

Edgar Filing: SYNERGX SYSTEMS INC - Form 10KSB

SYNERGX SYSTEMS INC  
Form 10KSB  
December 16, 2004

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20459

FORM 10-KSB

(Mark One)

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

For the fiscal year ended September 30, 2004  
OR

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

Commission File Number 0-17580

SYNERGX SYSTEMS INC  
(Exact name of Small Business Issuer in its charter)

Delaware 11-2941299  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

209 Lafayette Drive, Syosset, New York 11791  
(Address of principal executive offices) (zip code)

Issuer's telephone number, including area code: (516) 433-4700

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

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

Common Stock, \$.001 par value per share  
(Title of Class)

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements by reference in Part III of this Form 10-KSB ( )

State issuer's revenues for its most recent fiscal year: \$21,790,000

The aggregate market value of the voting stock held by non-affiliates of the Registrant, based upon the average bid and ask prices for the Registrant's Common Stock, \$.001 par value per share, as of December 7, 2004 was \$10,092,830

As of December 13, 2004, the Registrant had 5,136,862 shares of Common Stock outstanding.

Documents Incorporated by Reference: Definitive Proxy Statement to be filed.

PART I

## Edgar Filing: SYNERGX SYSTEMS INC - Form 10KSB

### ITEM 1. DESCRIPTION OF BUSINESS

#### The Company

Synergx Systems Inc. ("Synergx" or the "Company") is a Delaware corporation organized in October 1988 to acquire controlling interests in companies engaged in the design, manufacture, distribution, sale and servicing of fire, life safety security, audio-video, communication energy management, intercom, and other systems. Reference to Synergx or the Company include operations of each of its subsidiaries except where the context otherwise requires. Synergx's business is conducted through subsidiaries in the New York City metropolitan area and Dallas, Texas.

Synergx conducts its business in New York principally through Casey Systems Inc. ("Casey") its wholly owned subsidiary located in Long Island, New York and in Texas through General Sound (Texas) Company ("General Sound") its wholly owned subsidiary in Dallas, Texas.

#### Synergx Products

Synergx designs, manufactures, markets and sells its own proprietary life safety and communication systems and also engineers, distributes, markets and sells systems and products manufactured by other parties. Synergx's proprietary product line features the COMTRAK 1720 and 2000 Life Safety Systems and the TELTRAK Communications System.

In 1973, New York City passed Local Law 5 requiring that all office buildings of 100 feet or more be outfitted with smoke detectors, manual and audio communicating systems for life safety and fire reporting purposes. In anticipation of the demand that this legislation would create for equipment and systems employing improved technology and design features, Synergx engaged in extensive research and development which led to its proprietary COMTRAK 1720 Life Safety System which has been installed in numerous buildings since the early 1980's.

To meet the challenges of more stringent code requirements and a sluggish market for new construction, Synergx developed its new generation proprietary COMTRAK 2000 Life Safety System which utilizes the latest technology to not only meet the current code requirements, and satisfy the "wish list" of current COMTRAK customers, but many likely future code requirements as well. One of the improvements incorporated into the COMTRAK 2000 is a Fire Command Station which offers a color CRT display system along with three sectional displays. These features provide the operator with a wide variety of pertinent information, allowing for quicker response, which is critical in an emergency. In addition, the expanded memory capability of the new Fire Command Station enables a single station to control multi-building projects and permits simplified operation. COMTRAK 1720 and 2000 Systems are operating in approximately 100 buildings in New York City. Synergx has approvals from FM Approvals and various New York City agencies for the COMTRAK 1720 and COMTRAK 2000 System. Synergx has contracts or otherwise supports numerous additional buildings featuring third party systems. Casey is a strategic partner with Edwards Systems Technology ("EST"), a leading manufacturer of fire and security systems. Most of Casey's new life safety system sales now feature EST products and systems or interfaced COMTRAK-EST systems.

FM Approvals is an independent testing and certification laboratory similar to Underwriters Laboratory. In order for Synergx to sell and maintain their proprietary fire alarm systems, certification from an approved independent testing agency is required. Without this certification, Synergx would not be allowed to produce and maintain its fire systems for its existing customer base, as well as new customers.

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Neither Synergx, nor its officers or directors has any affiliation with FM Approvals.

TELTRAK Communications Systems. In the early 1980s, Synergx began investigating the intercom market and the possibilities of utilizing its computerized multiplex technology for this market. Significant construction of new high-rise housing occurred in the 1970s and 1980s and increased the potential demand for technologically advanced intercom systems. To meet this demand, Synergx developed a micro-processor-based combination intercom and security system using Casey's multiplex technology. The TELTRAK I intercom and security system is capable of a variety of accessory functions in addition to its basic intercom and security function. Synergx added video capabilities to its TELTRAK I technology and created the TELTRAK II, for installation in luxury condominium, cooperative and apartment buildings. Over 16,000 TELTRAK I and II units have been sold. In 1991, the redesigned TELTRAK III intercom/security station was introduced, with enhanced features to expand its use and competitiveness in the face of the reduced market for these products. New features, such as public address, enable important messages to be given to building occupants either locally or by groups in case of emergency.

Multiplex technology is a term that is used in the industry to define the systems architecture of the Company's equipment. All multiplex technology has basically the same concept with variation for specific equipment.

### Other Products

In the past eight years Synergx has sought to diversify its product lines to establish a greater base to absorb product support, R & D and other overhead and to provide product and customer diversification. To that end, Synergx has augmented its established position in marketing engineered life safety systems (proprietary and third party) by developing a significant business in engineered sound systems for application to a variety of users including, commercial establishments, hospitals, educational facilities and transit facilities (e.g. subway stations). Synergx has developed a focused unit with a high level of experience to penetrate this niche market with significant success as a substantial portion of Synergx's order position derives from this effort. In addition, Synergx organized new marketing units to focus on marketing, engineering and servicing systems and products manufactured by third parties, particularly national manufacturers. These marketing units are service oriented organizations which focus on close relationships with customers and key suppliers. During the last three years, Synergx has added marketing personnel and new security products from other manufacturers to accelerate its focus into the security market for the sale of products and services in the New York Metropolitan area.

In 1993, Synergx acquired assets of a company which manufactured and marketed sophisticated products and on-board information and communication systems with applications for municipal transit carriers, long-distance passenger carriers and bus and train builders. Synergx has integrated this operation into its New York division and has to date supplied products to customers such as Bombardier, Nippon Sharyo, Sumitomo, Kawasaki, Motive Power, Siemens, the New York City Transit Authority and AMTRAK. These customers have supplied Synergx's equipment to the Baltimore MTA, the Bi-State Development Agency (St Louis), the Boston MBTA, CONRAIL, the San Diego Trolley, the Washington Metropolitan Transit Authority (Washington, D.C.), and METRA (Chicago). Recently Synergx began to integrate its on board communication products with products supplied by other manufacturers. These integrated products include electronic signage and automatic announcement systems.

### Service

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Synergx continues to put an increasing priority on the development of an integrated and efficient service organization. Sales personnel have been dedicated to securing service contracts and are intensifying efforts to market service to COMTRAK, EST and other Synergx projects coming out of warranty and the renewal of such contracts. To improve customer service, Synergx maintains an office in New York City which houses its New York service management.

### General Sound (Texas) Company

Synergx conducts business in Texas through its subsidiary, General Sound (Texas) Company, which distributes, services, installs and designs a variety of sound, fire alarm, intercom and security systems in the Dallas/Ft. Worth, Texas area. General Sound concentrates its sales effort on the commercial market and schools. General Sound provides its customers, primarily electrical contractors, with engineered systems, assistance in design, installation support and post-installation service.

General Sound has non-exclusive distribution agreements for the Dallas/Ft. Worth area with Notifier, Dukane, and other manufacturers. The product mix and dependence on individual suppliers varies from year to year depending on customer requirements and market trends.

### Secure 724 LP

Synergx has a 25% investment in Secure 724 LP a Canadian research, development and marketing group which has developed technology to transmit alarm and other data from a secured site to a command center and to multiple Blackberry wireless handheld devices and/or cellular phones and to transmit commands or programming instructions to a wide variety of building systems. Casey is evaluating methods of integrating this technology into its existing products and systems to offer customers a wireless communication solution.

### Research and Development

During the fiscal years ended September 30, 2004 and 2003, Synergx spent approximately \$160,000 and \$155,000, respectively, for research and development of Synergx's life safety and communication systems.

### Customers and Suppliers

For the fiscal years ended September 30, 2004 and 2003, no customer accounted for more than 10% of Synergx's revenues. One supplier accounted for 9% and 11% of Synergx's cost of sales in the years ended September 20, 2004 and 2003, respectively.

### Regulations

Synergx believes that it is in compliance with applicable building codes, zoning ordinances, occupational, safety and hazard standards and other Federal, state and local ordinances and regulations governing its business activities.

### Competition

Synergx business is competitive; some of Synergx's competitors may have greater financial resources and may offer a broader line of fire and life safety products. Synergx also faces competition in the servicing of systems which it sells. Accordingly, even though Synergx may sell and install a fire and life safety control and communications system, it may not receive the contract to service that system. Synergx, however, believes that it can effectively compete with any entity which conforms with applicable rules and regulations.

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### Employees

Synergx and its subsidiaries have 128 full time employees, including 41 New York hourly employees that are covered by a Collective Bargaining Agreement expiring July 2005.

### Business Conditions

Synergx believes that its labor and material sources are sufficient and that other than normal competitive factors, and what is discussed above or under "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION", Synergx's operations and industry do not have any special characteristics which may have a material impact upon its future financial performance.

### Patents and Trademarks

The Company does not have any patents on its systems, but, it uses proprietary technology which it seeks to protect as trade secrets. The "Firetector", "Casey Systems" and "COMTRAK" trademarks are registered with the United States Patent and Trademark Office.

### ITEM 2. DESCRIPTION OF PROPERTY

The Company leases approximately 15,700 square feet of office, manufacturing and warehouse space in Syosset, New York under a seven year lease expiring June 2007. The rental schedule provides for monthly rent of \$13,966 during the first and second years of the initial term and with 3.3% yearly increases for the third through seventh years.

The Company has a lease for its service center in New York City that became effective August 2002 and runs through December 31, 2009. The lease is for office and warehouse space and provides for yearly rental of \$84,000 during the first year plus expenses with yearly escalation of 2% each year thereafter.

The Company leases a 7,700 square foot office and warehouse facility in Richardson, Texas, a suburb of Dallas, pursuant to a lease that was extended in October, 1997 and extended again in August, 2002 to expire on June 30, 2010 providing for annual rent on a net basis of \$50,152 escalating annually to \$64,016 in the final year of the lease.

Management believes there is sufficient space at these facilities for its current and intended business.

### ITEM 3. LEGAL PROCEEDINGS

In the normal course of its operations, the Company has been or, from time to time, may be named in legal actions seeking monetary damages. While the outcome of these matters cannot be estimated with certainty, Management does not expect, based upon consultation with legal counsel, that they will have a material effect on the Company's business or financial condition.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITIES HOLDERS.

None

PART II

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### ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

Synergx's Common Stock has been traded on the National Association of Securities Dealer's Inc. Automated Quotation System ("NASDAQ") since April 11, 1989 under the "FTEC" symbol and since May 2002 under the "SYNX" symbol. The following table shows the high and low bid and ask quotations for each fiscal quarter from December 31, 2002 through September 30, 2004 which quotations were obtained from the National Association of Securities Dealers Inc. (adjusted for a 2 for 1 stock split in July 2003)

Common Stock Quarter Ended	Bid		Ask	
	High	Low	High	Low
December 31, 2002	.725	.500	.750	.565
March 31, 2003	1.225	.570	1.275	.580
June 30, 2003	1.500	1.100	1.550	1.125
September 30, 2003	4.175	2.550	4.350	2.650
December 31, 2003	4.000	2.860	4.000	2.970
March 31, 2004	6.010	2.470	6.100	2.700
June 30, 2004	9.820	2.810	9.950	2.830
September 30, 2004	4.090	1.750	4.110	1.810

The above quotations represent prices between dealers, do not include retail markups, markdowns or commissions and may not represent actual transactions. As of December 13 2004, there were 442 record holders of Synergx's Common Stock.

On December 7, 2004, the closing bid and ask prices for the Common Stock were \$3.850 and \$3.790, respectively.

The Company has not paid any cash dividends on its Common Stock. Payment of cash dividends in the foreseeable future is not contemplated by the Company. Whether dividends are paid in the future will depend on the Company's earnings, capital requirements, financial condition along with economic and market conditions, industry standard and other factors considered relevant to the Company's Board of Directors. Payment of dividends is restricted in certain cases by the Company's credit facilities. Accordingly, no assurance can be given as to the amount or timing of future dividend payments, if any.

On September 30, 2002, the Company sold 340,000 units ("Units") in a private placement to an unaffiliated investor for \$.70 per Unit. Each Unit consists of one share of Common Stock and one warrant (the "Warrant") to purchase an additional share of Common Stock at \$.70 for a period of 24 months from September 30, 2002. These warrants were exercised in August and September 2004.

On May 29, 2003 the Company acquired 25% of Secure 724 LP by issuing to Nafund Inc., a Toronto based private equity fund affiliated with two of the Company's Directors, 300,000 shares of Common Stock and warrants to purchase 50,000 shares of Common Stock at \$1.15 share until May 29, 2005. The acquisition also called for the issuance of an additional 150,000 shares of Common Stock if Secure 724 LP satisfies certain development milestones by a target date and Nafund provides certain funding. The requirement to issue these additional shares expired as the milestones were not achieved by the target date.

#### Registration of Shares of Common Stock

The Company filed a Form S-3 registration statement, which became effective June 27, 2003. The registration statement was for an aggregate of 1,220,000 shares which provided for the registration of 680,000 in the private placement

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noted above and for 200,000 shares in connection the investment in Secure 724 LP, and 340,000 shares to two other private investors.

The Company filed a Form S-8 registration statement, which became effective July 22, 2003. The registration statement provided for the registration of 404,885 shares issueable under the 1997 Non-Qualified Stock Option Plan.

### ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

#### LIQUIDITY AND CAPITAL RESOURCES

In October 2003, the Company entered into a new \$3 million revolving credit facility with Hudson United Bank (the "Credit Facility"). This credit facility has an interest rate of prime plus 1/4% and expires in October 2005. Initial proceeds from the new credit facility were used to pay off a credit facility with Citizens Business Credit. Advances under the Credit Facility are measured against a borrowing base calculated on eligible receivables and inventory. The Credit Facility is secured by all assets of the Company and all of its operating subsidiaries.

The Credit Facility includes various covenants, which among other things, impose limitations on declaring or paying dividends, acquisitions and capital expenditures. The Company is also required to maintain certain financial ratios and tangible net worth covenants. At September 30, 2004, the Company was not in default with any of its financial covenants and at such time the full amount of the Credit Facility was available under the borrowing base calculation. At September 30, 2004, \$1,916,000 was owed under the Credit Facility.

Net cash used by operations for the year ended September 30, 2004 amounted to \$319,000 as compared to cash provided by operations of \$57,000 for the comparable prior year. The increase in cash being used by operations was primarily due to an increase in working capital requirements to fund an increase in accounts receivable resulting from significantly higher sales in 2004 and from an increase in inventory for projects expected to be shipped after September 30, 2004. The net cash outflow of \$319,000 from operations during 2004 coupled with equipment purchases of \$232,000 were funded by an increase of \$660,000 in bank borrowing. In addition, financing activities included \$316,200 of proceeds from exercise of warrants to purchase common stock by Genterra Inc., \$238,000 of proceeds from exercise of warrants to purchase common stock by an unaffiliated investor and \$62,000 from exercise of stock options by employees to purchase common stock under the Company's stock option plan.

The ratio of the Company's current assets to current liabilities increased to approximately 3.45 to 1 at September 30, 2004 compared to 2.65 to 1 at September 30, 2003. The increase in the current ratio is due to an improvement in cash flow due to continued profitable operations in 2004 from \$616,000 of proceeds from the exercise of warrants and employees stock options, and from a \$599,000 increase in accounts receivable in 2004. Working capital increased by \$1.8 million to \$7.5 million at September 30, 2004 compared to \$5.7 million at September 30, 2003 (including \$635,000 from an increase in cash); while bank borrowing increased by only \$660,000 since September 30, 2004.

#### RESULTS OF OPERATIONS

Revenues and Gross Profit

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	For the years ended September 30, 2004	2003
	(In thousands)	
Product Sales	\$16,720	\$14,720
Subcontract Sales	590	643
Service Revenue	4,480	4,451
	-----	-----
Total Revenue	\$21,790	\$19,814
Product Gross Margin	\$ 5,630	\$ 5,081
Subcontract Gross Margin	106	116
Service Gross Margin	1,291	1,298
	-----	-----
Total Gross Margin	\$ 7,027	\$ 6,495
Gross Profit Product %	34%	35%
Gross Profit Subcontractor %	18%	18%
Gross Profit Service %	29%	29%
	---	---
Total Gross Profit %	32%	33%

### Revenues

The increase in product revenues resulted from improved economic activity in both the Company's principal New York City market and its Dallas, Texas market. The majority of the increase came from our Dallas, Texas market as the Company experienced exceptionally strong product revenues compared to very low 2003 levels, improved product revenues from New York City transit projects that resulted from releases from our customers, and from higher sales of railcar communication products. In the Dallas, Texas market, higher product revenues resulted from certain cost reduction initiatives implemented during the last two years, which allowed the Company to price aggressively in that competitive market. The Company is continuing to quote business aggressively in both the Dallas, Texas and New York City metropolitan area.

Subcontract revenue decreased during 2004 as the Company was responsible for various small electrical installations in 2004 which in the aggregate accounted for less revenue than two large electrical installation projects generated in 2003.

Service revenues increased 1% during 2004 primarily due to higher service revenue from service contracts which offset a decrease in call-in service on fire alarm systems (replacement parts and service required by buildings). Lower call-in service resulted in part from certain customers converting to "all in" contracts that covers call-in service.

### Gross Profit

Gross profit margin from product revenues increased 11% to \$5,630,000 due to higher product sales (noted above) and related gross margin. Gross profit margin as a percentage of product revenues was 34% in 2004 compared to 35% in 2003. This decline in gross profit percentage was due to aggressive pricing necessary to obtain higher sales.

Gross profit margin related to subcontract revenues for 2004 decreased in absolute terms as the Company was responsible for a smaller amount of electrical installation by third parties (subcontract work).

Gross profit margin from service revenues decreased slightly during 2004



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due to lower call-in service revenue. Gross profit is normally higher on call in maintenance service for fire alarm systems.

### Selling, General and Administrative Expenses

Selling, General and Administrative Expenses ("S G &A") increased by 5% in 2004 over 2003 primarily as a result of the Company's continued expansion of its marketing programs for new products and from higher insurance costs. During the last two years additional staffing was added to address the markets for audio/visual and security products. Previously in 2001 the Company increased staffing in the railcar transit communication group as it addressed a marketing opportunity for future business over the next several years. These marketing initiatives helped to improve total sales in 2004. Consequently, S G & A expenses as a percentage of sales decreased 2% to 27% in 2004 due to higher sales volume compared to the relative fixed nature of these costs. The Company will continue to invest in staff to secure and support sales of new products in future years.

### Income Before Tax

The improvement in income before income taxes during 2004 is primarily due to the increase in gross profit caused by higher product revenues. Partially offsetting the improvement in overall gross profit was an increase in selling, general and administrative expenses of 5% during 2004 from additional management and sales staff to support product expansion directed at increased sales levels and from higher insurance costs. Unfavorably affecting income before income taxes were increases in interest expense of 34% in 2004 due to higher borrowing levels during 2004 and from higher depreciation and amortization. For 2004, the Company also recorded a loss of \$52,000 on its equity in the operating loss of Secure 724 LP compared to a loss of \$35,000 in 2003.

### Tax Provision

The Company's current income tax provision represents federal, state and local income taxes. Deferred taxes represent the net change in deferred tax assets and noncurrent deferred tax liability as it related to certain timing differences of book and tax deductions.

### Order Position

Synergx's order position, excluding service, decreased to \$12.8 million at September 30, 2004 compared to the \$16.5 million level at September 30, 2003. The Company expects to fulfill a significant portion of its order position over the next twelve months. The order position reflects recent large new orders for several subway complexes, which will be deliverable over several years as the projects are released. The order position includes \$1.6 million of orders for communication and announcement systems from several transit car manufacturers, that will be shippable over the next 24 month period. While quotation activity is brisk, there is no assurance when orders will be received and whether the order position will increase. Due to the fact that some of the Company's products are sold and installed as part of larger construction or mass transit projects, there is typically a delay between the booking of the contract and its revenue realization. The order position from time to time includes, and the Company continues to bid on, projects that include subcontractor labor, (electrical installation performed by others). The Company expects to be active in seeking orders where the Company would act as a prime contractor and is responsible for management of the project as well as electrical installation.

### Plan of Operations

During fiscal 2005, management intends to continue to focus on its

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intensified marketing programs that were begun in 1998 and to continue to contain or monitor fixed overhead as well as to reduce variable costs through improved efficiency and productivity. Specifically management is pursuing a strategy of aggressive marketing of products and systems to drive more revenue through established channels of distribution. A new General Manager has recently been added to our management staff to focus on these initiatives with a focus on reducing costs thereby enhancing the Company's competitiveness which combined with improved sales and marketing techniques should result in increased revenues over time. Management is analyzing how to integrate the Secure 724 technology into its marketing efforts by offering a wireless feature to augment existing new products and systems. However, competition remains severe in many of the Company's product categories and demand remains sporadic in the Dallas market area. Longer term, management expects increased demand for the Company's audio-visual, public address, security and other communication products. Enhancements in recent years to Synergx's management information systems and methods of approving and monitoring project costs have improved management's ability to pinpoint waste and/or third party (supplier or customer) cost responsibility. Further enhancements in these areas will be in progress during 2005.

The Company will continue to evaluate the performance and potential of its investment in Secure 724. Secure 724 currently has a very low overhead structure, however to fully capitalize and realize on its technology, Secure 724 must accelerate into the marketing phase of its development which will require additional staff, product development and production. Secure 724 is pursuing various routes to finance this stage including possible new investors and/or strategic relationships with prospective customers. There can be no assurance that Secure724 will secure the funding its requires to fully capitalize on its technology or that the Company's investment in Secure 724 will be profitable.

### Inflation

The impact of inflation on the Company's business operations has not been material in the past. Casey's labor costs are normally controlled by union contracts covering a period of three years and its material costs have remained relatively stable. However in July of 2002, the Company and its union agreed to a new three year contract that provides for wage/benefits increases of approximately 5% in each year. During 2001, under terms of the previous union contract, certain union members, upon passing certain test requirements, began moving up to higher paying categories that have multiple salary steps per year in excess of the 5% contractual level. In addition, the demand for highly skilled professionals has resulted in the need to assess salary levels in order to remain competitive. It is expected that required salary adjustments will exceed normal increases given in the past. The Company will try to mitigate the effect of these increases in labor costs by price increases, if possible, and expense reductions.

### ITEM 7. FINANCIAL STATEMENTS

Our financial statements together with accompanying notes and the report of Marcum & Kliegman LLP, our independent registered public accounting firm, are set forth on the pages indicated below.

Independent Registered Public Accounting Firm's Report

F1

Audited Consolidated Financial Statements

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Consolidated Balance Sheet	September 30, 2004	F2 - F3
Consolidated Statements of Operations	Years Ended September 30, 2004 and 2003	F4
Consolidated Statements of Stockholders' Equity	Years Ended September 30, 2004 and 2003	F5
Consolidated Statements of Cash Flows	Years Ended September 30, 2004 and 2003	F6
Notes to Consolidated Financial Statements		F7 - F24

### ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None

#### ITEM 8A. Controls and Procedures

Evaluation of disclosure controls and procedures. At the period end of this Annual Report on Form 10-KSB, the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded, as of the end of the fiscal year covered by this report, that:

The Company's disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in the reports it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified.

That Company's disclosure controls and procedures are effective to ensure that such information is accumulated and communicated to the Company's management, and made known to the Company's Chief Executive Officer and Chief Financial Officer, to allow timely decision regarding the required disclosure.

There have been no changes in the Company's internal controls over financial reporting that have materially affected, or is reasonably likely to materially affect the Company's internal controls over financial reporting during the period covered by the Annual Report.

### PART III

Item 9. Directors, Executive Officer, Promoters and Control Persons: Compliance with Section 16(a) of the Exchange Act.

The information required by this Item is incorporated by reference from our definitive Proxy Statement for the 2005 Annual Meeting of Stockholders.

Item 10. Executive Compensation

The information required by this Item is incorporated by reference from our definitive Proxy Statement for the 2005 Annual Meeting of Stockholders.

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

The information required by this Item is incorporated by reference from our definitive Proxy Statement for the 2005 Annual Meeting of Stockholders.

### Item 12. Certain Relationships and Related Transactions

The information required by this Item is incorporated by reference from our definitive Proxy Statement for the 2005 Annual Meeting of Stockholders.

### ITEM 13. EXHIBITS AND REPORTS ON FORM 8-K

#### (a) Exhibits

Exhibit No.	Description of Exhibit
3.1	Certificate of Incorporation of the Company, as amended
3.2	By-Laws of the Company (2)
4.1	Specimen Common Stock Certificate (2)
10.1	Credit Facility dated October 9, 2003 between Synergx Systems Inc. as borrower and Hudson United Bank as lender. (5)
10.8	Form of Lease dated February, 2000 between Casey Systems as Tenant and First Industrial L.P. as Landlord (3)
10.9	Form of Lease dated July 23rd, 2002 between Systems Service Technology Corp as Tenant and Balbo Realty LLC as Landlord(4)
10.10	Form of Subscription Agreement and Investment Letter dated September 30, 2002 between Synergx Systems and Investors Money Management (4)
10.11	Form of Limited Partnership Agreement dated May 29, 2003 between 3077118 Nova Scotia ULC (a Synergx Systems owned company) and Secure 724 LP (5)
22.1	Subsidiaries of the Registrant (Exhibit 22.1) (1)
31.1	Certification of Daniel S. Tamkin pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002*
31.2	Certification of John A. Poserina pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002*
32.1	Certification of Daniel S. Tamkin and John A. Poserina pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*

- - - - -

\* filed herewith

(1) Reference is made to the correspondingly numbered Exhibit to Amendment No. 1 to the Company's Registration Statement on Form S-2, Registration No. 33-51472, filed with the Commission on December 23, 1992, which is incorporated herein by reference.

(2) Reference is made to the correspondingly numbered Exhibit to Amendment No. 1 to the Company's Registration Statement on Form S-1, Registration No. 22-26050, filed with the Commission on January 23, 1989, which is incorporated herein by reference.

(3) Reference is made to the correspondingly numbered Exhibit to the

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Company's Annual Report on Form 10-KSB for the Fiscal Year Ended September 30, 2001, which Exhibit is incorporated herein by reference.

(4) Reference is made to the correspondingly numbered Exhibit to the Company's Annual Report on Form 10-KSB for the Fiscal Year Ended September 30, 2002, which Exhibit is incorporated herein by reference.

(5) Reference is made to the correspondingly numbered Exhibit to the Company's Annual Report on Form 10-KSB for the Fiscal Year Ended September 30, 2003 which Exhibit is incorporated herein by reference.

(b) Reports on Form 8-K

none

### Item 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this Item is incorporated by reference from our definitive Proxy Statement for the 2005 Annual Meeting of Stockholders.

### SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Company has duly caused this Report to be signed on its behalf by the undersigned, hereunto duly authorized.

SYNERGX SYSTEMS INC.  
(Registrant)  
By: /s/ Daniel S. Tamkin  
Daniel S. Tamkin,  
Chief Executive Officer and Director

Dated: December 16, 2004

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the Company and in the capacities and on the dates indicated.

SIGNATURE	TITLE	DATE
/s/ Daniel S. Tamkin Daniel S. Tamkin	Chairman, Chief Executive Officer and Director	December 16, 2004
/s/ Joseph Vitale Joseph Vitale	President, Chief Operating Officer and Director	December 16, 2004
/s/ John A. Poserina ----- John A. Poserina	Chief Financial Officer (Principal Accounting and Financial Officer), Secretary, and Director	December 16, 2004
/s/ Henry Schnurbach ----- Henry Schnurbach	Director	December 16, 2004
/s/ Dennis P. McConnell ----- Dennis P. McConnell	Director	December 16, 2004



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Prepaid expenses and other current assets	278,000
	-----
TOTAL CURRENT ASSETS	10,522,000
	-----
PROPERTY AND EQUIPMENT -at cost, less accumulated depreciation and amortization of \$1,499,000	509,000
OTHER ASSETS	678,000
	-----
TOTAL ASSETS	\$11,709,000
	=====

See accompanying Notes to the Consolidated Financial Statements

SYNERGX SYSTEMS INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEET

SEPTEMBER 30, 2004

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES

Notes and capital leases payable - current portion	\$ 47,000
Accounts payable and accrued expenses	2,507,000
Deferred revenue	506,000
	-----
TOTAL CURRENT LIABILITIES	3,060,000

Note payable to bank	1,916,000
Notes and capital leases payable - less current portion	20,000
Deferred taxes	65,000
	-----
TOTAL LIABILITIES	5,061,000
	-----

COMMITMENTS AND CONTINGENCIES

STOCKHOLDERS' EQUITY

Preferred stock, 2,000,000 shares authorized- none issued and outstanding	-
Common stock, 10,000,000 shares authorized, \$.001 par value; issued and outstanding 5,136,862 shares	5,000
Capital in excess of par	6,732,000
Accumulated deficit	(89,000)
	-----
TOTAL STOCKHOLDERS' EQUITY	6,648,000
	-----
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 11,709,000
	=====

See accompanying Notes to the Consolidated Financial Statements

SYNERGX SYSTEMS INC. AND SUBSIDIARIES

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## CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Year Ended September 30,	
	2004	2003
	-----	-----
Product sales	\$16,719,000	\$14,720,000
Subcontract sales	590,000	643,000
Service revenue	4,481,000	4,451,000
	-----	-----
Total revenues	21,790,000	19,814,000
	-----	-----
Cost of product sales	11,090,000	9,639,000
Cost of subcontract sales	484,000	527,000
Cost of service	3,189,000	3,154,000
Selling, general and administrative	5,989,000	5,729,000
Interest expense	87,000	64,000
Depreciation and amortization	171,000	154,000
Loss on equity investment	52,000	35,000
	-----	-----
	21,062,000	19,302,000
	-----	-----
Income before provision for income taxes	728,000	512,000
	-----	-----
Provision for income taxes:		
Current	225,000	180,000
Deferred	83,000	50,000
	-----	-----
	308,000	230,000
	-----	-----
Net Income	\$ 420,000	\$ 282,000
	=====	=====
Earnings Per Common Share		
Basic Earnings Per Share	\$ 0.09	\$ 0.07
	=====	=====
Diluted Earnings Per Share	\$ 0.09	\$ 0.06
	=====	=====
Weighted average number of common shares outstanding	4,671,701	3,850,811
Weighted average number of common and dilutive common share equivalents outstanding	4,912,203	4,433,735

See accompanying Notes to the Consolidated Financial Statements

SYNERGX SYSTEMS INC. and SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDER'S EQUITY

FOR THE YEARS ENDED SEPTEMBER 30, 2004 and 2003

TOTAL  
STOCKHOLDERS'

COMMON STOCK

CAPITAL  
IN EXCESS



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	EQUITY -----	SHARES -----	AMOUNT -----	OF PAR -----
Balance at October 1, 2002	\$4,734,000	3,748,860	\$ 4,000	\$5,521,000
Issuance of shares from investment in Secure 724	405,000	300,000		405,000
Issuance of warrants for investment in Secure 724	28,000			28,000
Exercise of employee stock options	6,000	12,284		6,000
Tax benefit of stock option exercise	11,000			11,000
Net earnings	282,000			
Balance at September 30, 2003	5,466,000	4,061,144	4,000	5,971,000
Exercise of employee stock options	62,000	115,718		62,000
Exercise of warrants	554,000	960,000	1,000	553,000
Tax benefit of stock option exercise	146,000			146,000
Net earnings	420,000			
Balance at September 30, 2004	=====	=====	=====	=====
	\$6,648,000	5,136,862	\$ 5,000	\$6,732,000

See accompanying Notes to the Consolidated Financial Statements

SYNERGX SYSTEMS INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Year Ended September 2004	2003
	-----	-----
OPERATING ACTIVITIES		
Net income	\$ 420,000	\$ 282,000
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	171,000	154,000
Deferred tax	83,000	49,000
Provision for doubtful accounts	(88,000)	(17,000)
Loss on equity investment	52,000	35,000
Tax benefit from employee stock plans	146,000	6,000
Changes in operating assets and liabilities:		
Accounts receivable	(511,000)	(747,000)
Inventories	(213,000)	(11,000)
Prepaid expenses and other current assets	154,000	85,000
Other assets	(38,000)	(41,000)
Accounts payable and accrued expenses	(566,000)	273,000
Deferred revenue	71,000	(11,000)
NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES	-----	-----
	(319,000)	57,000

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INVESTING ACTIVITIES		
Notes receivable from Secure 724 LP		(143,
Purchases of property and equipment	(232,000)	(164,
NET CASH (USED IN) INVESTING ACTIVITIES	(232,000)	(307,
FINANCING ACTIVITIES		
Principal payments on notes payable and capital lease obligations	(90,000)	(149,
Proceeds from notes payable and capital lease obligations		79,
Payments and proceeds from revolving line of credit - net	660,000	407,
Proceeds from exercise of stock options and warrants	617,000	6,
NET CASH PROVIDED BY FINANCING ACTIVITIES	1,187,000	343,
NET INCREASE IN CASH AND CASH EQUIVALENTS	636,000	93,
Cash and cash equivalents at beginning of period	293,000	200,
Cash and cash equivalents at end of period	\$ 929,000	\$ 293,
SUPPLEMENTAL CASH FLOW INFORMATION:		
Income taxes	\$ 266,000	94,
Interest	\$ 95,000	67,

### SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES:

In the year ended September 30, 2003, Synergx purchased from Nafund Inc. a 24.99% investment in Secure 724 in exchange for 300,000 shares of Common Stock and warrants to purchase 50,000 shares of Common Stock, with an aggregated market value of \$432,500, which is included in OTHER ASSETS (See Note 7)

See accompanying Notes to the Consolidated Financial Statements

### SYNERGX SYSTEMS INC.

#### Notes to Consolidated Financial Statements

#### 1. Summary of Significant Accounting Policies

##### Business

The Company operates in one industry segment: the design, manufacture, distribution, marketing and service of a variety of data communications product and systems with applications in the fire alarm, life safety, transit, security and communications industry. The Company conducts its business principally in the New York Metropolitan area and in Dallas, Texas.

##### Principles of Consolidation

The consolidated financial statements include the accounts of Synergx Systems Inc. and its subsidiaries, all of which are wholly owned (the "Company"). The principal operating subsidiaries are: Casey Systems Inc. ("Casey"), General Sound (Texas) Company ("GenSound"), and Systems Service Technology Corp. ("SST"). Significant intercompany items and transactions have been eliminated in consolidation.

##### Revenue Recognition

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Product sales include sale of systems, which are similar in nature, that involve fire alarm, life safety and security (CCTV and card access), transit (on board systems) and communication (paging, announcement and audio/visual). Product sales represent sales of product along with the integration of technical services at a fixed price under a contract with an electrical contractor or end user customer (building owner or tenant), or customer agent. Product sales are allocated using a constant gross profit percentage over the entire contract, and is recognized, using the percentage-of-completion method of accounting. The Company utilizes a units-of-work performed method to measure progress towards completion of the contract. The effects of changes in contract terms are reflected in the accounting period in which they become known. Contract terms provide for billing schedules that differ from revenue recognition and give rise to costs and estimated profits in excess billings, and billings in excess of costs and estimated profits. Costs and estimated profits in excess of billing were not material at September 30, 2004 and 2003 and have been included in accounts receivable. There was no billing in excess of costs and estimated profits at September 30, 2004 and 2003.

Subcontract sales principally represent revenues related to electrical installation of wiring and piping performed by others for the Company when the Company acts as the prime contractor and sells its products along with electrical installation. Subcontract sales are also recognized during the entire project using the percentage-of-completion method of accounting as electrical installation is performed at the job site.

### Revenue Recognition (continued)

Service revenue from separate maintenance contracts is recognized on a straight-line basis over the terms of the respective contract, which is generally one year. The unearned service revenue from these contracts is included in current liabilities as deferred revenue. Non-contract service revenue is recognized when services are performed.

### Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at September 30, 2004, and reported amounts of revenues and expenses during the fiscal year. Actual results could differ from those estimates.

### Accounts Receivable

Accounts receivable are reported net of an allowance for doubtful accounts. The allowance was determined by management to be adequate based on a periodic review of the status of the individual accounts receivable.

### Inventories

Inventories are priced at the lower of cost (first-in, first-out) or market and consist primarily of raw materials.

### Property and Equipment

Property and equipment are stated at historical cost. Leases meeting the criteria for capitalization are recorded at the present value of future lease payments.

Depreciation and amortization of machinery and equipment and furniture and fixtures are provided primarily by the straight-line method over their estimated

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useful lives. The Company depreciates machinery and equipment over periods of 3 to 10 years and amortizes leasehold improvements and assets acquired under capitalized leases utilizing the straight line method over the life of the lease or their economic useful life, whichever is shorter.

### Other Assets

Other assets consists principally of the 2003 investment in Secure 724 LP which is comprised of notes receivable of \$143,000 and 25% ownership in Secure 724 LP of \$432,500, less the 25% equity in the operating loss of Secure 724 LP of \$87,000. This investment includes the excess of cost over the fair value of the assets acquired on the date of acquisition of \$359,500. (see Note 3 - Investment in Secure 724 LP) Also included in other assets is the excess of cost over the fair value of the assets acquired in the 1990 acquisition of General Sound of approximately \$103,000.

The Company does not amortize goodwill but evaluates whether the carrying value of goodwill has become impaired.

### Advertising Costs

Advertising Costs are expensed as incurred during the year. Advertising Costs for the years ended September 30, 2004 and 2003 amounted to \$25,000 and \$27,000, respectively.

### Research and Development Costs

Research and development costs are expensed as incurred during the year. Research and development costs for the years ended September 30, 2004 and 2003 amounted to \$160,000 and \$155,000, respectively.

### Income Taxes

The Company accounts for income taxes under Statement of Financial Accounting Standards (SFAS) No. 109, "Accounting for Income Taxes". Under SFAS No. 109, the asset and liability method is used to determine deferred tax assets and liabilities based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

### Earnings Per Share

SFAS No. 128 "Earnings Per Share" requires companies to report basic and diluted earnings per share ("EPS") computations. Basic EPS excludes dilution and is based on the weighted-average common shares outstanding and diluted EPS gives effect to potential dilution of securities that could share in the earnings of the Company. Diluted EPS reflects the assumed issuance of shares with respect to the Company's employee stock options, non-employee stock options, and warrants.

### Cash Equivalents

The Company considers all highly liquid investments with maturities of three months or less when purchased to be cash equivalents.

### Concentration of Credit Risk

The Company's operations are located in two large U.S. cities (New York City, New York and Dallas, Texas), each of which is an independent market. The Company grants credit to its customers, principally all of which are general or specialized construction contractors, none of which individually constitutes a significant portion of outstanding receivables. Approximately 84% of such outstanding receivables at September 30, 2004 are due from customers in New

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York. The Company does not require collateral to support financial instruments subject to credit risk.

At September 30, 2004, the Company had cash of approximately \$768,000, that is subject to insured amount limitations.

### Stock Options and Similar Equity Instruments

The Company adopted the disclosure requirements of SFAS No. 123, "Accounting for Stock-Based Compensation," for stock options and similar equity instruments (collectively, "Options") issued to employees; however, the Company will continue to apply the intrinsic value based method of accounting for options issued to employees prescribed by Accounting Principles Board ("APB") Opinion 25, "Accounting for Stock Issues to Employees," rather than the fair value based method of accounting prescribed by SFAS No. 123. SFAS No. 123 also applies to transactions in which an entity issues its equity instruments to acquire goods or services from non-employees. Those transactions must be accounted for based on the fair value of the consideration received or the fair value of the equity instruments issued, whichever is more reliably measured.

On December 31, 2002, the FASB issued SFAS No. 148 ("SFAS 148"), Accounting for Stock-Based Compensation-Transition and disclosure. SFAS 148 amends SFAS No. 123, to provide an alternative method of transition to SFAS 123's fair value method of accounting for stock based employee compensation. SFAS 148 also amends the disclosure provisions of SFAS 123 and Accounting Principles Board ("APB") Opinion No. 28, "Interim Financial Reporting", to require disclosure in the summary of significant accounting policies of the effects of an entity's accounting policy with respect to stock based employee compensation on reported net income and earnings per share in annual and interim financial statements. While the statement does not amend SFAS 123 to require companies to account for employee stock options using the fair value method, the disclosure provisions of SFAS 123 are applicable to all companies with stock based employee compensation, regardless of whether they account for that compensation using the fair value method of SFAS 123, or the intrinsic value method of APB Opinion No. 25. The adoption of SFAS 148 did not have an impact on net income or pro forma net income applying fair value method as the Company did not have stock based compensation for the years ended September 30, 2004 and 2003.

## 2. Property and Equipment

Property and equipment (including those arising from capital leases) are summarized as follows:

	September 30, 2004
Machinery and equipment	\$1,770,000
Furniture and fixtures	176,000
Leasehold improvements	62,000
	-----
	2,008,000
Less accumulated depreciation and amortization	1,499,000
	-----
	\$509,000
	=====

Annual amortization of equipment under capital leases is included with depreciation and amortization expense.

Depreciation and amortization expense related to these assets were \$141,000 and

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\$138,000 for the years ended September 30, 2004 and 2003, respectively.

### 3. Investment in Secure 724 L.P.

On May 29, 2003, the Company (through a special purpose Nova Scotia subsidiary) acquired 25% of the equity of Secure 724 LP ("Secure 724 LP"), an Ontario limited partnership, from Nafund Inc. ("Nafund") in consideration of (a) 300,000 shares of Common Stock; (b) warrants to purchase 50,000 shares of Common Stock at \$1.15 per share for 24 months; (c) agreeing to provide secured loans of up to Cdn\$300,000 (which was approximately \$231,000 U.S. at September 30, 2004) to Secure 724 LP pro rata with equity/loans to be provided by Nafund and tied to certain development milestones and (d) 150,000 shares of Common Stock to be issued in the future upon Secure 724 LP satisfying the milestones by a target date. Either the Company and/or Nafund could have elected to provide all or any part of the above funding (regardless of whether the milestones are attained). The milestones were not attained by the target date. Accordingly, there is no further obligation to issue the 150,000 shares of Common Stock.

The 25% investment in Secure 724 L.P. for 300,000 shares of Common Stock and warrants to purchase 50,000 shares of Common Stock was valued at \$432,500. This investment is accounted for utilizing the equity method and is included in OTHER ASSETS. The underlying equity of this investment on the date of the transaction was approximately \$73,000; resulting in goodwill of approximately \$359,500; which will not be amortized but will be tested for impairment. For the years ended September 30, 2004 and 2003, respectively, a \$52,000 and \$35,000 adjustment to the equity investment was recorded to reflect the Company's 25% portion of the net loss of Secure 724 LP.

In connection with initial capital contribution per the partnership agreement, the Company advanced \$18,000 (Cdn\$25,000) to Secure 724 LP in May 2003 and upon reaching milestones advanced \$125,089 (Cdn\$175,000) in August 2003. Subsequent to September 30, 2004 an additional advance of \$8,000 (Cdn\$10,000) was made to Secure 724 LP. These notes receivable bear interest at a rate of 4% and mature in May 2006, August 2006, and October 2007, respectively.

This transaction was submitted to the stockholders of Synergx (as two directors of Synergx are directors of Secure 724 LP) and approved at its Annual Meeting on March 26, 2003.

There can be no assurance that the investment in Secure 724 LP will be profitable.

### 4. Long-Term Debt

On October 9, 2003, the Company entered into a new \$3 million revolving credit facility with Hudson United Bank (the "Credit Facility"). The Credit Facility has an interest rate of prime plus 1/4% on outstanding balances (4.75% at September 30, 2004) and expires in October 2005. The Credit Facility is secured by all assets of the Company and all of its operating subsidiaries. Advances under this Credit Facility are measured against a borrowing base calculated on eligible receivables and inventory.

Initial proceeds from the new Credit Facility were used to pay off a former credit facility with Citizens Business Credit Company. At September 30, 2004, the full amount of the Credit Facility was available under the borrowing base calculation and \$1,916,000 was outstanding under this facility.

The Credit Facility includes certain restrictive covenants, which among other things, impose limitations on declaring or paying dividends, acquisitions, and capital expenditures. The Company is also required to maintain certain financial ratios and tangible net worth covenants. At September 30, 2004 the Company was not in default with any of its financial covenants.

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Annual maturities of Loans and Notes and Capital Leases Payable are as follows:

	Bank Loan	Other Notes and Capital Leases Payable	Total
	-----	-----	-----
2005		\$47,000	\$47,000
2006	\$1,916,000	20,000	1,936,000
	-----	-----	-----
Total	\$1,916,000	\$67,000	\$1,983,000
	=====	=====	=====

### 5. Leases

The Company leases certain office and warehouse space under non cancelable operating leases expiring at various times through 2010. In February 2000, the Company signed a lease for office, manufacturing and warehouse space in Syosset, New York. The rental schedule provides for monthly rent of \$14,000 during the first and second years of the initial term and with 3.3% yearly increases for the third through seventh years. This lease expires in June 2007.

The Company has a lease for its service center in New York City that became effective August 2002 and runs through December 31, 2009. The lease is for office and warehouse space and provides for yearly rental of \$84,000 during the first year plus expenses with yearly escalation of 2% each year thereafter.

The Company leases an office and warehouse facility in Richardson, Texas, a suburb of Dallas, pursuant to a lease that was extended in August 2002 to expire on June 30, 2010 providing for annual rent on a net basis of \$50,000 escalating annually to \$64,000 in the final year of the lease.

The following is a schedule of future minimum payments, by year and in the aggregate, under operating leases with initial or remaining terms of one year or more at September 30, 2004:

	Total Operating Leases
2005	333,000
2006	343,000
2007	300,000
2008	155,000
2009	159,000
2010	73,000
	-----
Total minimum lease payments	\$1,363,000
	=====

Rental expense amounted to \$346,000 and \$314,000 for 2004 and 2003, respectively.

### 6. Significant Customers and Suppliers

During fiscal 2004 and 2003, no customer accounted for more than 10% of sales. One supplier accounted for 9% and 11% of the Company's cost of sales during fiscal 2004 and 2003, respectively.

### 7. Income Taxes

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During the years ended September 30, 2004 and 2003, the Company recorded a tax provision of \$308,000 and \$230,000, respectively. A reconciliation of such provision with the amounts computed by applying the statutory federal income tax rate is as follows:

	Year Ended September 30,	
	2004	2003
Statutory federal income tax rate	34%	34%
Computed expected tax from income	\$247,000	\$174,000
Increase in taxes resulting from:		
State and local income taxes, net of Federal tax benefit	51,000	47,000
Nondeductible expenses	2,000	11,000
Other	8,000	(2,000)
Provision	\$308,000	\$230,000

The Company provided \$12,000 and \$13,000 for state and local franchise and capital taxes for the years ended September 30, 2004 and 2003, respectively. These expenses have been included in selling, general and administrative expenses for each of the years presented.

The Company has recorded a current deferred tax asset and a non current deferred tax liability at September 30, 2004 and 2003 related to certain accelerated tax deductions or book provisions to be deducted in future tax returns. Management anticipates profitable operations to continue at a level that will result in the utilization of the entire deferred tax asset.

The components of deferred tax assets and liabilities at September 30, 2004 and 2003 consist of the following:

	2004	2003
Deferred Tax Assets		
Allowance for doubtful accounts	\$130,000	\$165,000
Inventory reserve	112,000	112,000
Net operating loss carryforward	18,000	18,000
Total deferred tax asset	\$260,000	\$295,000
Deferred Tax Liabilities		
Depreciation and amortization	\$65,000	\$18,000
Total deferred tax liability	\$65,000	\$18,000

### 8. Earnings Per Share

Shown below is a table that presents for 2004 and 2003 the computation of basic earnings per share, diluted earnings per share, weighted shares outstanding, and weighted average shares after potential dilution.

	Year Ended September 30	
	2004	2003
Basic EPS Computation		



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Net income available to common stockholders	\$ 420,000	\$282,000
Weighted average outstanding shares	4,671,701	3,850,811
 Basic earnings per share	 \$.09 ====	 \$.07 ====

### Diluted EPS Computation

Income available to common stockholders	\$ 420,000	\$282,000
Weighted-average shares	4,671,701	3,850,811
Plus: Incremental shares from assumed conversions		
Employee Stock Options	73,872	106,453
Warrants	166,630	476,471
Dilutive common shares	240,502	582,924
	-----	-----
Adjusted weighted-average shares	4,912,203	4,433,735
	-----	-----
Diluted earnings per share	\$.09 ====	\$.06 ====

### 9. Stockholders' Equity

On July 7, 2003, the Company's Board of Directors declared a 2-for-1 stock split of its outstanding stock. The stock split took the form of a dividend whereby the Company issued on July 25, 2003 to each stockholder of record at the close of business on July 18, 2003 one additional share for every share held on that date.

The Company filed a Form S-3 registration statement, which became effective June 27, 2003. The registration statement provided for the registration of the 1,220,000 shares that covered 680,000 shares that were issued in a private placement in 2002 of 340,000 units to an unaffiliated investor for \$.70 per unit (each unit consists of one share of Common Stock and one warrant to purchase an additional share of Common Stock at \$.70 until September 30, 2004), and for 200,000 shares in connection the investment in Secure 724 LP (see footnote 3), and 340,000 shares to two other private investors. The warrants were exercised in August and September 2004 for \$238,000.

The Company filed a Form S-8 registration statement, which became effective July 22, 2003. The registration statement provided for the registration of 404,885 shares issueable under the 1997 Non-Qualified Stock Option Plan.

### 10. Employee Stock Options and Warrants

In March 2004, the Company and its stockholders adopted a nonqualified stock option plan ("2004 Plan"), which will expire March 10, 2009, except as to options outstanding under a prior 1997 Plan. Under the 2004 Plan, the Board of Directors may grant options to eligible employees at exercise prices not less than 100% of the fair market value of the common shares at the time the option is granted. The number of shares of Common Stock that may be issued shall not exceed an aggregate of up to 10% of its issued and outstanding shares from time to time. Options vest at a rate of 20% per year commencing one year after date of grant. Issuances under the 2004 Plan are to be reduced by options outstanding under prior 1997 nonqualified stock option plan.

Transactions involving stock options are summarized as follows:

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	Stock Options Outstanding	Weighted Average Exercise Price of Options Outstanding
Balance September 30, 2002	203,582	.53
Options exercised	(12,284)	.52
	-----	
Balance September 30, 2003	191,298	.52
Options exercised	(115,718)	.54
	-----	
Balance September 30, 2004	75,580	.51

There were 75,580 exercisable options at September 30, 2004 and 178,073 exercisable options at September 30, 2003.

During the years ended September 30, 2004 and 2003 employees exercised stock options to purchase 115,718 and 6,334 shares, of Common Stock, respectively, for a total consideration of \$62,000 and \$14,000, respectively.

The following table summarizes information concerning currently outstanding and exercisable stock options.

Exercise Price	Outstanding at September 30, 2004	Weighted Average Contractual Life	Exercisable at September 30, 2004
-----	-----	-----	-----
.52	42,922	1.3 years	42,922
.50	32,658	1.3 years	32,658

In 1998, the Company granted Genterra Inc. ("Genterra") (formerly Mirtronics, Inc. an Ontario publicly-held corporation) warrants to purchase 620,000 shares of the Company's Common Stock at an exercise price of \$.51 per share at any time until December 31, 2003. In December 2003, Genterra exercised these warrants for \$316,200.

On September 30, 2002, the Company issued 340,000 warrants in connection with a private placement that were exercisable at \$.70 per share of Common Stock until September 30, 2004. (See Note - 9 Stockholders Equity) All of these warrants were exercised in August and September 2004 for \$238,000.

In May 2003, the Company issued 50,000 warrants in connection with its 25% investment in Secure 724 LP. The warrants are exercisable at \$1.15 per share of Common Stock until May 29, 2005. (See Note 3 - Investment in Secure 724 LP)

Transactions involving non-employee stock warrants are summarized as follows:

	Warrants Outstanding	Weighted Average Exercise Price of Warrants Outstanding
Balance September 30, 2002	960,000	.58
Warrants issued	50,000	1.15
	-----	
Balance September 30, 2003	1,010,000	.61
Warrants exercised	(960,000)	.58
	-----	
Balance September 30, 2004	50,000	1.15

All of these warrants were exercisable at the end of the periods indicated in the above schedule.

The following table summarizes information concerning currently outstanding and exercisable non-employee warrants.

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Exercise Price	Outstanding at September 30, 2004	Weighted Average Contractual Life	Exercisable at September 30, 2004
1.15	50,000	.7 years	50,000

### 11. Contingencies

In the normal course of its operations, the Company has been or, from time to time, may be named in legal actions seeking monetary damages. Management does not expect, based upon consultation with legal counsel, that any material item exists that will affect the Company's business or financial condition.

### 12. Other

Approximately 24% of the Company's employees are covered by collective bargaining agreements. On July 20, 2002, the union representing hourly employees and the Company ratified a Collective Bargaining Agreement expiring July 9, 2005, providing for an increase in salaries and benefits averaging approximately 4 1/2% per year over the life of the contract.

Effective January 1, 1996, the Board of Directors instituted a 401K plan for nonunion employees. The plan includes a profit sharing provision at the discretion of the Board of Directors. In September 2004 and 2003, a profit sharing contribution of \$43,000 and \$29,000, respectively, was authorized and charged to expense.

### 13. Fair Value of Financial Instruments

SFAS No. 107, "Disclosures about Fair Values of Financial Instruments", requires disclosing fair value to the extent practicable for financial instruments which are recognized or unrecognized in the balance sheet. The fair value of the financial instruments disclosed herein is not necessarily representative of the amount that could be realized or settled, nor does the fair value amount consider the tax consequences of realization or settlement.

For certain financial instruments, including cash and cash equivalents, trade receivables and payables, and short-term debt, it was assumed that the carrying amount approximated fair value because of the near term maturities of such obligations. The fair value of long-term debt was determined based on current rates at which the Company could borrow funds with similar remaining maturities, which amount approximates its carrying value.

### 14. Report Business Solutions

The Company's Board of Directors approved, in November 2003, to enter into an agreement to organize a new Ontario limited partnership to acquire and operate the business of RePort Business Solutions ("RePort") in partnership with NSC Holdings Inc. ("NSCH") and Nafund Inc. ("Nafund"). The Company has terminated these discussions and will not proceed with the investment.