,334	$ 17,046
December 31, 2008:					
Total assets	$ 187,786	$ 46,072	$ 13,338	$ 11,766	$ 258,962
Goodwill	$ 37,936	$ 25,532	$ -	$ -	$ 63,468

Segment information for the twelve months ended December 31, 2009 is as follows (in thousands):

	Direct Call Provisioning	Offender Management Software	Wholesale Services	Corporate & Other	Total
Revenue from external customers	$ 312,614	$ 22,698	$ 28,124	$ -	$ 363,436
Segment gross margin	$ 91,042	$ 13,074	$ 12,092	$ -	$ 116,208
Depreciation and amortization	27,568	3,482	160	123	31,333
Other operating costs and expenses	18,198	9,425	1,807	36,698	66,128
Operating income (loss)	$ 45,276	$ 167	$ 10,125	$ (36,821)	$ 18,747
Interest and other expenses, net				39,114	39,114
Segment loss before income taxes					(20,367)
Capital expenditures	$ 15,100	$ 228	$ 558	$ 567	$ 16,453
December 31, 2009:					
Total assets	$ 168,625	$ 53,015	$ 10,319	$ 8,115	$ 240,074
Goodwill	$ 37,936	$ 29,450	$ -	$ -	$ 67,386

(6)INCOME TAXES

Income tax expense (benefit) is as follows (in thousands):

	Year Ended December 31, 2007	Year Ended December 31, 2008	Year Ended December 31, 2009
Current:			
US Federal	$ -	$ 330	$ (88)
US State	965	486	324
Foreign	35	848	440
Total	1,000	1,664	676
Deferred:			
US Federal	2,260	1,696	993
US State	(996)	(552)	117
Foreign	(342)	(3,317)	(1,067)
Total	922	(2,173)	43
Total income tax expense (benefit)	$ 1,922	$ (509)	$ 719

Following is a summary of the components of loss before income taxes for the years ended December 31, 2007, 2008 and 2009 (in thousands):

	2007	2008	2009
U.S. income	$ (37,125)	$ (29,013)	$ (21,371)
Non-U.S. income	(1,357)	(5,515)	1,004
Total	$ (38,482)	$ (34,528)	$ (20,367)

Income taxes differ from the expected statutory income tax benefit, by applying the U.S. federal income tax rate of 35% to pretax earnings due to the following (in thousands):

	Year Ended December 31, 2007	Year Ended December 31, 2008	Year Ended December 31, 2009
Expected statutory income tax benefit	$ (13,469)	$ (12,085)	$ (7,128)
Amounts not deductible for income tax	1,556	1,894	1,529
State taxes, net of federal benefit	(171)	(66)	(48)
Change in valuation allowance	14,332	9,749	5,738
Effect of different tax rates in various jurisdictions	25	349	(52)
Impact of changes in tax rates in foreign jurisdictions	-	(1,841)	415
Tax credits in foreign jurisdiction	-	(188)	(368)
Other	(351)	1,679	633
Total income tax expense (benefit)	$ 1,922	$ (509)	$ 719

The tax effects of temporary differences that give rise to significant portions of the deferred income tax assets and deferred income tax liabilities as of December 31, 2008 and 2009, respectively, are presented below (in thousands):

	2008	2009
Net current deferred income tax assets:		
Allowance for doubtful accounts	$ 1,945	$ 2,188
Accrued expenses	2,055	845
Deferred revenue	4,354	4,295
Other	581	13
Current deferred income tax assets	8,935	7,341
Deferred income tax liabilities-other	(939)	(1,063)
Current deferred income tax liabilities	(939)	(1,063)
Less: valuation allowance	(6,840)	(5,684)
Net current deferred income tax asset	$ 1,156	$ 594
Net non-current deferred income tax assets (liabilities):		
Deferred income tax assets:		
Net operating loss and tax credit carryforwards	34,504	37,339
Accrued interest	9,738	13,436
Other	200	74
Non-current deferred income tax assets	44,442	50,849
Deferred income tax liabilities:		
Property and equipment principally due to differences in depreciation	(2,716)	(2,561)
Goodwill	(5,164)	(6,402)
Intangible assets	(14,627)	(13,564)
Non-current deferred income tax liabilities	(22,507)	(22,527)
Less: valuation allowance	(32,828)	(39,628)
Net non-current deferred income tax liability	(10,893)	(11,306)
Net deferred income tax liability	$ (9,737)	$ (10,712)

At December 31, 2009, the Company had U.S. federal net operating loss carryforwards for tax purposes aggregating approximately $109.9 million the majority of which, if not utilized to reduce taxable income in future periods, will expire from 2024 through 2029. Approximately $9.3 million of these net operating loss carryforwards are subject to certain rules under Internal Revenue Code Section 382 limiting their annual usage. The Company believes these annual limitations will not ultimately affect its ability to use substantially all of the net operating loss carry forwards for income tax purposes. As a result of the change of control related to certain acquisitions, the use of the net operating losses may be limited going forward under Internal Revenue Code 382. At December 31, 2009, the Company had net operating loss carryforwards for tax purposes in Australia aggregating less than $0.1 million, which do not expire, and no operating loss carryforwards in the remaining foreign tax jurisdictions.

The Company accounts for the uncertainty in income taxes on the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. The tax benefit from an uncertain tax position may be recognized only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities. The determination is based on the technical merits of the position and presumes that each uncertain tax position will be examined by the relevant taxing authority that has full knowledge of all relevant information.

The Company's unrecognized tax benefits of $0.7 million and $0.4 million at December 31, 2008 and 2009, respectively, relate to various foreign jurisdictions.

The following table summarizes the activity related to the Company's unrecognized tax benefits (in thousands):

	Total
Balance at December 31, 2007	$ 663
Increases related to prior year's tax positions	27
Foreign currency translation	(22)
Balance at December 31, 2008	668
Decreases related to prior year's tax positions	(316)
Increases related to current year's tax positions	23
Foreign currency translation	(18)
Balance at December 31, 2009	$ 357

Included in the unrecognized tax benefits of $0.4 million at December 31, 2009 was a $0.3 million tax expense that, if recognized, would impact the annual effective tax rate. The Company also accrued potential interest of $0.1 million in 2007, and less than $0.1 million during both 2008 and 2009, respectively, related to these unrecognized tax benefits. The Company does not expect unrecognized tax benefits to change significantly over the next 12 months. The Company classified interest and penalties on income tax-related balances as income tax expense.

The Company or one of its subsidiaries file income tax returns in the U.S. federal jurisdiction, Canada, the United Kingdom, Australia and various states. The Company has open tax years for the U.S. federal return from 1996 forward with respect to its net operating loss carryforwards, where the IRS may not raise tax for these years, but can reduce net operating loss carryforwards. Otherwise, with few exceptions, the Company is no longer subject to federal, foreign, state, or local income tax examinations for years prior to 2005.

A valuation allowance is provided when it is more likely than not that some portion or the entire net deferred tax asset will not be realized. The Company calculated the deferred tax liability, deferred tax asset, and the related valuation of net deferred tax assets, including net operating loss carryforwards, for the taxable temporary differences on a jurisdiction by jurisdiction basis. The valuation allowance represents the excess deferred tax assets including the net operating loss carryforwards, over the net deferred tax liabilities, excluding deferred liabilities that are not available to offset deferred tax assets. The Company has offset the net deferred tax assets, including net operating loss carryforwards, with a valuation allowance of $39.7 million and $45.3 million at December 31, 2008 and 2009, respectively. The Company increased the valuation allowance because future taxable income may not be realized to utilize net operating losses.

(7)REDEEMABLE CONVERTIBLE PREFERRED STOCK

At December 31, 2009, the Company had 5,100 shares of Series A Redeemable Convertible Preferred Stock ("Preferred Stock"), which was issued in December 2007. Each share of the Preferred Stock has a stated value of $2,534 and accrues dividends annually at 12.5% of the stated value. The Preferred Stock has a liquidation preference equal to the greater of its per share purchase price plus any accrued but unpaid dividends and the amount the holder would receive if such share were converted to shares of common stock. At the election of the Board of Directors, the Company may redeem shares of Preferred Stock at any time on or after January 1, 2010. The redemption price is equal to the greater of the liquidation amount or the fair market value as of the redemption date.

Each share of Preferred Stock is convertible into 200 shares of Class A Common Stock, as adjusted for certain events. The intrinsic value of the conversion option was zero as the fair value of the Class A Common Stock was less than the conversion price at the commitment date.

The Company accrues dividends on the Preferred Stock; however the Company's Credit Agreement contains financial and operating covenants which limit the ability to make dividend payments to the Company's shareholders. As of December 31, 2009, the Company had accrued but unpaid dividends of $2.7 million for the Series A Preferred Stock. The accrued but unpaid dividends are included in the redemption amount of the Preferred Stock at December 31, 2009.

(8)STOCKHOLDERS' EQUITY

Common Stock

In 2007, in conjunction with the issuance of the Preferred Stock (see Note 7), the Company's shareholders approved a 1 for 1,000 reverse stock split for the Class A Common Stock and Class B Common Stock. Except as otherwise noted, all shares, options and warrants have been restated to give retroactive effect to the reverse split. In connection with the reverse split, authorized shares of common stock were reduced to 1,300,000 shares of capital stock with a par-value of $0.001.

In 2008, the Company authorized an additional 65,000 shares of Class B Common Stock and filed a Third Amended and Restated Certificate of Incorporation, which authorized 1,365,000 shares of capital stock with a par value of $0.001. 1,190,000 shares were designated Class A Common Stock, 10,000 were designated Preferred Stock, of which 5,100 were designated as Series A Convertible Preferred Stock, and 165,000 were designated Class B Common Stock.

On March 25, 2009, the Company filed a Fourth Amended and Restated Certificate of Incorporation, which authorized 1,685,000 shares of capital stock with a par value of $0.001. Additionally, the board of directors issued a unanimous resolution to adopt a Fourth Amendment to the 2004 Restricted Stock Plan which increased the number of shares of Class B Common Stock authorized for issuance thereunder from 165,000 to 175,000 shares. The Fourth Amended and Restated Certificate of Incorporation designated 1,500,000 shares as Class A Common Stock, 10,000 shares as Preferred Stock, of which 5,100 were designated as Series A Convertible Preferred Stock, and 175,000 shares as Class B Common Stock. All issued shares of Common Stock are entitled to vote on a one share/one vote basis.

As of December 31, 2009, 14,132 shares of Class A Common Stock were issued and outstanding and 126,660 shares of the Class B Common Stock were issued and outstanding. Shares of Class B Common Stock are subject to vesting as described below. Other than provisions related to vesting and a $57,000 per share liquidation preference for the Class A Common Stock, holders of the shares of Class A Common Stock and Class B Common Stock have identical rights and privileges. The Company's Credit Agreement restricts the ability to pay dividends to holders of the Company's capital stock.

Warrants

The holders of the Senior Subordinated Notes hold warrants to purchase an aggregate of 51.01 shares of Class A Common Stock. The warrant exercise price is $10 per share, is immediately exercisable upon issuance, and expires on September 9, 2014. As a result, the Company discounted the face value of the Senior Subordinated Notes by $2.9 million representing the estimated fair value of the stock warrants at the time of issuance. The warrants had a de minimis fair value as of December 31, 2008 and 2009.

Restricted Stock Purchase Plan

The Company has a 2004 Restricted Stock Purchase Plan under which certain of its employees may purchase shares of Class B Common Stock. The maximum number of authorized shares that may be delivered pursuant to awards granted under the 2004 Restricted Stock Purchase Plan is 175,000, which equals 10.4% of the total authorized shares of common stock.

The Company's board of directors administers the 2004 Restricted Stock Purchase Plan. The plan is designed to serve as an incentive to attract and retain qualified and competent employees. The per share purchase price for each share of Class B Common Stock is determined by the Company's board of directors. Class B Common stock will vest based on performance criteria or ratably over a period or periods, as provided in the related restricted stock purchase agreement.

As of December 31, 2009, 126,660 shares of Class B Common Stock were issued under the 2004 Restricted Stock Purchase Plan. Of this amount, (a) 57,072 of these shares were issued to our Chief Executive Officer; (b) 11,414 shares were issued to our Chief Financial Officer; and (c) 58,174 shares were issued to eleven of the Company's executives and to current or previous members of the Company's board of directors.

These shares are subject to forfeiture pursuant to the terms of the 2004 Restricted Stock Purchase Plan and the restrictions described hereafter. The restriction period of 33.33% of the shares issued to the majority of the Company's executives, ends upon the sale of the Company's stock by certain of its other stockholders. The restriction period for 33.34% of the stock ends upon the lapse of time, ratably over three to four years from the date of issue. With respect to the remaining shares, the restriction period ends upon the Company attaining certain performance measures determined by its board of directors. Upon a change of control, the restriction period could end for all of the restricted shares that have not previously vested. The restricted shares are entitled to dividends, if declared, which will be distributed upon termination of the restriction period with respect to any such restricted shares.

The Company measures compensation expense on these restricted shares commensurate with their vesting schedules. For the portion of the restricted shares that vest contingently with the occurrence of certain events, the Company records compensation expense when such events become probable. The incremental compensation expense on the restricted shares issued was determined based on the estimated fair value of the Class B Common Stock, which resulted in less than $0.1 million in compensation expense charged to "Selling General and Administrative Expense" in the consolidated statement of operations for each of the years ended December 31, 2007, 2008 and 2009.

As of December 31, 2009, there was approximately $0.1 million total unrecognized compensation cost related to the 2004 Restricted Stock Purchase Plan, of which approximately half is expected to be recognized over a weighted average period of 2 years and the remaining half will be recognized upon the sale of the Company's stock by certain of the Company's other shareholders.

(9)RELATED-PARTY TRANSACTIONS

The Company has a consulting services agreement with H.I.G. pursuant to which H.I.G. receives an annual consulting services fee of $750,000 for management, consulting and financial advisory services. Required minimum annual consulting fee payments for the remaining term are as follows (in thousands):

Year Ended December 31:		
2010	$	750
2011		750
2012		750
2013		750
2014		750
Thereafter		3,563
Total	$	7,313

The consulting services agreement, as amended, has an eleven-year commitment period. In connection with this agreement, the Company paid $0.8 million for each of the three years ended December 31, 2007, 2008, and 2009.

The Company has a professional services agreement, as amended, with H.I.G., pursuant to which H.I.G. is paid investment banking fees equal to 2% of the value of any transaction in which the Company (i) sells all or substantially all of its assets or a majority of its stock, (ii) acquires any other companies or (iii) secures any debt or equity financing. In 2007, in connection with its acquisition of Syscon and the issuance of the Series A Redeemable Convertible Preferred Stock, H.I.G. received a professional services fee equal to 2% of each transaction value, or approximately $1.0 million and $0.2 million, respectively. In 2008, H.I.G. received a professional service fee of $0.8 million for their services related to the refinancing of the Company's revolving credit arrangement. No transactions took place during 2009, requiring payment under the professional services agreement.