

SECURITIES AND EXCHANGE COMMISSION

FORM 10-Q/A

Quarterly report pursuant to sections 13 or 15(d) [amend]

Filing Date: 2001-02-02 | Period of Report: 2000-03-31
SEC Accession No. 0000912057-01-003950

(HTML Version on secdatabase.com)

FILER

PROTECTION ONE INC

CIK: 916230 | IRS No.: 931063818 | State of Incorporation: DE | Fiscal Year End: 0930
Type: 10-Q/A | Act: 34 | File No.: 001-12181-01 | Film No.: 1524182
SIC: 7380 Miscellaneous business services

Mailing Address
3900 SW MURRAY BLVD
BEAVERTON OR 97005

Business Address
6011 BRISTOL PARKWAY
CULVER CITY CA 90230
3103386930

PROTECTION ONE ALARM MONITORING INC

CIK: 916310 | IRS No.: 931065479 | State of Incorporation: DE | Fiscal Year End: 0930
Type: 10-Q/A | Act: 34 | File No.: 001-12181 | Film No.: 1524183
SIC: 7380 Miscellaneous business services

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3900 SW MURRAY BLVD
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6011 BRISTOL PARKWAY
CULVER CITY CA 90230
3103386930

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q/A - 2

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

For the quarterly period ended March 31, 2000

or

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

For the transition period from _____ to _____

0-24780

(Commission File Number)

33-73002-01

(Commission File Number)

PROTECTION ONE, INC.

(Exact Name of Registrant
As Specified In Its Charter)

PROTECTION ONE ALARM MONITORING,

INC.

(Exact Name of Registrant
As Specified In Its Charter)

Delaware

(State or Other Jurisdiction
Of Incorporation or Organization)

Delaware

(State or Other Jurisdiction
of Incorporation or Organization)

93-1063818

(I.R.S. Employer Identification No.)

93-1064579

(I.R.S. Employer Identification No.)

6011 Bristol Parkway,

Culver City, California 90230

(Address of Principal Executive Offices,
Including Zip Code)

6011 Bristol Parkway,

Culver City, California 90230

(Address of Principal Executive Offices,
Including Zip Code)

(310) 342-6300

(Registrant's Telephone Number,
Including Area Code)

(310) 342-6300

(Registrant's Telephone Number,
Including Area Code)

Indicate by check mark whether each of the registrants (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that such registrants were required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes /x/ No //

As of May 1, 2000, Protection One, Inc. had outstanding 127,029,361 shares of Common Stock, par value \$0.01 per share. As of such date, Protection One Alarm Monitoring, Inc. had outstanding 110 shares of Common Stock, par value \$0.10 per share, all of which shares were owned by Protection One, Inc. Protection One Alarm Monitoring, Inc. meets the conditions set forth in General Instructions H(1)(a) and (b) for Form 10-Q and is therefore filing this form with the reduced disclosure format set forth therein.

INTRODUCTORY NOTE-RESTATEMENT

Following extensive conversations with the Staff of the SEC which have been previously disclosed, we have restated our Consolidated Financial Statements as of December 31, 1999, 1998 and 1997 and for the years then ended and for each of the three fiscal quarters ended March 31, 2000, June 30, 2000, and September 30, 2000. This restatement primarily relates to the amortization of customer accounts acquired and amounts allocated to obligations assumed in the Westinghouse Security Systems (WSS) acquisition. A description of the adjustments which comprise the restatement is disclosed in Note 2 of the Consolidated Financial Statements filed with this Form 10-Q/A-2.

For the purpose of this Form 10-Q/A-2 we have amended and restated in its entirety the March 31, 2000 Form 10-Q/A. In order to preserve the nature and the character of the disclosures as of the date of the original March 31, 2000 Form 10-Q, no attempt has been made in this Form 10-Q/A-2 to modify or update such disclosures except as required to reflect the results of the restatement.

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PART I

FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PROTECTION ONE, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)

(Unaudited)

	<u>March 31,</u> <u>2000</u>	<u>December 31,</u> <u>1999</u>
	RESTATEMENT NOTE 2	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,612	\$ 7,658
Restricted cash	779	11,175
Marketable securities	-	6,664

Receivables, net	39,495	71,716
Inventories	10,617	12,908
Prepaid expenses	2,420	3,471
Related party tax receivable & current deferred tax assets	42,592	59,456
Other assets	9,210	13,332
	<u> </u>	<u> </u>
Total current assets	106,725	186,380
Property and equipment, net	49,998	60,912
Customer accounts, net	991,911	1,132,095
Goodwill, net	888,878	1,056,671
Other	34,431	76,500
	<u> </u>	<u> </u>
Total assets	\$ 2,071,943	\$ 2,512,558
	<u> </u>	<u> </u>

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:

Current portion of long-term debt	\$ 37,774	\$ 35,498
Accounts payable	5,967	23,205
Accrued liabilities	51,248	74,248
Purchase holdbacks	8,763	20,213
Deferred revenue	52,889	61,149
	<u> </u>	<u> </u>

Total current liabilities	156,641	214,313
Long-term debt, net of current portion	664,962	1,077,152
Other liabilities	597	4,173
	<u> </u>	<u> </u>

Total liabilities	822,200	1,295,638
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Commitments and contingencies (See Note 7)

Stockholders' equity:

Preferred stock, \$0.10 par value, 5,000,000 authorized, none outstanding	–	–
Common stock, \$0.01 par value, 150,000,000 shares authorized, 126,945,337 shares issued and outstanding at March 31, 2000 and December 31, 1999	1,269	1,269
Additional paid-in capital	1,387,056	1,358,978
Accumulated other comprehensive income, net	(99)	(1,805)
Accumulated deficit	(138,483)	(141,522)
	<u> </u>	<u> </u>

Total stockholders' equity	1,249,743	1,216,920
	<u> </u>	<u> </u>

Total liabilities and stockholders' equity	\$ 2,071,943	\$ 2,512,558
	<u> </u>	<u> </u>

The accompanying notes are an integral part of these consolidated financial statements.

PROTECTION ONE, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

(Dollars in thousands, except for per share amounts)
(Unaudited)

	Three Months Ended March 31,	
	2000	1999
	RESTATED NOTE 2	
Revenues:		
Monitoring and related services	\$ 116,171	\$ 127,244
Installation and rental	18,552	21,303
Total revenues	134,723	148,547
Cost of revenues:		
Monitoring and related services	33,762	29,697
Installation and rental	10,110	11,784
Total cost of revenues	43,872	41,481
Gross profit	90,851	107,066
Operating expenses:		
Selling, general and administrative expenses	41,044	40,400
Amortization of intangibles and depreciation expense	61,508	44,403
Acquisition expense	4,362	4,866
Severance and other nonrecurring expense	3,050	2,000
Total operating expenses	109,964	91,669
Operating income (loss)	(19,113)	15,397
Other (income) expense:		
Interest expense, net	19,481	20,171
Other	(282)	(345)
Loss before income taxes & extraordinary gain	(38,312)	(4,429)
Income tax (expense) benefit	9,426	(1,264)
Loss before extraordinary item	(28,886)	(5,693)
Extraordinary gain, net of tax effect of \$17,191	31,926	-
Net income (loss)	\$ 3,040	\$ (5,693)
Other comprehensive income (loss):		
Unrealized loss on marketable securities, net of tax effect of \$633 and \$511	\$ 995	\$ (767)
Unrealized loss on currency translation, net of tax effect of \$474 and \$521	711	(781)
Comprehensive income (loss):	\$ 4,746	\$ (7,241)
Loss per common share	\$ (0.23)	\$ (0.04)
Extraordinary gain per common share	\$ 0.25	\$ -

Net income(loss) per common share	\$	0.02	\$	(0.04)
Weighted average common shares outstanding (in thousands)		126,945		126,839

The accompanying notes are an integral part of these consolidated financial statements.

PROTECTION ONE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)
(Unaudited)

	Three Months Ended	
	March 31,	
	2000	1999
	RESTATED	
	NOTE 2	
Cash flow from operating activities:		
Net income (loss)	\$ 3,040	\$ (5,693)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Extraordinary gain	(31,926)	-
Amortization of intangibles and depreciation	61,508	44,403
Accretion of debt premium	(1,573)	(1,659)
Deferred income taxes	(9,815)	1,271
Provision for doubtful accounts	6,811	3,043
Loss on sale of marketable securities	-	343
Other	(3,520)	(4,817)
Changes in assets and liabilities, net of effects of acquisitions and dispositions:		
Receivables, net	4,256	(1,865)
Other current assets	(10,550)	1,253
Accounts payable	197	380
Other liabilities	(5,082)	(1,991)
Net cash provided by operating activities	13,346	34,668
Cash flows from investing activities:		
Purchase of installed security systems, net	(13,180)	(78,601)
Purchase of property and equipment, net	(5,089)	(12,170)
Sale of investments	-	2,544
Acquisition of alarm companies, net of cash received	-	(20,722)
Sale of European operations and other investments	183,025	-
Net cash provided by (used in) investing activities	164,756	(108,949)
Payments on long-term debt	(212,594)	-

Proceeds from long term-debt	26,087	82,130
Funding from parent	2,414	(222)
	<u> </u>	<u> </u>
Net cash provided by (used in) financing activities	(184,093)	81,908
	<u> </u>	<u> </u>
Effect of exchange rate changes on cash and equivalents	(55)	(964)
	<u> </u>	<u> </u>
Net increase (decrease) in cash and cash equivalents	(6,046)	6,663
Cash and cash equivalents:		
Beginning of period	7,658	10,025
	<u> </u>	<u> </u>
End of period	\$ 1,612	\$ 16,688
	<u> </u>	<u> </u>
Interest paid during the period	\$ 31,244	\$ 13,524
	<u> </u>	<u> </u>
Taxes paid during the period	\$ 72	\$ 256
	<u> </u>	<u> </u>

SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES:

In the first quarter of 2000 the Company sold its European operations for \$225,000 and certain investments for \$19,000 to Westar Capital, as discussed in Note 3. In exchange, the Company received \$183,025 in cash and \$60,975 market value of its outstanding bonds. The Company also received \$14,985 market value of its bonds and a \$14,198 note receivable from Westar Capital for payment of the Company's 1998 income tax receivable of \$20,287 and an intercompany receivable of \$8,896.

The accompanying notes are an integral part of these consolidated financial statements.

PROTECTION ONE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(DOLLAR AMOUNTS IN THOUSANDS)

(Unaudited)

1. Basis of Consolidation and Interim Financial Information:

Protection One, Inc., a Delaware corporation ("Protection One" or the "Company"), is principally engaged in the business of providing security alarm monitoring services, which include sales, installation and related servicing of security alarm systems for residential and small business subscribers in North America, and until February 29, 2000, the United Kingdom and Continental Europe.

Westar Capital, Inc. ("Westar Capital"), a wholly-owned subsidiary of Western Resources, Inc. ("Western Resources"), owns approximately 85% of the Company's common stock. The accompanying unaudited consolidated financial statements include the accounts of Protection One and its wholly owned subsidiaries.

The Company's unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles ("GAAP") for interim financial information and in accordance with the instructions to Form 10-Q. Accordingly, certain information and footnote disclosures normally included in financial statements presented in accordance with generally accepted accounting principles have been condensed or omitted. These financial statements should be read in conjunction with the audited financial statements and notes thereto

for the year ended December 31, 1999, included in the Company's Annual Report on Form 10-K/A-2 filed with the Securities and Exchange Commission (the "SEC").

In the opinion of management of the Company, all adjustments considered necessary for a fair presentation of the financial statements have been included. The results of operations for the three months ended March 31, 2000 are not necessarily indicative of the results to be expected for the full year.

The Company expects to adopt two new statements on January 1, 2001. SFAS No. 133 and No. 137, "Accounting for Derivative Instruments and Hedging Activities" establish accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, (collectively referred to as derivatives) and for hedging activities. The statements require that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measures those instruments at fair value. Changes in the derivative's fair value will be required to be recognized currently in earnings unless specific hedge accounting criteria are met. In addition, the statements will require the Company to formally document, designate and assess the effectiveness of transactions that receive hedge accounting. The Company has not traditionally been required to utilize derivative instruments in managing its business. Therefore, management has not yet determined what, if any, the impact these pronouncements will have upon adoption.

Certain reclassifications have been made to prior year information to conform with the current year presentation.

2. Restatement of Financial Statements:

Following extensive conversations with the staff of the SEC which have previously been disclosed, the Company has restated its Consolidated Financial Statements as of December 31, 1999, 1998 and 1997 and for the years then ended and for each of the three fiscal quarters ended March 31, 2000, June 30, 2000, and September 30, 2000. This restatement primarily relates to the amortization of customer accounts acquired and amounts allocated to obligations assumed in the Westinghouse Security

Systems (WSS) acquisition. A description of the principal adjustments which comprise the restatement is as follows:

The first adjustment reflects a change in the historical amortization expense recorded for customer accounts acquired in the WSS acquisition. The life of the acquired WSS customers was initially estimated at ten years. Straight-line amortization had originally been implemented. With the restatement, an eight-year estimated life and an accelerated amortization method will be used for customers acquired from WSS as of the acquisition date.

The second adjustment reverses a special charge of \$12,750 for excess customer attrition that was recorded in the fourth quarter of 1997. This charge had been recorded for attrition experienced in the WSS customer account base in 1997.

The third adjustment reduces a repurchase obligation (SAMCO contract financing) to more closely match the estimated fair value of the obligation to the estimated fair value of WSS customer accounts on a per account basis. This change in valuation has the effect of reducing the obligation and goodwill and eliminating \$14,837 of a non-recurring \$16,348 pre-tax gain that was reported in 1998 when this obligation was repaid.

The fourth adjustment reduces goodwill as a result of a purchase price adjustment related to the WSS acquisition. Goodwill has been reduced by the amount of the claim made by our parent company of \$33,772. A receivable had not originally been recorded for this claim. The change was made to establish this receivable by our parent which reduces recorded goodwill at the Company. Our parent entered into a comprehensive settlement agreement with Westinghouse in November 2000 and received \$37,500.

A summary of the net effect of the restatement has been reflected in the quarterly results for the three month periods ending March 31 as follows:

As Previously Reported

Restatement

As Restated

<u>Amount</u>	<u>Earnings Per Share</u>	<u>Amount</u>	<u>Earnings Per Share</u>	<u>Amount</u>	<u>Earnings Per Share</u>
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(Dollars in thousands, except for per share amounts)

Loss before extraordinary gain

Quarter Ended:

March 31, 2000	\$ (27,969)	\$ (.22)	\$ (917)	\$ (.01)	\$ (28,886)	\$ (.23)
March 31, 1999	(4,785)	(.04)	(908)	-	(5,693)	(.04)

Net income (loss)

Quarter Ended:

March 31, 2000	\$ 3,957	\$.03	\$ (917)	\$ (.01)	\$ 3,040	\$.02
March 31, 1999	(4,785)	(.04)	(908)	-	(5,693)	(.04)

Prior to this restatement, during the third quarter of 1999 the Company changed its amortization method for its customer account intangible assets from a straight-line to an accelerated method to more closely match future amortization cost with the estimated revenue stream from these assets. The effect of the change in accounting principle increased amortization expense reported in the third

quarter of 1999 by \$47,000. The change in the WSS customer account amortization method restates the results of 1997, 1998 and 1999 and thereby reduces the cumulative charge recorded in the third quarter of 1999.

See the Company's Form 10-Q/A for the quarter ended September 30, 2000 for a more detailed breakdown of the restatement items for the quarterly periods restated in 2000.

3. Change in Accounting Estimate:

The excess of the cost over the fair value of net assets of businesses acquired is recorded as goodwill. The Company has historically amortized goodwill on a straight-line basis over 40 years. The Company re-evaluated the original assumptions and rationale utilized in the establishment of the carrying value and estimated useful life of goodwill. The Company concluded that due to continued losses and increased levels of attrition experienced in 1999, the estimated useful life of goodwill should be reduced from 40 years to 20 years. As of January 1, 2000, the remaining goodwill, net of accumulated amortization, is being amortized over its remaining useful life based on a 20-year life. The resulting increase in annual goodwill amortization on the Company's existing account base will be approximately \$23,000 for North America and \$6,000 for Multifamily. The additional goodwill recorded for Europe prior to its sale on February 29, 2000 was approximately \$1,000.

The change in estimate resulted in additional goodwill amortization for the first quarter of 2000 of \$7,613. The resulting reduction to net income was \$6,833 or a decrease in earnings per share of \$0.05.

Amortization expense for the three months ended March 31, 2000 and March 31, 1999, was \$14,239 and \$8,165, respectively.

4. Related Party Sale and Amendment to Revolving Credit Agreement:

On February 29, 2000 the Company sold its European operations and certain investments to Westar Capital. The consideration received was approximately \$244,000, comprised of approximately \$183,025 in cash and certain of the Company's outstanding debt securities Westar Capital had acquired in open market purchases for approximately \$60,975. As part of the agreement, Westar Capital agreed to pay Protection One a portion of the net gain, if any, on a subsequent sale of the business on a declining basis over the four years following the closing. The cash proceeds of the sale were used to reduce the \$240,000 outstanding balance under the \$250,000 Senior Credit Facility between the Company and Westar Capital.

Concurrently, the Senior Credit Facility was amended to, among other things, (1) reduce the commitment to \$115,000 (resulting in availability of approximately \$58,000 after the sale of the European operations), (2) increase the leverage ratio covenant to 5.75 to 1.0,

(3) reduce the interest coverage ratio to 2.10 to 1.0, (4) change the termination date to January 2, 2001, (5) change the loan pricing grid to one based on leverage ratio rather than credit rating, (6) allow for the inclusion of certain add-backs to the calculation of EBITDA, (7) eliminate as an Event of Default Western Resources' failure to own more than 50% of the Company, (8) waive compliance with the leverage ratio and interest coverage ratio covenants for the fiscal quarters ended September 30, 1999 and

December 31, 1999, and (9) provide for an increase in the amount of the commitment by up to \$40,000 for the purpose of consummating acquisitions approved by Westar Capital.

Westar Capital also transferred to Protection One certain outstanding debt securities of the Company and a note for payment of certain intercompany amounts owed by Westar Capital to the Company. In March 2000, the note with Westar Capital was reduced by \$9,304 through delivery of additional outstanding debt securities of the Company.

The carrying amount for the respective debt securities received for the above transactions were as follows:

Debt Security (Interest Rate)	February 29 Transaction	March Transactions	Total
Senior Subordinated Discount Notes (13.625%)	\$ 38,892	\$ 4,832	\$ 43,724
Convertible Senior Subordinated Notes (6.75%)	49,550	-	49,550
Senior Subordinated Notes (8.125%)	46,110	10,000	56,110
Totals	\$ 134,552	\$ 14,832	\$ 149,384

No gain or loss was recognized on the related party sale of the European operations. Adjustments were made to Additional Paid-In Capital to reflect the amounts that would have been considered gains or losses had the buyer not been a related party. The transactions were approved by the independent directors of the Protection One and Monitoring Boards of Directors upon the recommendation of a special committee of the Protection One Board of Directors. The special committee obtained a "fairness opinion" from an investment banker with regard to the sale of the European operations.

Pro Forma Financial Information:

The following unaudited pro forma consolidated results of operations for the quarters ended March 31, 2000 and March 31, 1999 assume the sale of the European operations occurred on January 1, 1999.

	Quarter Ended	
	March 31,	
	2000	1999
	(in thousands, except per share amounts)	
	RESTATED	
	NOTE 2	
Revenues	\$ 106,818	\$ 109,014
Loss before extraordinary item	(25,043)	(4,643)
Net income (loss)	6,883	(4,643)
Net income (loss) per common share (basic and diluted):		
Loss before extraordinary item	(.20)	(.04)
Net income (loss)	.05	(.04)

The pro forma financial information is not necessarily indicative of the results of operations had the sale of the European operations to Westar Capital been reflected for the entire period, nor do they purport to be indicative of results which will be obtained in the future.

The following unaudited proforma consolidated assets and liabilities as of December 31, 1999 assume the sale occurred on December 31, 1999.

	<u>December 31, 1999</u>
	(in thousands)
	RESTATED
	NOTE 2
Total assets	\$ 2,201,802
Total liabilities	1,078,570

5. Customer Accounts:

The following reflects the changes in the Company's investment in customer accounts (at cost) for the following periods:

	Three Months Ended <u>March 31, 2000</u>	Year Ended <u>December 31, 1999</u>
	RESTATED	
	NOTE 2	
Beginning customer accounts, net	\$ 1,132,095	\$ 1,022,863
Acquisition of customer accounts, net	7,930	333,195
Amortization of customer accounts, net	(38,946)	(187,092)
Non-cash charges to purchase holdbacks	(1,362)	(36,871)
Sale of European operations	(107,806)	-
Total customer accounts	<u>\$ 991,911</u>	<u>\$ 1,132,095</u>

Accumulated amortization of the investment in customer accounts at March 31, 2000 and December 31, 1999 was \$339,378 and \$328,787 respectively. The 1999 accumulated amortization excluding Europe was \$303,586.

In conjunction with certain purchases of customer accounts, the Company withholds a portion of the purchase price as a reserve to offset qualifying losses of the acquired customer accounts for a specified period as provided for in the purchase agreements, and as a reserve for purchase price settlements of assets acquired and liabilities assumed. The estimated amount to be paid at the end of the holdback period is capitalized and an equivalent current liability established at the time of purchase. As of March 31, 2000 and December 31, 1999, purchase holdbacks were \$8,763 and \$20,213, respectively.

6. Debt:

During the first quarter of 2000 the Company's outstanding debt decreased by \$407,689. The decrease resulted primarily from the \$183,025 reduction of the Senior Credit Facility and the

extinguishment of debt securities received in the sale of the European operations and related party transactions, as discussed in Note 3. In March 2000, the Company used available cash to pay down an additional \$20,000 of the Senior Credit Facility and also purchased an additional \$6,000 face value of the Senior Subordinated Discount Notes. The total first quarter extraordinary gain from this extinguishment of debt and the extinguishment of the debt securities received in the transactions with Westar Capital is \$31,926, net of tax of \$17,191.

As of March 31, 2000, and December 31, 1999, total borrowings under the Senior Credit Facility were \$37,000 and \$225,000, respectively. The remaining availability under this facility as of March 31, 2000, and December 31, 1999 was \$78,000 and \$25,000, respectively. The Company's ability to borrow under the facility is subject to compliance with certain financial covenants, including a leverage ratio of 5.75 to 1.0 and an interest coverage ratio of 2.10 to 1.0. At March 31, 2000, these ratios were approximately 4.4 to 1.0 and 2.7 to 1.0, respectively.

The indentures governing the Company's outstanding senior and subordinated notes contain similar covenants with different calculations relating to the Company's ability to incur indebtedness. The Company is in compliance with all covenants contained in these indentures.

7. Commitments and Contingencies:

The Company, its subsidiary Protection One Alarm Monitoring, Inc. ("Monitoring"), and certain present and former officers and directors of Protection One are defendants in a purported class action litigation pending in the United States District Court for the Central District of California, *Ronald Cats, et al v. Protection One, Inc., et al.*, No CV 99-3755 DT (RCx). Pursuant to an Order dated August 2, 1999, four pending purported class actions were consolidated into a single action. In March 2000, plaintiffs filed a Second Consolidated Amended Class Action Complaint ("Amended Complaint"). Plaintiffs purport to bring the action on behalf of a class consisting of all purchasers of publicly traded securities of Protection One, including common stock and notes, during the period of February 10, 1998 through November 12, 1999. The Amended Complaint asserts claims under Section 11 of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 against Protection One, Monitoring, and certain present and former officers and directors of Protection One based on allegations that various statements concerning Protection One's financial results and operations for 1997 and 1998 were false and misleading and not in compliance with generally accepted accounting principles. Plaintiffs allege, among other things, that former employees of Protection One have reported that Protection One lacked adequate internal accounting controls and that certain accounting information was unsupported or manipulated by management in order to avoid disclosure of accurate information. The Amended Complaint further asserts claims against Western Resources and Westar Capital as controlling persons under Sections 11 and 15 of the Securities Act of 1933 and Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. A claim is also asserted under Section 11 of the Securities Act of 1933 against Protection One's auditor, Arthur Andersen LLP. The Amended Complaint seeks an unspecified amount of compensatory damages and an award of fees and expenses, including attorneys' fees. The Company believes that all the claims asserted in the Amended Complaint are without merit and intends to defend against them vigorously. We cannot currently predict the impact of this litigation which could be material.

Six Protection One dealers have filed a class action lawsuit in the U. S. District Court for the Western District of Kentucky alleging breach of contract because of the Company's interpretation of their dealer contracts. The action is styled *Total Security Solutions, Inc., et al. v. Protection One Alarm Monitoring, Inc.*, Civil Action No. 3:99CV-326-H (filed May 21, 1999). In September 1999, the Court granted Protection One's motion to stay the proceeding pending the individual plaintiff's pursuit of arbitration as required by the terms of their agreements. As of May 1, 2000, none of these dealers have commenced arbitration.

Other Protection One dealers have threatened litigation or arbitration based upon a variety of theories surrounding calculations of holdback and other payments. The Company believes it has complied with the terms of these contracts and intends to vigorously defend its position. Although the Company believes that no individual such claim will have a material adverse effect, the Company cannot currently predict the aggregate impact of these disputes with dealers which could be material.

The Company is a party to claims and matters of litigation incidental to the normal course of its business. The ultimate outcome of such matters cannot presently be determined; however, in the opinion of management of the Company, the resolution of such matters will not have a material adverse effect upon the Company's consolidated financial position or results of operations.

Under the Company's agreements with dealers, the Company may be required to purchase customer accounts on an ongoing basis. The Company is currently spending less than \$5,000 per month to purchase these customer accounts.

8. Segment Reporting:

The Company's reportable segments include North America, Multifamily and Europe. North America provides residential, commercial and wholesale security alarm monitoring services, which include sales, installation and related servicing of security alarm systems in the United States and Canada. Multifamily provides security alarm services to apartments, condominiums and other multi-family dwellings. The Europe segment provided security alarm services to residential and business customers in Europe.

The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies in the Company's 1999 Form 10-K/A-2. The Company manages its business segments based on earnings before interest, income taxes, depreciation and amortization (EBITDA).

Three Months Ended March 31, 2000

(Dollars in thousands)

RESTATED

NOTE 2

	North America	Multifamily	Europe(2)	Consolidated
Revenues	\$ 96,678	\$ 10,141	\$ 27,904	\$ 134,723
EBITDA	34,923	4,122	6,400	45,445
Amortization of intangibles and depreciation expense	52,254	3,834	5,420	61,508
Other(1)	3,050	-	-	3,050
Operating income (loss)	(20,381)	288	980	(19,113)

Three Months Ended March 31, 1999

(Dollars in thousands)

RESTATED

NOTE 2

	North America	Multifamily	Europe	Consolidated
Revenues	\$ 99,017	\$ 9,996	\$ 39,534	\$ 148,547
EBITDA	45,015	4,598	12,187	61,800
Amortization of intangibles and depreciation expense	36,620	2,297	5,486	44,403
Other(1)	2,000	-	-	2,000
Operating income	6,395	2,301	6,701	15,397

(1)

"Other" includes employee severance in 1999, and employee severance and costs related to the sale of the European operations in 2000.

(2)

Information for Europe is for the two months ended February 29, 2000.

9. Related Party Transactions:

In the first quarter, the Company expensed \$1,087 for marketing services provided under the marketing agreement it has with Paradigm Direct LLC ("Paradigm"). Westar Capital has a 40% ownership interest in Paradigm. During the first quarter, the Company began acquiring new accounts under the Paradigm pilot program which is anticipated to be extended through June 30, 2000. At March 31, 2000, the Company has a prepaid balance with Paradigm of approximately \$1,018 for anticipated account purchases.

During the first quarter of 2000, the Company incurred charges of approximately \$738 for services under the services agreement with Western Resources.

At March 31, 2000, the Company had a note receivable from Westar Capital of \$4,895, related accrued interest income of \$103 and a net intercompany balance owed to Western Capital of \$1,747 primarily for intercompany billings for services provided under the services agreement.

At March 31, 2000, the Company had outstanding borrowings of \$37,000 from the Senior Credit Facility held by Westar Capital. During the first quarter of 2000, interest expense of \$3,473 was accrued on borrowings from this facility and total interest payments of \$4,223 were made to Westar Capital.

10. Income Taxes:

The income tax benefit recorded for the three-month period ended March 31, 2000 is approximately 25% of the pre-tax loss. This rate represents the expected effective rate for 2000. The difference between the expected annual effective rate of 25% and the federal statutory rate of 35% is primarily attributable to non-deductible goodwill amortization. The Company has a tax sharing agreement with Western Resources which allows it to be reimbursed for tax deductions utilized by Western Resources in its consolidated tax return. If the Company did not file its taxes on a consolidated basis with Western Resources, the Company's deferred tax assets might not be realizable and the Company might not be in a position to record a tax benefit for losses incurred.

11. Unrealized Gains and Losses:

The following reflects the changes in unrealized gains and losses in marketable securities and in currency fluctuations for the quarter ended March 31, 2000:

Unrealized loss on marketable securities	\$ (1,202)
Less: reclassification adjustment for losses included in sale of European operations	(2,830)
Net unrealized gain	\$ 1,628
Unrealized loss on currency translation	\$ (1,236)
Less: reclassification adjustment for losses included in sale of European operations	(2,421)
Net unrealized gain	\$ 1,185

12. Recent Developments:

On March 29, 2000, Western Resources announced that its Board of Directors had approved the separation of its electric utility business from its non-electric businesses. Western Resources indicated that the separation is expected to be accomplished by means of a voluntary exchange offer. The exchange offer will provide Western Resources shareholders with the opportunity to exchange some or all of their Western Resources common stock for shares in Westar Capital. Western Resources also indicated that Westar Capital is expected to consist of

the approximate 85% ownership interest in the Company, an approximate 45% ownership interest in ONEOK Inc., a Tulsa-based natural gas company, a 100% ownership interest in Protection One Europe (formerly the Europe segment of the Company), and a 40% ownership in Paradigm Direct LLC, and other investments.

The Western Resources announcement indicates that Westar Capital expects to make a partial disposition of its interest in the Company through the issuance of \$15,000 in preferred stock to a third party.

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

FORWARD-LOOKING STATEMENTS

Certain matters discussed here and elsewhere in this Form 10-Q/A-2 are forward-looking statements. The Private Securities Litigation Reform Act of 1995 has established that these statements qualify for safe harbors from liability. Forward-looking statements may include words like the Company believes, anticipates, expects or words of similar meaning. Forward-looking statements describe the Company's future plans, objectives, expectations, or goals. Such statements address future events and conditions concerning capital expenditures, earnings, restructuring the dealer program and the methods of customer acquisition, litigation, possible corporate restructurings, mergers, acquisitions, dispositions, liquidity and capital resources, compliance with debt covenants, interest, ability to enter new markets successfully and capitalize on growth opportunities, and accounting matters. What happens in each case could vary materially from what the Company expects because of such things as future economic conditions; legislative developments; competitive markets; and other circumstances affecting anticipated operations, revenues and costs.

Unless the context otherwise indicates, all references in this Report on Form 10-Q/A-2 (this "Report") to the "Company," "Protection One," "we," "us" or "our" or similar words are to Protection One, Inc., its wholly owned subsidiary, Protection One Alarm Monitoring, Inc. ("Protection One Alarm Monitoring") and Protection One's other wholly owned subsidiaries. Protection One's primary asset is, and Protection One operates primarily through, its investments in Protection One Alarm Monitoring and its other wholly owned subsidiaries. Both Protection One and Protection One Alarm Monitoring are Delaware corporations organized in September 1991.

The following Management's Discussion and Analysis of Financial Condition and Results of Operations updates the information provided in and should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations in our 1999 Annual Report on Form 10-K/A-2.

Overview

Protection One is one of the leading providers of property monitoring services, providing electronic monitoring and maintenance of its alarm systems to nearly 1.5 million customers in North America. We also provide our customers with enhanced services that include:

extended service protection;

patrol and alarm response;

two-way voice communication;

medical information service; and

cellular back-up.

Approximately 85% of our revenues are contractually recurring for monitoring alarm security systems and other related services.

Our principal activity is responding to the security and safety needs of our customers. Our revenues are generated primarily from recurring monthly payments for monitoring and servicing the alarm systems that are installed in our customers' homes and businesses. Security systems are designed to detect burglaries, fires and other events. Through a network of 57 service branches and 13 satellite offices we provide repair service of security systems and, in certain markets, armed response to verify that an actual emergency has occurred.

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We provide our services to residential (both single family and multifamily residences), commercial and wholesale customers. In prior years, the Company's strategy was focused primarily on growing its customer account base to achieve critical mass. We believe we have reached such critical mass and our strategic focus has now shifted to the following areas:

improving customer service;

reducing attrition;

reducing customer acquisition costs, and diversifying our customer acquisition strategy to include dealers, internal sales, tuck-in acquisitions and direct marketing;

integrating and building infrastructure such as common platforms for our central stations, billing, and other applications;

enhancing revenues and margins by offering additional services to new and existing customers;

establishing name recognition by targeting our growth to areas near existing branches to increase customer density; and

growing our commercial business.

Our company is divided into two business segments:

Protection One North America ("North America") generated approximately \$96.7 million, or 71.8%, of our revenues in the first quarter of 2000 and is comprised of Protection One Alarm Monitoring-our core alarm monitoring business based in Culver City, California.

Multifamily generated approximately \$10.1 million, or 7.5%, of our revenues in the first quarter of 2000 and is comprised of our alarm monitoring business servicing the multifamily/apartment market based in Addison, Texas.

On February 29, 2000 we sold Protection One Europe ("Europe") which generated approximately \$27.9 million of revenues through February 29, 2000. Europe was comprised of:

Protection One Continental Europe—an alarm monitoring business servicing continental Europe established from our purchase of Compagnie Europeenne de Telesecurite ("CET") in September 1998, based in Paris and Vitrolles, France with offices in Germany, Switzerland, Belgium and the Netherlands; and

Protection One United Kingdom—an alarm monitoring business servicing the United Kingdom established from our purchase of Hambro Countrywide Security in May 1998, based in Basingstoke, United Kingdom.

Sale of European Assets and Other Transactions

On February 29, 2000 the Company sold its European operations and certain investments to Westar Capital. The consideration received was approximately \$244 million, comprised of approximately \$183 million in cash and certain of the Company's outstanding debt securities Westar Capital had acquired in open market purchases for approximately \$61 million. As part of the agreement, Westar Capital agreed to pay Protection One a portion of the net gain, if any, on a subsequent sale of the business on a declining basis over the four years following the closing. The cash proceeds of the sale were used to reduce the \$240 million outstanding balance under the \$250 million Senior Credit Facility between the Company and Westar Capital.

Concurrently, the Senior Credit Facility was amended to, among other things, (1) reduce the commitment to \$115 million (resulting in availability of approximately \$58 million after the sale of the European operations), (2) increase the leverage ratio covenant to 5.75 to 1.0, (3) reduce the interest

coverage ratio to 2.10 to 1.0, (4) change the termination date to January 2, 2001, (5) change the loan pricing grid to one based on leverage ratio rather than credit rating, (6) allow for the inclusion of certain add-backs to the calculation of EBITDA, (7) eliminate as an Event of Default Western Resources' failure to own more than 50% of the Company, (8) waive compliance with the leverage ratio and interest coverage ratio covenants for the fiscal quarters ended September 30, 1999 and December 31, 1999, and (9) provide for an increase in the amount of the commitment by up to \$40 million for the purpose of consummating acquisitions approved by Westar Capital.

Westar Capital also transferred to Protection One certain outstanding debt securities of the Company and a note for payment of certain intercompany amounts owed by Westar Capital to the Company. In March 2000, the note with Westar Capital was reduced by \$9.3 million through the delivery of additional outstanding debt securities of the Company.

The carrying amount for the respective debt securities received for the above transactions were as follows:

Debt Security (Interest Rate)	February 29 Transaction	March Transactions	Total
	(in thousands)		
Senior Subordinated Discount Notes (13.625%)	\$ 38,892	\$ 4,832	\$ 43,724
Convertible Senior Subordinated Notes (6.75%)	49,550	–	49,550
Senior Subordinated Notes (8.125%)	46,110	10,000	56,110

Totals \$ 134,552 \$ 14,832 \$ 149,384

No gain or loss was recognized on the related party sale of the European operations. Adjustments were made to Additional Paid-In Capital to reflect the amounts that would have been considered gains or losses had the buyer not been a related party. The transactions were approved by the independent directors of the Protection One and Monitoring Boards of Directors upon the recommendation of a special committee of the Protection One Board of Directors. The special committee obtained a "fairness opinion" from an investment banker with regard to the sale of the European operations.

Change in Estimate of Useful Life of Goodwill

We re-evaluated the original assumptions and rationale utilized in the establishment of the carrying value and estimated useful life of goodwill. Management concluded that due to continued losses and increased levels of attrition experienced in 1999, the estimated useful life of goodwill should be reduced from 40 years to 20 years. As of January 1, 2000, the remaining goodwill, net of accumulated amortization, will be amortized over its remaining useful life based on a 20-year life. On our existing account base, we anticipate that this will result in an increase in annual goodwill amortization of approximately \$23 million for North America and \$6 million for Multifamily. The additional goodwill recorded for Europe prior to its sale on February 29, 2000 was approximately \$1 million.

Attrition

Subscriber attrition has a direct impact on our results of operations since it affects both our revenues and amortization expense. We define attrition as a ratio, the numerator of which is the number of lost customer accounts for a given period, net of certain adjustments, and the denominator of which is the average number of accounts for a given period. In some instances, we use estimates to derive attrition data. The adjustments made to lost accounts are primarily related to those accounts which are covered under a purchase price holdback and are "put" back to the seller. We reduce the gross accounts lost during a period by the amount of the guarantee provided for in the purchase agreements with sellers. In some cases, the amount of the purchase holdback may be less than actual attrition experience.

Our actual attrition experience shows that the relationship period with any individual customer can vary significantly and may be substantially shorter or longer than ten years. Customers discontinue service with us for a variety of reasons, including relocation, service issues and cost. A portion of the acquired customer base can be expected to discontinue service every year. Any significant change in the pattern of our historical attrition experience would have a material effect on our results of operations.

We monitor attrition each quarter based on an annualized and trailing twelve-month basis. This method utilizes each segment's average customer account base for the applicable period in measuring attrition. Therefore, in periods of customer account growth, customer attrition may be understated and in periods of customer account decline, customer attrition may be overstated. When appropriate, we will adjust amortization of the cost of customer accounts.

Customer attrition by business segment for the three months ended March 31, 2000 and 1999 is summarized below:

	Customer Account Attrition			
	March 31, 2000		March 31, 1999	
	Annualized	Trailing	Annualized	Trailing
	First Quarter	Twelve	First	Twelve
		Month	Quarter	Month
North America	11.9%	16.1%	11.2%	8.9%
Europe(a)	10.9%	10.2%	4.4%	(c)
Multifamily	7.9%	8.3%	4.9%	4.5%
Total Company(b)	11.1%	14.3%	10.0%	8.1%

- (a) Europe represents annualized activity through February 29, 2000.
- (b) Does not include Europe.
- (c) European operations were acquired in 1998 and disposed of on February 29, 2000.

The Company experienced high levels of attrition for the North America segment in 1999 with quarterly annualized attrition reaching peak levels of 19.1% and 16.3% in the third and fourth quarters, respectively. The quarterly annualized attrition rate for North America in the first quarter of 2000 was 11.9% as compared to 11.2% in the first quarter of 1999. Management believes the significant decrease in attrition for North America over the last three quarters is a result of efforts to improve customer service and collections of outstanding accounts. The increase in attrition for Multifamily is partly due to an adjustment to the calculation of attrition for certain accounts related to businesses acquired by Multifamily in 1998.

Dealer Program

The number of accounts being purchased through the dealer program has decreased significantly from over 25,000 in March 1999 to less than 2,500 in March 2000. While our previous customer acquisition strategy relied primarily on the dealer program, our new customer acquisition strategy relies on a more balanced mix of dealers, internal sales, "tuck-in" acquisitions and direct marketing. In February 2000, we started a commission only internal sales program, with a goal of acquiring accounts at a cost lower than our external programs. This program utilizes our existing branch infrastructure in 11 markets. We have therefore decreased our reliance on account generation through the dealer program.

Three Months Ended March 31, 2000 Compared to Three Months Ended March 31, 1999

We separate our business into three reportable segments: North America, Multifamily, and through February 29, 2000, Europe. North America provides security alarm monitoring services, which include

sales, installation and related servicing of security alarm systems in the United States and Canada. Multifamily provides security alarm services to apartments, condominiums and other multi-family dwellings. The Europe segment provided security alarm services in Europe and was sold on February 29, 2000.

North America Segment

We present the table below for comparison of the North America operating results for the periods presented. Next to each period's results of operations, we provide the relevant percentage of total revenues so that you can make comparisons about the relative change in revenues and expenses.

	Three Months Ended March 31,	
	2000	1999
	(dollars in thousands)	
	RESTATED	
Revenues:		
Monitoring and related services	\$ 93,167	96.4%
	\$ 95,247	96.2%

Installation and rental	3,511	3.6	3,770	3.8
Total revenues	96,678	100.0	99,017	100.0
Cost of revenues:				
Monitoring and related services	28,125	29.1	23,833	24.1
Installation and rental	3,224	3.3	3,561	3.6
Total cost of revenues	31,349	32.4	27,394	27.7
Gross profit	65,329	67.6	71,623	72.3
Selling, general and administrative expenses	26,261	27.2	21,889	22.1
Acquisition and transition expense	4,145	4.3	4,719	4.8
Amortization of intangibles and depreciation expense	52,254	54.1	36,620	37.0
Other charges	3,050	3.1	2,000	2.0
Operating income (loss)	\$ (20,381)	(21.1)%	\$ 6,395	6.4%

2000 Compared to 1999. We had a net decrease of 26,246 customers in the first quarter of 2000 as compared to a net increase of 32,367 customers in the first quarter of 1999. The average customer base for the first quarters of 2000 and 1999 were 1,191,519 and 1,212,231, respectively, or a decrease of 20,712 customers. The decrease in customers is primarily attributable to the significant decrease in the number of accounts being purchased from dealers which has not yet been offset by growth from our other customer acquisition strategies.

	Three Months Ended March 31,	
	2000	1999
Beginning Balance, January 1,	1,204,642	1,196,047
Additions, net of holdback put backs	9,280	66,269
Customer losses, net of holdback put backs	(35,526)	(33,902)
Ending Balance, March 31,	1,178,396	1,228,414
Annualized quarterly attrition	11.9%	11.2%

Monitoring and related service revenues decreased approximately \$2.3 million in the first quarter of 2000 as compared to the first quarter of 1999 due to the smaller average customer base. The average monthly revenue per account based on the average number of customers for the respective period was \$26.06 for 2000 and \$26.19 for 1999. Although we have had some price increases during the past year, an increase in customer credits issued in the first quarter of 2000 more than offset the higher monthly

rates. We issued additional customer credits to maintain customer goodwill because of billing problems encountered when we implemented a new billing and collections system in our Beaverton monitoring station. We believe these problems have been corrected and therefore expect the level of credits to decrease in the second quarter of 2000.

Installation and rental revenues consist primarily of revenues generated from our internal installations of new alarm systems. These revenues decreased by approximately \$0.26 million or 6.9% from the first quarter of 1999.

Cost of monitoring and related services revenues for the first quarter of 2000 increased by \$4.3 million, or 18.0%, to \$28.1 million from \$23.8 million for the first quarter of 1999. Compensation costs for the monitoring stations increased by approximately \$2.7 million due primarily to an increase in personnel from approximately 1,090 to 1,300 employees. The increase in employees is a direct result of our efforts to improve the level of customer service. In addition, telecom costs increased \$0.4 million, vehicle costs increased \$0.6 million and parts and materials costs increased \$0.8 million.

Cost of installation and rental revenues was \$0.34 million or 9.5% less than in the first quarter of 1999. These costs as a percentage of installation and rental revenues were approximately 92% for the first quarter of 2000 as compared to approximately 94% for the first quarter of 1999.

Selling, general and administrative expenses increased \$4.4 million from \$21.9 million in the first quarter of 1999 to \$26.3 million in the first quarter of 2000. The increase is generally comprised of an increase in bad debt and collection expenses of approximately \$2.1 million, and an increase of \$1.6 million in subcontract expense primarily for outside information technology support. We attribute these increases to problems encountered in connection with the implementation of our new billing and collection software which started in November 1999. We believe the significant problems have been resolved and that these costs will decrease in the second quarter.

Acquisition expenses generally decreased due to the reduced level of account acquisitions in the first quarter of 2000 as compared to 1999. In the first quarter of 1999 we acquired nearly 27,000 new accounts, over 90% of which were through the dealer program. In the first quarter of 2000 we acquired 13,729 accounts, approximately 50% of which were through the dealer program. The most significant decrease was third party monitoring expense which dropped from \$1.9 million to \$0.8 million. This decrease was a direct result of our concentrated effort in late 1999 to move such accounts to our own monitoring stations. The overall decrease was partially offset by increases in costs related to the old dealer program of \$1.9 million.

Amortization of intangibles and depreciation expense for the first quarter of 2000 increased by \$15.7 million, or 42.9%, to \$52.3 million from \$36.6 million in the first quarter of 1999. As discussed in our 1999 Annual Report on Form 10-K/A-2, we changed the amortization method on most of our customer base from a 10-year straight line method to a 10-year declining balance method as of the third quarter in 1999. Therefore, the amortization expense on these accounts for the first quarter of 1999 was calculated using a straight line method whereas the amortization expense for the first quarter of 2000 is calculated using the declining balance method. This change does not include our Westinghouse customer pool for which we adopted an 8-year accelerated amortization method from the date of the WSS acquisition. See Note 2 of the Consolidated Financial Statements. Subscriber amortization for these periods increased from \$28.4 million for the first quarter of 1999 to \$34.5 million for the first quarter of 2000.

As discussed above, we also changed our estimate of the useful life of goodwill from 40 years to 20 years. As a result, amortization expense increased \$4.7 million from \$5.7 million in the first quarter of 1999 to \$10.4 million for the first quarter of 2000. Additionally, in the first quarter of 2000 depreciation expense increased \$4.8 million from \$2.6 million for the first quarter of 1999 to \$7.4 million in the first quarter of 2000. This increase is due to accelerated depreciation of the general

ledger and accounts receivable systems installed in 1999. We have decided to move to another general ledger and accounts receivable system in 2000 which we believe is better suited to our needs. Depreciation charges for the old system have been accelerated so that no remaining costs will be left unamortized when we move to the new systems later in 2000.

Other charges for the first quarter of 1999 consisted of officer's severance costs of \$2.0 million. For the first quarter of 2000, these charges consist of \$1.5 million for officer's severance and \$1.55 million for expenses relating to the sale of the European operations.

Interest expense, net for the first quarter was \$18.4 million and \$17.1 million for 2000 and 1999, respectively. During the first quarter of 1999, borrowings under the Senior Credit Facility rose from \$42.4 million to \$124.0 million with interest rates as low as 6.2%. During the first quarter of 2000, borrowings under the Senior Credit Facility decreased from \$225.0 million to \$37.0 million at interest rates ranging from 7.8% to 8.4%. In the first quarter of 1999 we accrued interest charges on the \$350 million Senior Subordinated Notes at 8.125%, however, since we have not completed the required exchange offer, the interest rate relating to this debt increased to 8.625% in June 1999. Total debt decreased during the first quarter of 2000 from \$1,048.1 million to \$702.4 million.

Multifamily Segment

We present the table below for comparison of the Multifamily operating results for the periods presented. Next to each period's results of operations, we provide the relevant percentage of total revenues so that you can make comparisons about the relative change in revenues and expenses.

	Three Months Ended March 31,			
	2000		1999	
	(dollars in thousands)			
Revenues:				
Monitoring and related services	\$ 8,688	85.7%	\$ 8,580	85.8%
Installation and rental	1,453	14.3	1,416	14.2
Total revenues	10,141	100.0	9,996	100.0
Cost of revenues:				
Monitoring and related services	1,935	19.1	1,676	16.8
Installation and rental	1,382	13.6	1,042	10.4
Total cost of revenues	3,317	32.7	2,718	27.2
Gross profit	6,824	67.3	7,278	72.8
Selling, general and administrative expenses	2,702	26.7	2,680	26.8
Amortization of intangibles and depreciation expense	3,834	37.8	2,297	23.0
Operating income	\$ 288	2.8%	\$ 2,301	23.0%

2000 Compared to 1999. We increased our customer base a total of 6,719 customers, or 2.3%, from March 31, 1999 to March 31, 2000. The average customer base was 295,982 for the first quarter

of 2000 compared to 288,119 for the first quarter of 1999. The change in Multifamily's customer base for the period is shown below.

	Three Months Ended	
	March 31,	
	2000	1999
Beginning Balance, January 1,	294,960	285,954
Additions, net of holdback put backs	7,868	7,849
Customer losses, net of holdback put backs	(5,825)	(3,519)
Ending Balance	297,003	290,284
Annualized quarterly attrition	7.9%	4.9%

Monitoring and related services revenues for the first quarter increased by \$0.1 million, or 1.2%, to \$8.7 million from \$8.6 million for the first quarter of 1999.

Cost of monitoring and related revenues for the first quarter of 2000 increased by \$0.2 million, or 15.4% to \$1.9 million from \$1.7 million for the first quarter of 1999. Monitoring and related service expenses as a percentage of monitoring and related service revenues increased to 22.2% from 19.5% during 1999. The percentage increase is primarily related to an increase in salaries as a result of the current competitive labor market.

Cost of installation and rental revenues increased by \$0.4 million or 32.6% to \$1.4 million in the first quarter of 2000 from \$1.0 million in the first quarter of 1999. Installation and rental cost of revenues increased primarily due to the significant number of installations in 1999 which used less sophisticated monitoring equipment than Multifamily's standard contracts, combined with the increased use in 2000 of wireless systems which is expected to reduce future service costs.

Amortization of intangibles and depreciation expense for the first quarter of 2000 increased by \$1.9 million, or 102.5% to \$3.8 million in 1999 reflecting a change in estimate of goodwill life to 20 years which will increase annual goodwill amortization by approximately \$5 million.

Europe Segment

The results of operations for the first quarter of 2000 reflect only those results through February 29, 2000. The operating results for the first quarter of 1999 reflect activity for the three months ended March 31, 1999.

	Two Months Ended		Three Months Ended	
	February 29,		March 31,	
	2000		1999	
(dollars in thousands)				
Revenues:				
Monitoring and related services	\$ 14,316	51.3%	\$ 23,417	59.2%
Installation and rental	13,588	48.7	16,117	40.8
Total revenues	27,904	100.0	39,534	100.0
Cost of revenues:				
Monitoring and related services	3,702	13.3	4,187	10.6
Installation and rental	5,504	19.7	7,181	18.2
Total cost of revenues	9,206	33.0	11,368	28.8
Gross profit	18,698	67.0	28,166	71.2
Selling, general and administrative expenses	12,081	43.3	15,831	40.0
Acquisition and transition expense	217	0.8	148	0.4
Amortization of intangibles and depreciation expense	5,420	19.4	5,486	13.9
Operating income	\$ 980	3.5%	\$ 6,701	16.9%

2000 Compared to 1999. The change in our customer base from January 1, 2000 through February 29, 2000 is shown below:

	Two Months Ended February 29, 2000
Beginning Balance, January 1,	123,599
Additions, net of holdback put backs	5,718
Customer losses, net of holdback put backs	(2,285)
Ending Balance	127,032

Revenues of approximately \$4.5 million in the first two months of 2000 and \$9.5 million in the first quarter of 1999 were recognized as revenue as a result of ongoing reductions in the liability under recourse obligations. In relation to this revenue, we also recognized interest expense of approximately \$1.0 million and \$2.7 million and depreciation expense of approximately \$0.8 million and \$1.6 million for the respective periods.

Liquidity and Capital Resources

We believe we currently maintain the ability to generate sufficient cash to fund future operations of the business. Generally, cash will be generated from a combination of our existing \$115.0 million Senior Credit Facility, which had approximately \$78 million of availability at March 31, 2000, subject to compliance with the provisions of the debt covenants in the agreement, as well as revenue from our security monitoring customer base which generated \$39.0 million of positive EBITDA from the North America and Multifamily operations in the first quarter of 2000. EBITDA does not represent cash flow from operations as defined by generally accepted accounting principles, should not be construed as an

alternative to operating income and is indicative neither of operating performance nor cash flows available to fund our cash needs. Items excluded from EBITDA are significant components in understanding and assessing our financial performance. We believe that presentation of EBITDA enhances an understanding of our financial condition, results of operations and cash flows because EBITDA is used to satisfy our debt service obligations and our capital expenditure and other operational needs as well as to provide funds for growth. In addition, EBITDA is used by senior lenders and subordinated creditors and the investment community to determine the current borrowing capacity and to estimate the long-term value of companies with recurring cash flows from operations. Our computation of EBITDA may not be comparable to other similarly titled measures of other companies.

The Senior Credit Facility matures on January 2, 2001. As of May 4, 2000, we have borrowed \$49.0 million from this facility. We intend to refinance the Senior Credit Facility with a third party lender prior to the maturity date. There is no assurance we will be able to obtain financing on similar terms with no disruption to our operations or liquidity, or at all.

Operating Cash Flows for the Three Months Ended March 31, 2000. Our operating activities provided net cash flows of \$13.3 million, a decrease of \$21.3 million from the comparable period for 1999, primarily due to a decrease in EBITDA of \$16.4 million from \$61.8 million in the first quarter of 1999 to 45.4 million in the first quarter of 2000.

Investing Cash Flows for the Three Months Ended March 31, 2000. Our investing activities provided net cash flows of \$164.8 million in the first quarter of 2000 compared to a use of cash of \$108.9 in the first quarter of 1999. This increase is due to the sale of the European operations and certain other investments to Westar Capital for \$183.0 million in cash along with \$61.0 million in other consideration. We also reduced the purchases of customer accounts and fixed assets by \$93.2 million from \$111.5 million in the first quarter of 1999 to \$18.3 million in the first quarter of 2000.

Financing Cash Flows for the Three Months Ended March 31, 2000. We decreased our borrowings under our Senior Credit Facility by \$188.0 million. At March 31, 2000 the Senior Credit Facility had a weighted average interest rate of 8.4% and an outstanding balance of \$37.0 million.

Material Commitments

We have future, material, long-term commitments made in the past several years in connection with our growth. We believe these commitments will be met through a combination of borrowings under our Senior Credit Facility, refinancings and positive operating cash flows. The following reflects these commitments as of March 31, 2000 and as of March 31, 1999:

Debt Security	Maturity	March 31,	March 31,
	Date	2000	1999
Convertible Senior Subordinated Notes(a)	September 2003	\$ 53,950	\$ 103,500
Senior Subordinated Discount Notes	June 2005	61,765	107,900
Senior Unsecured Notes	August 2005	250,000	250,000
Senior Subordinated Notes	January 2009	293,890	350,000
Senior Credit Facility	January 2001	37,000	124,000
		\$ 696,605	\$ 935,400

(a)

These notes are convertible into Protection One common stock at a price of \$11.19 per share, which is currently above the price at which our shares are traded in the public stock markets.

We are in compliance with the financial covenants under the amended Senior Credit Facility and the indentures for the first quarter of 2000.

In March 2000, Moody's, S & P and Fitch downgraded their ratings on our outstanding securities with outlook remaining negative. As of May 4, 2000, these ratings were as follows:

	Senior	Senior
	Unsecured	Subordinated
	Debt	Unsecured Debt
S & P	B+	B-
Moody's	B2	Caa1
Fitch	B+	B-

In April, we purchased an additional \$21.9 million face value of our debt securities which resulted in an extraordinary gain, net of tax, of \$4.8 million in the second quarter. We may also acquire additional debt securities in the open market or through negotiated transactions based upon market conditions and other factors. We expect that we would also realize an extraordinary gain on extinguishment of debt on any such purchases.

Capital Expenditures

We anticipate making capital expenditures of approximately \$85 million in 2000. Of such amount, we believe we will invest approximately \$65 million to acquire customer accounts, \$10 million to complete the development and installation of our new software platforms, \$5 million for replacement of vehicles, and \$5 million for other capital items. Capital expenditures for 2001 and 2002 are expected to be approximately \$123 million each year of which approximately \$108 million would be to acquire accounts and \$15 million for vehicles and other capital items. These estimates are prepared for planning purposes and may be revised. Actual expenditures for these and possibly other items not presently anticipated may vary from these estimates during the course of the years presented.

Tax Matters

Protection One is consolidated into income tax returns filed by its parent, Western Resources. The two parties have entered into a tax sharing agreement whereby Western Resources will make cash payments to us for current tax benefits utilized for income tax return purposes and which will require cash payments from us for current tax expenses incurred for income tax return purposes. This arrangement has allowed us to provide a current tax benefit for the year ended December 31, 1999, as well as for the three months ended March 31, 2000. If the Company did not file its taxes on a consolidated basis with Western Resources, the Company's deferred tax assets might not be realizable and the Company might not be in a position to record a tax benefit for losses incurred.

In the future, if and when we generate income for tax return purposes, we will proportionately over time utilize existing net operating loss carryforwards in amounts up to approximately \$60 million. Currently, the deferred tax assets related to the net operating loss carryforwards are fully reserved due to uncertainty as to their future realizability. However, when net operating loss carryforwards are utilized, the relief of the corresponding reserve will not create a benefit, but, as required by generally accepted accounting principles, will reduce our goodwill balances. The net financial statement effect of this treatment will cause us to recognize deferred tax expense we might otherwise not recognize.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company has not experienced any significant changes in its exposure to market risk since December 31, 1999. For additional information on the Company's market risk, see the Form 10-K/A-2 for the year ended December 31, 1999.

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PART II

OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

Information relating to legal proceedings is set forth in Note 7 of the Notes to Consolidated Financial Statements included in Part I of this report, which information is incorporated herein by reference.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS.

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SHAREHOLDERS.

None.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) Exhibits. The following exhibits are filed with this Current Report on Form 10-Q or incorporated by reference.

Exhibit Number	Exhibit Description
10.1	Marketing Agreement as of February 28, 2000 between Monitoring and Paradigm for marketing services.
27.1	Restated Financial Data Schedule.

(b) During the quarter ended March 31, 2000, the Company filed five Reports on Form 8-K. A Current Report on Form 8-K dated January 18, 2000, reported the receipt of a waiver on Monitoring's Senior Credit Facility until January 31, 2000. A Current Report on

Form 8-K dated January 26, 2000, reported Western Resources reached agreement with its banks to eliminate the cross-default provisions relating to the Company. A Current Report on Form 8-K dated February 1, 2000, reported the receipt of a waiver on Monitoring's Senior Credit Facility until February 29, 2000. A current report on Form 8-K dated February 29, 2000, reported the sale of the Company's European operations and certain investments to Westar Capital. A Current Report on Form 8-K dated March 29, 2000, reported fourth quarter and 1999 year-end earnings.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrants have duly caused this report to be signed on their behalf by the undersigned thereunto duly authorized.

Date: February 1, 2001

PROTECTION ONE, INC.
PROTECTION ONE ALARM MONITORING, INC.

BY: /S/ ANTHONY D. SOMMA
Anthony D. Somma
Chief Financial Officer

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Exhibit List

<u>Exhibit Number</u>	<u>Exhibit Description</u>
10.1	Marketing Agreement as of February 28, 2000 between Monitoring and Paradigm for marketing services.
27.1	Restated Financial Data Schedule.

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[PROTECTION ONE, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS \(Dollars in thousands\) \(Unaudited\)](#)

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MARKETING AGREEMENT

This MARKETING AGREEMENT (this "Agreement") is entered into as of February 28, 2000, by and among Protection One Alarm Monitoring, Inc., a Delaware corporation ("Protection One"), Paradigm-Direct, LLC, a Delaware limited liability company ("Paradigm"), and Marketing Services Company I, LLC d/b/a Protection One Marketing Services, a Delaware limited liability company and a wholly owned subsidiary of Paradigm ("POMS").

WHEREAS, Protection One wishes to engage POMS to provide marketing services for Protection One; and

WHEREAS, POMS desires to provide such services to Protection One, under the terms and conditions hereinafter set forth and in exchange for the consideration hereinafter set forth;

NOW, THEREFORE, for and in consideration of the premises and the obligations undertaken by the parties pursuant hereto, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties do hereby agree as follows:

ARTICLE I DEFINITIONS

As used in this Agreement, the following terms have the meanings set forth below:

"Customer" means any person, business, corporation or other entity that as a result of the account generation efforts of POMS described herein, has executed a P-One Contract and for which there exists an installed and operational security alarm system, capable of being monitored in a designated Protection One facility as of or after the date of this Agreement.

"Customer Account" means an account of a Customer. The Customer Account package shall include any and all related credit applications, credit checks, agreements, records, correspondence and files.

"Dealer Territory" means those zip codes within the Protection One "Territory" (as defined below) in which Protection One has authorized dealers that have contracted to purchase Qualified Leads from Protection One.

"Independent Contractor" means any person or entity with which POMS has contracted to perform installation services for Customers.

"Marketing Year" shall mean the twelve-month period commencing on the day after the completion of the Pilot Program and each subsequent twelve-month period.

"Marketing Services" means those services provided by POMS to Protection One as more fully described on **Exhibit B** to this Agreement.

"Pilot Program" means the program described in Section 2.2 hereof.

"P-One Contract" means a contract in a form provided by Protection One, for the provision of security alarm system services and any addendum thereto and related certificates, between Protection One and a Customer.

"Qualified Customer Account" means a Customer Account that meets all of the criteria described on Exhibit A hereto. POMS and Protection One may revise **Exhibit A** as a result of the annual program review meetings described herein, which such revision shall be initialed by both Protection One and POMS and substituted for the previous version of **Exhibit A** following such revision.

"Qualified Leads" means leads that are (a) subject to taped verification of the Customer's agreement to a sales appointment (or other means of verification if mutually agreed by Protection One

and POMS); (b) within the Territory; and (c) credit scored at a minimum of 600 FICO score; or any other mutually agreed upon criteria, which the parties shall document in a written amendment to this Agreement.

"Targeted Number of Qualified Customer Accounts" means 50,000 for the first Marketing Year and thereafter such number as the parties may agree to in the annual program review meetings described herein, the results of which shall be documented by mutual written agreement.

"Territory" means the territory within serviceable distance from Protection One service branches. Such territory shall be further defined by a list of acceptable zip codes provided to POMS by Protection One and may be updated no less frequently than quarterly upon thirty (30) days advanced notice..

"Third Party" means any person or entity with which POMS has contracted to perform any part of the Marketing Services for Protection One.

ARTICLE II ENGAGEMENT; PILOT PROGRAM; ANNUAL REVIEW

2.1 *Engagement.* Protection One hereby engages POMS to generate Qualified Customer Accounts for sale to Protection One, generate Qualified Leads for sale to Protection One, and to provide to Protection One the Marketing Services.

2.2 *Pilot Program.* The Pilot Program shall be deemed to have commenced as of November 18, 1999 and shall end at such time as POMS has delivered 2,500 Qualified Customer Accounts. POMS shall use its best efforts to produce these first 2,500 sales within a 5 month time frame or sooner. In consideration of the accounts to be generated under the Pilot Program, POMS shall issue an invoice to Protection One in the amount of \$1,070,875 in November 1999 and a second invoice in the same amount in January 2000. If this Agreement is terminated prior to the end of the Pilot Program and provided that POMS has received the payments described above, then Protection One shall submit an invoice to Paradigm in an amount equal to (x) \$856.70 times (y) the excess of 2,500 over the number of Qualified Customer Accounts delivered to Protection One. Payment of each invoice described above shall be due net thirty (30) days after receipt of the invoice by the receiving party.

2.3 *Annual Program Review Meetings.* Protection One and POMS each agree to meet no less than ninety (90) days prior to the expiration of each Marketing Year to review the Qualified Customer Account criteria, the Customer Account fees, the Qualified Leads fee, the Targeted Number of Qualified Customer Accounts, the minimum number of Qualified Leads to be purchased, the fee schedule for warranty and inspection repairs, the Marketing Services description, sublease and office equipment fees and the budget for the program. The parties may adjust any of those items referenced in this Section 2.3 as they may mutually agree to and such revised terms shall be documented in a written amendment signed by both parties. Failure to reach agreement as to any such adjustments shall offer the parties the termination rights described in Article X below.

ARTICLE III DUTIES OF POMS

3.1 *Personnel.* POMS shall provide such personnel as may be required to fulfill the obligations of POMS hereunder.

3.2 *Independent Contractors and Other Agents.* If POMS engages Independent Contractors, Third Parties or any other persons or entities (collectively "Agents") to perform one or more services under the supervision of POMS for Protection One, POMS shall use commercially

reasonable efforts to cause such Agents to deliver each such service in a competent and timely fashion. POMS shall not engage an Independent Contractor to perform installation services on its behalf under this Agreement unless such

Independent Contractor meets the insurance, licensing and other criteria set forth on **ExhibitC** hereto as modified from time to time by Protection One as reasonably necessary due to changes in regulation or industry standard.

3.3 *Compliance with Laws.* POMS shall perform its duties hereunder and provide all services in material compliance with all applicable laws, including without limitation all laws relating to telemarketing and security industry sales and installation.

3.4 *Approval of Marketing Materials, Contracts, etc.* POMS shall not use any telemarketing scripts, advertising copy or comparable materials until such materials have been approved in writing by Protection One, which approval will not be unreasonably withheld or delayed. POMS shall not use any form of Customer contract until such form has been approved in writing by Protection One, which approval will not be unreasonably withheld or delayed.

ARTICLE IV DUTIES OF PROTECTION ONE

4.1 *Account Creation and Testing.* Protection One shall provide the following: the account creation and testing services described in the POMS Installer Procedures Manual or approved substitutes therefor, as it may be amended from time to time, and if no such manual exists, the account creation and testing services provided to Protection One dealers generally, provided however, that Protection One shall have the right to approve any amendments to or substitutions for the POMS Installer Procedures Manual, such approval not to be unreasonably withheld.

4.2 *Other Obligations Assumed.* Protection One shall assume, commencing and effective from the date the Qualified Customer Account is connected to and accepted by Protection One's monitoring facility, the obligation to provide, in a competent and timely manner, monitoring, warranty, repair and other services and benefits (including without limitation, Lifetime Service, SafetyNet™, and Free Move program,) pursuant to the P-One Contracts for the Qualified Customer Accounts, provided that such programs, services or benefits are generally available and offered by Protection One. P1 shall perform the post installation inspections described in the POMS Installer Procedure Manual, and if no manual exists the same post-installation inspections applicable to Protection One dealers generally. Except for those obligations of POMS hereunder which Protection One specifically agrees to assume, pay, perform or discharge pursuant to this Agreement, Protection One does not assume or agree to pay, perform or discharge any liability or obligation of POMS, whether known or unknown, including, without limiting the generality of the foregoing, any: (a) liability of POMS for any taxes, including sales taxes arising in connection with POMS' transactions with the Customers, provided however, that POMS shall not be liable for any sales tax arising from the sale of a Qualified Customer Account to Protection One and POMS shall only be liable for one imposition of sales tax respecting any item of equipment sold by the vendor to POMS' Independent Contractor; (b) liability in connection with representations or warranties made by POMS' Independent Contractors to Customers which are not contained in the P-One Contracts; (c) liability in connection with any of POMS employees, including salaries, benefits, commissions or any employment benefit plan of POMS; and (d) other obligation of POMS, whether or not such obligation now exists, hereinafter arises, is incurred or is created after the date hereof.

4.3 *Compliance with Laws.* Protection One shall perform its duties hereunder and provide all services in material compliance with all applicable laws, including without limitation, all laws relating to monitoring and servicing of security alarm system accounts. Protection One shall use commercially reasonable efforts to ensure the P-One Contracts are in material compliance with all applicable laws.

4.4 *Sharing Compliance Information.* Unless otherwise prohibited by law or pre-existing contractual agreement, Protection One agrees, upon request by POMS, to share with POMS any compliance information in its possession about a prospective Independent Contractor for POMS' use in evaluating such prospective Independent Contractor for suitability. Protection One makes no

representation or warranty as to the accuracy, completeness, or effectiveness of such information, nor does Protection One make any representation or warranty about the suitability of any prospective Independent Contractor.

ARTICLE V SALES OF ACCOUNTS

5.1 *Provisions Applicable to Qualified Customer Accounts.* The number of accounts Protection One will purchase will be limited to POMS quarterly forecasted amount plus 20% (with forecasts subject to Protection One approval), unless Protection One otherwise agrees in advance in writing. Protection One agrees to purchase no less than the forecasted (with forecasts subject to Protection One approval) number of Qualified Customer Accounts if offered for sale by POMS. Protection One's approval of POMS forecasts shall not be unreasonably withheld.

5.2 *Warranty and Repair Obligations.*

(a) Ninety (90) Day Service Warranty by POMS. During the first ninety (90) days from the transfer of a Customer Account, POMS shall be responsible for the expense of providing warranty repair service for each Customer Account for all repairs that in Protection One's judgment relate to installation of the alarm system, regardless of whether the alarm system is owned by the Customer or not. Protection One shall apply the standards indicated in the Protection One Installation Manual in determining whether repairs relate to installation of the alarm system. Protection One's fee schedule for such service or repairs is set forth on **Exhibit D** attached hereto, which such schedule may be revised as a result of the annual review meetings described herein. Unless otherwise provided in a separate agreement between POMS and Protection One, Protection One will perform the warranty repair service, then offset costs therefor from other payments due POMS hereunder, or if such further payments are not sufficient, then POMS agrees to reimburse Protection One for such repair services upon receipt of an invoice from Protection One therefor, according to the following formula:

$$\begin{aligned}\text{offset amount} &= (\text{total time and materials for that month}) \times (\text{Fee Schedule}) \\ \text{offset invoice} &= (\text{gross invoice to P-One from POMS}) - (\text{offset amount}).\end{aligned}$$

(b) Inspection Program Repairs. Protection One may inspect the Customer Account's alarm system within 90 days of the installation and/or purchase of such alarm system as a part of Protection One's ongoing inspection program. If Protection One determines in an inspection that an alarm system is not installed in compliance with Protection One Installation Standards, then Protection One may repair such alarm system and offset the costs therefor (in accordance with the fee schedule set forth on **Exhibit D**, as amended from year to year) from payments otherwise due POMS hereunder, or if such payments are not sufficient, then POMS agrees to reimburse Protection One for such repair services upon receipt of an invoice from Protection One therefor. POMS will not be responsible for repairs or service to non-operational systems that are not related to installation.

(c) Chargeable Services. Chargeable services (including repairs which are excluded from the service plan, such as repairs necessitated by a Customer's misuse of the alarm system) will be performed solely by Protection One and charged to the Customer. POMS shall not solicit from or perform chargeable services at Customer's premises unless otherwise agreed to by the parties in writing.

5.3 *Procedure for Rejected Accounts; Right of First Refusal.*

(a) Rejection of Accounts. POMS acknowledges that Protection One may reject a Customer Account delivered to Protection One by POMS, for failure to meet the criteria indicated on Exhibit A hereto. Protection One reserves the right to reject any account for reasons not specified

in **Exhibit A**; however, in such instance, and provided such Account meets the criteria specified in **Exhibit A**, then Protection One shall be required to pay POMS the purchase price for such Account and is additionally responsible for communicating to the Customer that the Account has not been accepted, and at Protection One's option, removing the yard signs, window decals and any installed equipment from the premises of such account. Protection One shall notify POMS in writing of its decision to reject a Customer Account within five (5) business days of having received the Customer Account package in contract administration and failure to provide notice within such five day period shall be deemed acceptance of such account.

(b) **Re-submission of Rejected Customer Accounts.** If Protection One rejects an account deemed not in accordance with **Exhibit A**, Protection One will return the account to POMS within 5 business days of the rejection with a description of the deemed non-compliance. POMS shall have 5 business days thereafter in which to resolve such account and re-submit to Protection One and Protection One will accept all such accounts POMS resolves and re-submits for payment, provided such account meets the criteria indicated on **Exhibit A**. If POMS does not resolve such account then the P-One Contract for the rejected account must be canceled, any decals, yard signs or other equipment containing Protection One's name or any variant thereof must be removed from the Customer's premises within five (5) days following the resolution period, Customer's account must be removed from the Protection One central station within three (3) days following the resolution period, and the Customer must be notified by POMS in writing that their account will be removed from Protection One and when such removal will occur. Protection One reserves the right to so notify such Customers of the cancellation on its own behalf, provided however, that no such notice made by Protection One shall relieve POMS of its obligation to do so.

(c) **Protection One Right of First Refusal.** Protection One shall have the exclusive preemptive right to accept and own the Customer Account with any and all prospective Customer or Customers whom POMS may contact either directly or indirectly during the term of this Agreement, and POMS shall take commercially reasonable steps to ensure that its Independent Contractors not interfere with Protection One's rights hereunder. POMS hereby agrees that during the term of this Agreement, it shall not engage in the business of monitoring or servicing of security alarm system accounts nor will it engage in solicitation on behalf of a third party for the purpose of obtaining such monitoring or servicing rights.

ARTICLE VI QUALIFIED LEADS

6.1 *Leads Management.* Protection One agrees to purchase and POMS agrees to deliver a minimum of 50,000 Qualified Leads in the first Marketing Year within the Protection One Territory. Each month Protection One and POMS will mutually agree to, and Protection One will generate a file of, the targeted number of Qualified Leads that can be purchased per Designated Market Area (DMA); and Protection One will provide to POMS monthly an updated Territory zip code list for the subsequent month. Quarterly, Protection One and POMS will create a new lead acquisition plan. If a new plan is not created, the plan from the previous quarter will remain in effect. Any reduction in the maximum number of Qualified Leads that can be purchased in any DMA shall not reduce or otherwise affect Protection One's aggregate obligation to purchase no less than 50,000 Qualified Leads in the first Marketing Year, and any other minimums determined thereafter.

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ARTICLE VII FEES AND EXPENSES

7.1 *Pilot Program.* Protection One shall pay the fees described in Section 2.2 with respect to the Pilot Program.

7.2 *Customer Account Fees.* Protection One shall pay to POMS a Customer Account Fee equal to \$775.00 for each Qualified Customer Account delivered by POMS to Protection One during the first Marketing Year. The Customer Account Fee to be paid during subsequent Marketing Years shall be determined by the parties during the annual review meetings described herein. Protection One shall pay the Customer Account fees net ten (10) days after receipt of an invoice therefor.

7.3 *Customer Continuation Fees.* Protection One shall pay POMS \$20 for each Qualified Customer Account that remains an account in good standing at the end of each full twelve month period during the life of such Qualified Customer Account, regardless of whether this Agreement is in effect. For purposes of this Agreement, an account in good standing shall mean one in which the Customer is current in his outstanding balance and Protection One is providing service to such Customer. Protection One shall provide POMS monthly, a list of POMS-generated Qualified Customer Accounts in good standing, and POMS will bill Protection One for those accounts for which the \$20 payment is due (those accounts in good standing meeting a twelve month anniversary during that month). For those accounts which are not in good standing at the end of any twelve month period during the life of such account, and provided that this Agreement remains in effect and POMS is not in breach of any of the terms hereunder, Protection One shall allow a ninety (90) day grace period following the expiration of such twelve month period, for the Qualified Customer Account to become an account in good standing. If on or prior to the expiration of such grace period (if applicable), such Qualified Customer Account becomes an account in good standing, then POMS will be entitled to the \$20 payment for such account. Notwithstanding anything to the contrary contained in this section, in the event the Marketing Agreement is terminated, Protection One shall have the option to make a one time lump sum payment of \$75.00 per account in good standing at the time of termination in lieu of any further \$20 obligations. Additionally, Paradigm will have the option to request a one time lump sum payment of \$60.00 per account in good standing at the time of termination in lieu of any further \$20 obligations, provided, however, that such lump sum payment does not cause Protection One to default on its debt covenants. Payment of the lump payment shall be due within 30 days of the effective time of termination. POMS shall have ninety (90) days following such termination to bring any otherwise eligible Qualified Customer Accounts into good standing and if any such accounts become in good standing during such ninety (90) day period, POMS shall be entitled to the one time lump sum payment for such accounts.

7.4 *Bonus Expenses.* Protection One shall budget a lump sum of not more than \$25,000, for the purpose of rewarding specific POMS employees for exceptional performance during calendar years 1999 (while employed by Protection One) and 2000 (while employed by POMS), which Protection One may distribute, in whole or in part, in its sole discretion to POMS for distribution to such employees as Protection One deems deserving of such reward.

7.5 *Qualified Leads Fee.* Paradigm shall sell, and Protection One shall purchase, Qualified Leads for a fee of \$115.00 per lead (including Qualified Leads generated during the Pilot Program) during the first Marketing Year. The parties may adjust such fee as a result of the annual review meetings described herein.

7.6 *Marketing Services Budget.* The approved budget for the Marketing Services for the first Marketing Year is attached hereto as **Exhibit E**. POMS shall invoice Protection One the approved budget in twelve monthly installments and payment therefor shall be due net 30 days from receipt of invoice by Protection One.

7.7 *General.* Except as otherwise expressly provided herein, all payments required under this Agreement shall be due net thirty (30) days after receipt of the corresponding invoice and shall be submitted to POMS or Protection One, as the case may be, at the address provided under Article XI hereof. The parties shall be entitled to withhold such portion of each payment as is required to be withheld by applicable law and any taxing authority of competent jurisdiction.

ARTICLE VIII RELATIONSHIP OF THE PARTIES.

8.1 *Independent Contractor.* The relationship between Paradigm and POMS on the one hand and Protection One on the other hand, and established by this Agreement is that of independent contractors, and nothing contained in this Agreement shall be construed to (i) constitute the parties as partners, joint venturers, joint employers, co-owners or otherwise as participants in a joint or common undertaking; (ii) prevent any party from entering into any other business; or (iii) except as expressly provided herein, allow any party to create or assume obligations on behalf of or in the name of the other. All financial and other obligations associated with Paradigm's and POMS' businesses, except as provided otherwise herein, are the sole responsibility of Paradigm and POMS, and vice versa with respect to Protection One.

8.2 *Loan of Equipment; Space Sharing Arrangements.* As long as this Agreement is in effect, Protection One agrees to sublease to POMS and POMS agrees to sublet from Protection One, reasonably necessary office space in those locations where POMS employees are working on site for Protection One. Such subleases will be subject to standard commercial terms for similar space and are contingent upon landlord approval, provided however, that during the Pilot Period and first Marketing Year, the rent for such subleased space shall be \$0.00. Additionally, Protection One will provide reasonably necessary office equipment in such sublease locations, which shall be provided at no additional charge during the Pilot Period and first Marketing Year. The parties may adjust such sublease and equipment fees as a result of the annual review meetings described herein.

8.3 *Former Protection One Employees.* For those POMS employees who have been awarded stock options under Protection One's stock option or long term incentive plans during their previous employment with Protection One, continuing employment with POMS shall be treated as continuing employment with Protection One for the limited purpose of determining vesting under those plans. Nothing contained in this Section 8.3 shall be deemed to nor shall it create a relationship of joint employer between Protection One and POMS.

8.4 *Insurance.* POMS and Protection One each represent that it has now and during the term of this Agreement will maintain in full force and effect policies of general liability and errors and omissions insurance with coverage of not less than One Million Dollars (\$1,000,000), and shall maintain in full force and effect a policy of automobile liability insurance with coverage of not less than Five Hundred Thousand Dollars (\$500,000), employer's liability insurance with coverage of not less than Five Hundred Thousand Dollars (\$500,000), and workers compensation insurance coverage in the minimum amount required by law. Each party shall during the term of this Agreement name the other as an additional insured on all such policies, as respects the duties of the party so naming the other hereunder. Each party shall provide to the other certificates evidencing such insurance policies and coverages. Each party shall attempt to obtain a waiver of subrogation on such policies with respect to the other party, provided however, that should such waiver require a party to pay an additional premium, then no such waiver shall be required.

8.5 *Non-Competition.*

(a) Except as otherwise agreed in a writing signed by all parties, the parties agree that for as long as this Agreement is in effect, and for a period of six months thereafter, they will not enter

into any marketing or other relationship with any other company, individual or entity which provides the same or similar services to those of the other party.

(b) POMS agrees that it will not knowingly solicit Customers in the sub-600 (FICO credit score) marketplace without the prior written consent of Protection One.

8.6 *Non-Solicitation.*

(a) *Customer Accounts.* For ten (10) years from the termination of this Agreement, neither Paradigm nor POMS, nor any of their representatives or agents, shall directly or indirectly (i) solicit any form of security service business (including soliciting or performing contract repair service from Customers) from, (ii) accept any alarm system or other security business from or (iii) enter into any agreement for the provision of any form of security services with: any Customer of any Customer Account which Protection One acquired from POMS hereunder, any person or entity who moves into the residence or business location previously occupied by such Customer at the time Protection One acquired such Customer Account from POMS hereunder, any person or entity for which Protection One provided to POMS a lead or referral or any other person or entity to which Protection One provides monitoring, repair or alarm services. Nothing in this Section 8.6 shall prevent or preclude POMS, while this Agreement is in effect and has not been terminated, from directly soliciting or selling referrals which a Customer provided to POMS at the time of the original sale of the alarm system to such Customer.

(b) *Employees.* During the term of this Agreement and for a period of ninety (90) days after the date of the termination of this Agreement for any reason, neither party shall directly or indirectly or as a partner, limited partner, agent, representative, stockholder,

creditor or consultant or in any other capacity with any business, recruit, offer to employ or otherwise solicit the employment of any person who was at any time within ninety (90) days prior to such action an employee of the other party or without the prior written consent of the other party; provided, however, that a general classified advertisement which is not directed to the other party's employees shall not violate the restrictions set forth herein so long as neither party offers employment to any employee of the other or to a person who was an employee of such party within the previous ninety (90) days.

(c) Remedy for Breach. The parties acknowledge and agree that the remedy at law for any breach or threatened breach of the provisions of this section will be inadequate and, accordingly, each party covenants and agrees that the parties shall, in addition to any other rights or remedies which they may have, be entitled to such equitable and injunctive relief as may be available from any court of competent jurisdiction to prevent the opposing party from violating any of the provisions of this Section 8.6.

(d) Validity. In the event that any of the provisions of this Section 8.6 shall be determined by a court of competent jurisdiction to be in violation of applicable law for any reason whatsoever, then any such provision or provisions shall not be deemed to be void, but shall be deemed to be automatically amended so as to comply with the applicable law. In any event, if any of such provisions shall be determined by a court of competent jurisdiction to be wholly or partially invalid, such determination shall not affect the binding effect of the other provisions of this Section 8.6 or any of the other provisions of this Agreement.

ARTICLE IX TRADEMARKS AND LICENSING

9.1 *License Granted for POMS Trade Name.* Protection One hereby grants to POMS a non-exclusive license to use the trade name "Protection One Marketing Services" (the "Licensed Trade Name"), only in connection with POMS' duties under the Letter of Intent and this Agreement.

9.2 *License Granted for use of Protection One Marks in Providing the Services.* Protection One hereby grants POMS a non-exclusive license to use certain Protection One marks (the "Marks") on behalf of Protection One in performing its duties and obligations under this Agreement. POMS shall have the right to sublicense (the "Sublicense") the Marks to the Independent Contractors for the limited purpose of permitting the Independent Contractor to identify itself to the Customer as a Protection One alarm installer and permitting the Independent Contractor to use the P-One Contracts, identification signs and other materials provided by Protection One. Any Sublicense granted by POMS shall terminate on the earlier of the termination of this Agreement or any agreement entered into between POMS and the Independent Contractor. Periodically Protection One will publish a list of such Marks POMS is authorized to use in providing the services hereunder.

9.3 *Right to Grant Licenses.* Protection One hereby represents that it is the true owner of the Licensed Property (as defined herein) and that it has the full right and authority to grant the licenses described in this Section 9.

9.4 *Terms Applicable to the Licenses.*

(a) Term. The term of the licenses granted hereunder shall run concurrently with the term of this Agreement.

(b) Licensed Property. The Licensed Trade Name and the Marks shall be collectively referred to as the "Licensed Property".

(c) Use Limited to This Agreement. POMS agrees that the Licensed Property shall be used only as provided herein and shall not be used by POMS in any other manner. Except as provided herein, POMS agrees that it shall at no time either during or after the term of this Agreement, use or authorize the use of any trademark, trade name, service mark, service name, logo or other designation identical with or colorably similar to the Licensed Property. In addition, except as provided herein, POMS shall not use any other mark or name in connection with the Licensed Property or use any name or mark confusingly similar to the Licensed Property, including, without limitation, any other mark or name containing the name "Protection One."

(d) Ownership. POMS hereby acknowledges and agrees that as between POMS and Protection One the Licensed Property are the valid trade names trademarks and service marks solely owned by Protection One and licensed to POMS and that only Protection One and its designated licensees have the right to use the Licensed Property. POMS agrees that upon termination of the Letter of Intent and/or this Agreement for any cause whatsoever, its rights to use the same shall terminate, provided, however, that termination of the Letter of Intent as a result of the consummation of the Marketing Agreement shall not effect such a termination. POMS shall not either during or after the term of this Agreement, do anything or aid or assist any other party to do anything, which would infringe upon, harm, or contest the rights of Protection One in the Licensed Property or in any other mark or name which incorporates any part thereof.

(e) Licenses are Non-exclusive. POMS understands and agrees that the licenses of the Licensed Property granted herein are non-exclusive and Protection One has the right itself to operate under the Licensed Property or similar or dissimilar names and marks and to grant other licenses in, to, and under the Licensed Property or other similar or dissimilar names and marks.

(f) Reservation of Rights. All rights in the Licensed Property other than those specifically granted to POMS herein are reserved to Protection One for its own use and benefit. POMS acknowledges that it shall not acquire any rights of whatsoever nature in the Licensed Property as a result of POMS' use thereof, and that all use of the Licensed Property by POMS, and all goodwill which may arise from such use, shall inure to the sole benefit of Protection One. POMS agrees that it shall not, directly or indirectly, during the term of this Agreement or thereafter, attack the ownership by Protection One of the Licensed Property or any name or mark similar to the Licensed Property or the validity thereof or attack the validity of the licenses granted to it herein. POMS further agrees not to interfere with in any manner or attempt to prohibit the use or registration of the Licensed Property, or any similar name or mark, by Protection One. POMS further agrees that it shall not at any time apply for any registration of any copyright, trademark, service mark or other designation which would affect the ownership of the Licensed Property or file any document with any governmental authority to take any action which would affect the ownership of the Licensed Property.

(g) Corporate Name. Except as otherwise expressly provided herein, POMS shall not use the Licensed Property or any part thereof in or as part of POMS' corporate name and POMS shall not perform any activity or incur any obligation or indebtedness, except in its corporate name, provided, however, subject to the other terms and conditions set forth herein, POMS during the Term may indicate that it is doing business as "Protection One Marketing Services."

(h) Restrictions on Use. POMS shall use the Licensed Property with such words qualifying or identifying the independent contractor relationship of Protection One and POMS as Protection One from time to time shall reasonably prescribe. POMS shall not use the Licensed Property in connection with the sale or lease of any unauthorized product or service or in any other manner not expressly authorized by this Agreement or separately in writing by Protection One. If POMS uses the Licensed Trade Name on any of POMS' stationery, other forms or business cards, POMS agrees to display the Licensed Trade Name on such stationery, other forms, and business cards used in its business in the manner prescribed by Protection One. POMS agrees to obtain such fictitious or assumed name certificates or registrations as may be required by applicable law, provided the fictitious or assumed name is approved in writing by Protection One and Protection One is provided a copy of the certificate and/or registration. Protection One may at any time require POMS to cease using such fictitious or assumed name, and to cancel any corresponding certificate and/or registration.

(j) Discontinuance. If Protection One decides to discontinue or modify use of any Mark, or substitute one or more additional trade or service marks, with respect to itself and for all other licensees, then POMS agrees to comply within a reasonable time after written notice thereof by Protection One, and the sole obligation of Protection One in any such event shall be to reimburse POMS for the out-of-pocket costs, if any, of complying with this obligation. In addition, POMS shall replace obsolete identification signs or material with new signs or material should Protection One adopt new marks replacing, as to itself and all other licenses, one or more Marks identified by Protection One in such list as hereinbefore specified.

(k) Reports. Upon reasonable notice from Protection One, POMS shall provide to Protection One reports containing such statistical and other types of information as Protection One shall reasonably request for the purpose of ascertaining or determining compliance with the licensing provisions of this Agreement. Further, upon Protection One's request, POMS shall provide Protection One with samples of all advertising and other literature, packages, labels, and labeling prepared by POMS which use the Marks or the logos. When using the Marks or the logos under this Agreement, POMS undertakes to comply with all laws pertaining to trademarks in force at any time.

(l) Protection of Rights. POMS agrees to assist Protection One and Protection One agrees to reimburse POMS for all associated reasonable costs to the extent necessary in the procurement of any protection or to protect any of Protection One's rights to the Licensed Property, and Protection One, if it so desires, may commence or prosecute any claims or suits in its own name or in the name of POMS or joining POMS as party thereto. When known, POMS shall notify Protection One in writing of any infringements or imitations by others of the Licensed Property which are the same as or similar to those covered by this Agreement. Protection One shall have the sole right to determine whether any action shall be taken on account of any such infringements or limitations. POMS shall not institute any suit or take any action on account of any such infringements or imitations without first obtaining the written consent of Protection One.

ARTICLE X TERM; TERMINATION

10.1 *Term of Services.* This Agreement shall become effective on the date of execution hereof by the parties. The term of POMS' engagement under Section 2.1 hereof (the "Term") shall commence on the date of completion of the Pilot Program and shall continue for a period of three Marketing Years.

10.2 *Termination.*

(a) This Agreement may be terminated as follows:

(i) Upon the mutual agreement of the parties hereto.

(ii) Upon the failure of Paradigm or POMS to comply with any material term, condition or covenant of this Agreement by due notice hereunder from Protection One to the breaching party, subject to the following cure period. Written notice of default shall be sent to the breaching party and the breaching party shall have 30 days following receipt of such notice to remedy the default. If the breach is not cured to the satisfaction of Protection One within such 30-day period, Protection One may terminate this Agreement immediately by giving further notice to such effect to the breaching party.

(iii) Upon the failure of Protection One to comply with any material term, condition or covenant of this Agreement by due notice hereunder from POMS to Protection One, subject to the following cure period. Written notice of default shall be sent to Protection One and Protection One shall have 30 days following receipt of such notice to remedy the default. If the breach is not cured to the satisfaction of POMS within such 30-day period, POMS may terminate this Agreement immediately by giving further notice to such effect to Protection One.

(iv) If the Pilot Program is not completed by April 18, 2000, Protection One may terminate this Agreement by giving notice to such effect to Paradigm and POMS within 15 days following such date.

(v) Protection One may terminate this Agreement by giving notice to such effect to Paradigm and POMS at any time after the expiration of the first Marketing Year of the Term under the following circumstances:

(A) POMS does not deliver to Protection One the Targeted Number of Qualified Customer Accounts for the preceding Marketing Year; or

(B) The attrition on Qualified Customer Accounts delivered by POMS to Protection One exceeds by 25% or greater that of a "statistically valid random sample" of Protection One's traditional dealer business over a similar period of time; or

(C) Either Mark Byron or David Graf ceases to be an employee of either Paradigm or any entity that controls Paradigm, or either is no longer actively involved in the management of POMS or the delivery of the Marketing Services to Protection One hereunder.

(vi) Provided the parties have met at least ninety (90) days prior to the expiration of a Marketing Year to discuss plans for the following year, then either party may terminate this Agreement at any time after the first Marketing Year if they fail to agree on the terms subject to adjustment pursuant to Section 2.3 above. Termination pursuant to this provision shall become effective thirty (30) days after the new Marketing Year.

(b) If this Agreement terminates for any reason, with or without cause, such termination shall not affect or negate or obviate any obligation of any party to any other party arising prior to the date of such termination and any termination of this Agreement shall be without prejudice to any right, remedy or recourse to which the terminating party may be entitled under this Agreement or otherwise at law or in equity. Furthermore, the provisions of Sections 5.2, 5.3, 7.3, 8.4, 8.5, 8.6, and 16.11, Article XI, Article XIII, Article XIV, Article XV, and any other sections that expressly provide for post-termination obligations shall survive the termination of this Agreement.

(c) If this Agreement terminates for any reason, with or without cause, and notwithstanding any provision herein to the contrary, Protection One shall be have the right, but not the obligation, to offer employment to any POMS employee who was previously employed by Protection One.

ARTICLE XI NOTICES

11.1 *Form.* Any notice, consent, authorization, direction or other communication required or permitted to be given hereunder shall be in writing and shall be delivered either by personal delivery or by telecopier or similar telecommunication device marked "Urgent," and addressed as follows:

In the case of Paradigm or POMS, at:

Two Executive Drive
Fort Lee, NJ 07024
Attention: Marc Byron, CEO

With a copy to:

Allen Rothman, Esq.
Robinson, Brog, et al
1345 Sixth Avenue
New York, NY 10105

In the case of Protection One, at:

818 Kansas Avenue
Topeka, KS 66612
Attention: Annette Beck, President

With a copy to:

Renée T. Kingsley, Esq.
Protection One
6225 N. State Hwy 161, Suite 400
Irving, TX 75038

11.2 *Delivery, Receipt, and Change of Address.* Any notice, consent, authorization, direction or other communication as aforesaid shall be deemed to have been effectively delivered and received, if

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sent by telecopier or similar telecommunications device on the business day of such transmission or, if the transmission occurs after 5:00 p.m. (at the place of receipt) on the next business day (proof of transmission required and overnight courier delivery of originals required) or, if delivered, to have been delivered and received on the date of such delivery provided, however, that if such date is not a business day, then it shall be deemed to have been delivered and received on the business day next following such delivery. The failure of any party to mark "Urgent" on a delivery shall not negate the notice provided hereunder. Any party hereto may change its address for service by written notice given as aforesaid.

ARTICLE XII PERFORMANCE OF DUTIES; REQUESTS FOR INFORMATION

12.1 *General Duties.* Each of Protection One and POMS hereby covenant and agree that it shall, during the Term (as hereinafter defined), perform each of their duties and obligations as set forth in this Agreement in a competent and timely manner and in a manner consistent with the best interests of and so as not to harm or injure the other.

12.2 *Requests for Information.* The regular reports which the parties shall exchange, along with a schedule for delivery thereof, are listed on **Exhibit F** hereto. All such other requests for information shall be met within a reasonable time period, provided however that the parties shall provide to each other any requested documents, records, data or information necessary to comply with government regulations or court order within seventy-two (72) hours after the receipt of a written request therefor. In addition, upon reasonable notice and at such times as are reasonably practical, the parties shall allow authorized representatives of the other party access to the books and records of such party maintained with respect to this Agreement.

ARTICLE XIII CONFIDENTIALITY

13.1 *Confidentiality.* The parties agree that no party shall disclose any material terms of this Agreement for any purpose, without the prior written consent of the other parties, unless such disclosure is made in connection with a lawsuit or arbitration proceeding to enforce or interpret this Agreement; is required by law, court order, rule or regulation (including without limitation laws, rules and regulations relating to any public or private offering or trading of shares of common stock or other debt or equity securities of a party or its affiliate company); or is being made to any investor or lender (including their respective counsel and advisors) of a party, in which case, prior to such disclosure, such investor or lender shall agree to abide by the provisions of this Section 13.1. The parties agree to maintain as secret and confidential all "Confidential Information," as defined herein, and agree not to use, disclose, transfer, sell or make such information available to any successors or third parties, except as authorized in advance and in writing by the party to which such information belongs. The term "Confidential Information" means any trade secrets, proprietary or other information reasonably known by a party to be confidential or

designated as confidential by a party, relating to this Agreement or the Customer Accounts, including without limitation the names, addresses and telephone numbers of Protection One's authorized dealers, POMS Independent Contractors, the business plans, pricing and marketing strategies of either party and any of the following information relating to Customers whose Customer Accounts are being purchased by Protection One under this Agreement and which is hereby designated by the parties to be confidential: any Customer lists; any lists, notes, or compilations which contain the names, addresses, telephone numbers and any contract information for or relating to the Customers; and copies of contracts, agreements, and related documents between Protection One and the Customers.

ARTICLE XIV INDEMNIFICATION

14.1 *Indemnification by Paradigm.* Paradigm shall indemnify and hold Protection One and its affiliates, and their respective directors, officers, employees and representatives, harmless from and against any and all claims, demands, regulatory proceedings and causes of action, and all damages, liabilities, losses, penalties, costs (including settlement costs) and expenses associated therewith (including but not limited to attorneys' fees) suffered or incurred by Protection One, any of its affiliates or any of their respective directors, officers, employees or representatives, arising from or relating to any of the following:

(a) Any breach by Paradigm or its respective employees or representatives of any of its representations, warranties, covenants or agreements set forth in this Agreement; or

(b) Any (i) libel, slander or defamation, (ii) intentional or negligent infliction of emotional distress, (iii) duress, (iv) invasion of the right of privacy, (v) negligent supervision, (vi) discrimination, harassment or intimidation, (vii) other intentional or negligent tort, or (viii) violation of law in each case on the part of Paradigm or its employees or representatives in connection with any training of Protection One's employees conducted by Paradigm or its respective employees or representatives from or after September 16, 1999.

14.2 *Indemnification by POMS.* POMS shall indemnify and hold Protection One and its affiliates, and their respective directors, officers, employees and representatives, harmless from and against any and all claims, demands, regulatory proceedings and causes of action, and all damages, liabilities, losses, penalties, costs (including settlement costs) and expenses associated therewith (including but not limited to attorneys' fees) suffered or incurred by Protection One, any of its affiliates or any of their respective directors, officers, employees or representatives, arising from or relating to any of the following:

(a) Any breach by POMS or its respective employees or representatives of any of its representations, warranties, covenants or agreements set forth in this Agreement;

(b) Any claims relating to a Customer Account arising out of the acts or omissions of POMS or its employees, agents or representatives prior to transfer of such account to Protection One, including without limitation claims relating to marketing, sales and installation, except to the extent such claims arise out of acts or omissions of Protection One employees, agents or representatives;

(c) Any (i) libel, slander, defamation or product disparagement, (ii) infringement of copyright, title, slogan or other property rights, (iii) piracy, plagiarism, unfair competition or idea misappropriation, or (iv) invasion of the right of privacy, in each case on the part of POMS or its employees or representatives in connection with the rendering of the Marketing Services hereunder; or

(d) Any (i) libel, slander or defamation, (ii) intentional or negligent infliction of emotional distress, (iii) duress, (iv) invasion of the right of privacy, (v) negligent supervision, (vi) discrimination, harassment or intimidation, (vii) other intentional or negligent tort, or (viii) violation of law in each case on the part of POMS or its employees or representatives in connection with any training of Protection One's employees conducted by POMS or its respective employees or representatives from or after September 16, 1999.

14.3 *Indemnification by Protection One.* Protection One shall indemnify and hold Paradigm and POMS and their affiliates, and their respective directors, officers, employees and representatives, harmless from and against any and all claims, demands, regulatory proceedings and causes of action, and all damages, liabilities, losses, penalties, costs (including settlement costs) and expenses associated therewith (including but not limited to attorneys' fees) suffered or incurred by Paradigm or POMS, any

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of their affiliates or any of their respective directors, officers, employees or representatives, arising from or relating to any of the following:

- (a) Any breach by Protection One or its employees or representatives of any of its representations, warranties, covenants or agreements set forth in this Agreement; or
- (b) Any claims relating to a Customer Account arising out of the acts or omissions of Protection One or its employees or representatives after the transfer of such account to Protection One, except to the extent such claims arise out of acts or omissions of POMS employees, agents or representatives.
- (c) Any (i) libel, slander or defamation, (ii) intentional or negligent infliction of emotional distress, (iii) duress, (iv) invasion of the right of privacy, (v) negligent supervision, (vi) discrimination, harassment or intimidation, (vii) other intentional or negligent tort, or (viii) violation of law in each case on the part of Protection One or its employees or representatives in connection with any training of Paradigm's employees conducted by Protection One or its employees or representatives prior to September 16, 1999;
- (d) Except as otherwise indicated in Sections 14.1(b) and 14.2(d) herein, (A) any employment-related claims asserted by any Protection One employee who was released from employment with Protection One prior to the effective date of this Agreement, and (B) any employment-related claims asserted by any former Protection One employee who becomes a POMS employee, arising out of or relating to such employee's employment with Protection One prior to December 1, 1999; or
- (e) Provided, POMS has obtained appropriate Protection One authority for the termination or modification of such agreement, any action taken by POMS or its employees in terminating or modifying the terms of any Protection One affinity agreement in effect as of the date of this Agreement.

14.4 *Conditions Precedent to Indemnification.* A party's obligations to indemnify, defend and reimburse hereunder are subject to a prior written thirty (30) day notice by the party seeking indemnification, of a claim, unless the claim involves litigation in which case the party seeking indemnification shall provide the indemnifying party with notice of such litigation within ten (10) business days after receipt of such complaint provided, however, so long as the indemnifying party is not in default hereunder, that indemnifying party shall have the right to conduct and control the defense, settlement or compromise of any claim subject to the party seeking indemnity's right to be kept currently informed and to participate in the defense.

ARTICLE XV REPRESENTATIONS AND WARRANTIES

15.1 *Paradigm and POMS.* Paradigm and POMS represent and warrant to Protection One that:

- (a) Each of them has full legal right, power and authority to execute, deliver and perform this Agreement and to consummate the transactions contemplated hereby. This Agreement has been duly executed and delivered by each of them and constitutes a valid and legally binding obligation of each of them, enforceable against each of them in accordance with its terms.
- (b) The execution, delivery and performance by each of them of this Agreement and the consummation by each of them of the transactions contemplated hereby do not and will not (i) conflict with or result in a violation of any provision of, or constitute (with or without the giving of notice or the passage of time or both) a default under, or give rise (with or without the giving of notice or

the passage of time or both) to any right of termination, cancellation or acceleration under, or require any consent, approval, authorization or waiver of, or notice to, any party to, any

contract, agreement, instrument or obligation to which either of them is a party or by which either of them or any of their respective properties may be bound, (ii) result in the creation or imposition of any lien or encumbrance upon the properties of either of them or (iii) violate any applicable law binding upon either of them.

15.2 *Protection One.* Protection One represents and warrants to Paradigm and POMS that:

(a) Protection One has full legal right, power and authority to execute, deliver and perform this Agreement and to consummate the transactions contemplated hereby. This Agreement has been duly executed and delivered by Protection One and constitutes a valid and legally binding obligation of Protection One, enforceable against it in accordance with its terms.

(b) The execution, delivery and performance by Protection One of this Agreement and the consummation by Protection One of the transactions contemplated hereby do not and will not (i) conflict with or result in a violation of any provision of, or constitute (with or without the giving of notice or the passage of time or both) a default under, or give rise (with or without the giving of notice or the passage of time or both) to any right of termination, cancellation or acceleration under, or require any consent, approval, authorization or waiver of, or notice to, any party to, any contract, agreement, instrument or obligation to which Protection One is a party or by which it or any of its properties may be bound, (ii) result in the creation or imposition of any lien or encumbrance upon the properties of Protection One or (iii) violate any applicable law binding upon Protection One.

ARTICLE XVI MISCELLANEOUS

16.1 *Further Assurances.* Each party agrees that upon the reasonable request of the other, it will execute, acknowledge and deliver any and all such further instruments, and do and perform any and all such other acts as may be necessary or appropriate in order to carry out the intent and purposes of this Agreement.

16.2 *Waivers or Modifications.* No waiver, modification or cancellation of any term or condition of this Agreement shall be effective unless executed in writing by the party to be charged therewith. No written waiver shall excuse the performance of any act(s) other than those specifically referred to therein. A waiver of any breach by any party hereunder shall not constitute a waiver of any subsequent breach(es) by such party hereunder.

16.3 *Legal Expenses.* In case legal proceedings shall be brought for the breach of any covenant herein contained, and a breach shall be established, the prevailing party shall be entitled to recover from the other party all expenses incurred thereby, including reasonable attorneys' fees and disbursements.

16.4 *Governing Law.* This Agreement and the performance hereof will be construed and governed in accordance with the laws of the State of New York, without regard to its choice of law principles.

16.5 *Severability.* If any provision of this Agreement is held to be illegal, invalid or unenforceable, such provisions will be fully severable and this Agreement will be construed and enforced as if such illegal, invalid or unenforceable provision never comprised a part hereof; and the remaining provisions hereof will remain in full force and effect and will not be affected by the illegal, invalid or unenforceable provision or by its severance herefrom. Furthermore, in lieu of such illegal, invalid or unenforceable provision, there will be added automatically as part of this Agreement a provision as similar in its terms to such illegal, invalid or unenforceable provision as may be possible and be legal, valid and enforceable.

16.6 *Entire Agreement.* This Agreement and the Exhibits hereto constitute the entire agreement between the parties hereto pertaining to the subject matter hereof and supersede all prior agreements, understandings, negotiations, and discussions, whether oral or written, of or by and between the parties hereto in respect of such subject matter, including without limitation the Letter of Intent dated September 16, 1999 between Protection One and Paradigm. This Agreement may not be amended except by a written instrument hereafter signed by each of the parties hereto.

16.7 *Binding Agreement.* This Agreement is binding upon, and inures to the benefit of, the parties, their permitted assigns, and their respective successors. Nothing in this Agreement, expressed or implied, is intended to confer on any person, other than the parties or their respective successors, any rights, remedies, or liabilities under this Agreement.

16.8 *Assignment/Change of Control.*

(a) POMS may not assign this Agreement without the prior written consent of Protection One except (1) to any affiliate company; or (2) to any proposed non-affiliated assignee, provided that the proposed assignee (i) has the financial capability to perform the obligations of POMS hereunder, (ii) management of the assignee has substantial relevant direct marketing experience; and (iii) is not in direct competition with Protection One or its affiliates in any material respect. POMS shall provide Protection One with any background information on the proposed assignee as reasonably requested.

(b) Protection One may not assign this Agreement without the prior written consent of POMS, except (1) to any affiliate company; or (2) to any proposed non-affiliated assignee, provided that the proposed assignee (i) has the financial capability to perform the obligations of Protection One hereunder; (ii) management of the proposed assignee has substantial relevant alarm monitoring and servicing experience; and (iii) is not in direct competition with POMS or Paradigm. Protection One shall provide POMS with any background information on the proposed assignee as reasonably requested.

(c) Notwithstanding anything in this Section 16.8 to the contrary, if Western Resources or one of its subsidiary companies ceases to be a majority shareholder of Protection One (such event to be referred to herein as divestiture), then Protection One, or its successor entity shall notify Paradigm within thirty (30) days from the date of divestiture whether Protection One or its successor entity wishes to continue this Agreement. If Protection One or its successor entity elects to terminate, then this Agreement will be terminated on the date that is fifteen (15) calendar days following notice to Paradigm of such election and all obligations and payments accruing through such date of termination shall be paid as provided hereunder, except that with respect to the Customer Continuation Fees described in Section 7.3 herein, Protection One or its successor would have the option to make a one time lump sum payment of \$75.00 per account in good standing at the time of termination in lieu of any further \$20 obligations. Additionally, Paradigm would have the option to request a one time lump sum payment of \$60.00 per account at the time of termination in lieu of any further \$20 obligations, provided, however, that such lump sum payment does not cause Protection One or its successor to default on its debt covenants. Payment of the lump payment would be due within thirty (30) days of the effective date of termination.

16.9 *Counterparts.* This Agreement may be executed in one or more counterparts, each of which when so executed shall be deemed an original, and such counterparts together shall constitute one and the same instrument.

16.10 *No Impairment of Rights.* No delay or omission by any party hereto in exercising any right, power or privilege hereunder will impair such right, power or privilege, nor will any single or partial exercise of any such right, power or privilege preclude any further exercise thereof of the exercise of any other right, power or privilege.

16.11 *Disputes.* The parties will attempt to resolve any dispute, controversy or claim arising out of or relating to this Agreement, any obligations of the parties hereunder, the relationship of the parties created hereby, or the breach, termination, enforcement, interpretation or validity hereof, including the determination of the scope or applicability of this agreement to arbitrate (a "Dispute"), through good faith

negotiations. If a Dispute cannot be resolved by negotiation, it shall be exclusively and finally resolved by confidential arbitration and any party may submit a Dispute to arbitration.

The arbitration proceeding shall be held in Chicago, Illinois before a sole arbitrator in accordance with the laws of the State of New York for agreements made in and to be performed in New York. The arbitration shall be administered by J.A.M.S. pursuant to its commercial arbitration rules. The arbitrator shall in the award allocate all the costs of the arbitration, including fees of the arbitrator and reasonable attorneys' fees of the prevailing party against the party who did not prevail. The arbitrator shall also have the power to impose any sanction against any party permitted by New York law. Judgment on the award may be entered in any court having jurisdiction. Notwithstanding anything to the contrary contained in this Section 16.11, the arbitration proceeding and arbitrator shall apply New York substantive law. The award shall be in writing and shall indicate the factual findings and the reasons upon which the decision is based. In the event of a breach or alleged breach of the confidentiality, non-competition, or non-solicitation provisions of this Agreement the parties shall not be obligated to seek remedies exclusively through arbitration as provided herein, but may at the petitioning party's election seek any and all equitable remedies in any court of competent jurisdiction. However, the parties agree that the arbitrator may award equitable relief, including, without limitation, temporary restraining orders, injunctions and specific performance. In the event of a breach or alleged breach of this Agreement, a party also may at its election exercise its remedies of set-off or recoupment even if an arbitration proceeding is then pending and without waiver of any right to require arbitration.

16.12 *Westar Capital Guaranty*. Simultaneously with the execution and delivery of this Agreement, Westar Capital, Inc. has executed and delivered a guaranty of the obligations of Protection One with respect to any payments due hereunder from Protection One, in the form attached hereto as **Exhibit G**.

IN WITNESS WHEREOF, the parties have caused this Agreement to be executed by their duly authorized representatives as of the day and year first above written.

Protection One Alarm Monitoring, Inc.

By: /s/ Annette Beck

Name: Annette Beck

Title: President and COO

Paradigm Direct, LLC

By: /s/ Marc Byron

Name: Marc Byron

Title: CEO

Marketing Services Company I, LLC

By: /s/ Marc Byron

Name: Marc Byron

Title: CEO

EXHIBIT A

Customer Account Criteria

Each Customer Account offered to Protection One must comply with the following criteria:

- (a) the account must have monthly recurring revenue of at least \$32.95;
- (b) the installation of the alarm system shall be completed and the alarm system shall be fully operational, capable of being monitored by Protection One's monitoring facility, and capable of being billed for monitoring and repair services by Protection One;
- (c) Protection One shall have received, in its reasonable judgment, a satisfactory result from its telephone survey to the Customer;
- (d) the Customer Account shall have met the criteria set forth in the definition of Customer Account;
- (e) all original documentation (including monitoring codes, upload codes, download codes, installer codes and programming codes) shall have been delivered to Protection One;
- (f) the alarm system shall have sent test signals to Protection One's monitoring facility in a manner reasonably acceptable to Protection One;
- (g) the Customer shall have paid any installation of additional equipment charges if applicable;
- (h) the Customer shall have a credit score of at least FICO 600 at the time such Customer's credit score is run by POMS; and
- (i) the installation of the alarm system shall be compliant with the standard as set forth in the Protection One Installation Manual as in effect from time to time.

EXHIBIT B

Marketing Services

1.

Consulting.

Respond to Protection One requests and actively initiate advice relating to marketing and business strategies and tactics, including but not limited to, areas such as follows:

Design and/or re-design of products (equipment offerings/packages, services, etc.)

Pricing of product and services, both list and promotional

Packaging of products, for instance, if a retail or online offering is needed

New or revised distribution channels (retail, internet, etc)

Brand development and market positioning

General advertising, including internet strategy

New direct response vehicles, particularly if they overlap with general advertising and/or customer service (internet, yellow pages, etc.)

Affinity and/or partnership strategies

Business development and long range marketing plans

Manage market research projects and agencies, generating business and/or marketing objectives and tactics, as appropriate.

2.

Special Projects.

Specific time-limited projects that arise from time to time and may relate to the implementation of tactical plans that derive from consulting or to Protection One business development, including but not limited to, areas such as follows:

Affinity programs with new Protection One partners and/or other divisions, with or without a direct response component

Marketing/advertising/promotional/customer acquisition plan and implementation in support of armed response/patrol geographic expansion

3.

Materials

Creation of marketing materials in support of Protection One business units including but not limited to customer communications, sales collateral material, dealer recruitment and trade show support.

4.

Account Production Activity Excluded

The Marketing Services described in this Exhibit do not include activities of POMS which are incidental to POMS generation of Qualified Customer Accounts and Qualified Leads.

EXHIBIT C

Independent Contractor Criteria

1. Use of the Protection One name as a part of Independent Contractor's company name or the Protection One logo in place of Contractor's own company insignia is prohibited.
2. Independent Contractor and/or any of its employees or subcontractors thereof, may not present themselves as employees of Protection One.
3. Independent Contractor and/or any of its employees or subcontractors thereof, do not have any right to make any commitment on the behalf of Protection One.
4. Independent Contractor must keep all alarm and city/county and other licenses current and must maintain insurance coverages required by the approved POMS Independent Contractor Agreement.
5. Independent Contractor is required to maintain an appropriate facility for a place of business which effectively portrays the quality service and reliability that is associated with Protection One.
6. It is the responsibility of the Independent Contractor to ensure that their employees present themselves in a professional manner. In this respect, employees should be clean and well groomed, preferably in uniform.
7. Automobiles driven should be clean and well maintained. Employees which enter the customer's home shall always carry some form of identification, preferably a badge.
8. It is also the responsibility of the Independent Contractor to ensure that its employees have not been convicted of a felony or misdemeanor involving theft, dishonesty, etc., are not suffering from habitual drunkenness or from narcotics addiction or dependence, and do not have a record of traffic violations which could result in a suspension of a drivers license or excessive insurance claims.
9. Independent Contractor must take reasonable steps to ensure that its employees and subcontractors are performing their duties in compliance with all applicable laws.

EXHIBIT D

Schedule of Warranty/Inspection Repair Fees

The obligation of POMS for charges described below, including repairs or service required as a result of Protection One's inspection of the installation, shall be limited to service or inspections performed during the first 90 days after installation, after which time Protection One shall take over all obligations for service and repair of the Qualified Customer Accounts. Protection One shall have the right to insist on the termination of any subcontractor whose installs continue to be in material, chargeable non-compliance with Protection One's Installation Standards for a period of more than sixty (60) days.

Labor

Labor will be charged for repairs of installed systems that do not comply with Protection One Installation Standards, provided however, that no labor shall be charged where the non-compliance may be repaired by Protection One at a cost of less than \$16.25 (or one quarter hour).

Except as otherwise provided above, labor will be charged as follows: the first hour will be charged to cover the initial trip at a \$50.00 minimum, to include the first 30 minutes. Then \$16.25 will be charged for each additional quarter hour, totaling \$82.50 for the first hour of labor.

\$65.00 per hour will be charged after the first hour of repair. This rate will be charged at \$16.25 per quarter hour increments.

Equipment Pricing

Equipment will be charged for repairs on installations that do not comply with Protection One Installation Standards at Protection One's cost plus 10% to cover freight and handling.

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EXHIBIT E

Marketing Budget

(see attached)

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EXHIBIT F

Reports

To Be Determined by Mutual Agreement of the Parties

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SPECIMEN

Exhibit G

Form of Westar Capital Guaranty

GUARANTY

FOR VALUE RECEIVED, Westar Capital, Inc., a Kansas corporation ("Guarantor"), by this agreement (the "Guaranty"), hereby guarantees to Paradigm Direct, LLC, a Delaware limited liability company ("Paradigm"), and Marketing Services Company I, LLC, a Delaware limited liability company d/b/a Protection One Marketing Services ("POMS"), the full and timely payment of each payment obligation of Protection One Alarm Monitoring, Inc., a Delaware corporation ("POI"), under the Marketing Agreement dated February 28, 2000 to which Paradigm, POMS and POI are parties (the "Marketing Agreement").

This Guaranty is a guarantee of performance and payment and not of collection and the Guarantor expressly waives any right to require that any action be brought against POI or to require that resort be had to any security in the favor of Paradigm or POMS or to any other right or remedy which may be available to Paradigm or POMS. Demand may be made under this Guaranty by or on behalf of Paradigm or POMS at any time, or on any number of occasions and as often as the occasion therefor may arise. The obligations of the Guarantor assumed hereunder are several from those of POI and all other persons, and the Guarantor is the principal obligor with respect thereto. All of the obligations of the Guarantor shall be unlimited.

This Guaranty shall be a continuing guaranty and the liability and obligations of the Guarantor hereunder shall be absolute and unconditional and shall remain in full force and effect without regard to, and shall not be released, discharged, diminished, limited or in any way impaired by, (i) any termination of the Marketing Agreement, (ii) any exercise or non-exercise of any right, power or remedy under this Guaranty or any forbearances or extensions of time for performance allowed to POI, (iii) any bankruptcy, insolvency, reorganization, liquidation or other proceeding relating to POI or any of its properties or creditors, or (iv) Guarantor's sale of its interests in or the assets of POI.

The obligations of the Guarantor hereunder shall continue in full force and effect until all the obligations of POI under the Marketing Agreement have been fully satisfied.

The Guarantor agrees to pay all costs and legal expenses, including reasonable attorney's fees, which Paradigm or POMS may incur in enforcing the obligations of the Guarantor under this Guaranty.

The Guarantor hereby waives presentment, demand, protest, collection or the taking of any other action by Paradigm or POMS and notice of protest, dishonor or nonpayment.

This Guaranty shall be governed by Kansas law.

The Guarantor represents, warrants and acknowledges that (i) it is the majority shareholder of POI, (ii) it will receive significant benefits from the execution, delivery and performance of the Marketing Agreement by POMS, (iii) POMS has conditioned its execution and delivery of the Marketing Agreement on the execution and delivery of this Guaranty, and (iv) there is sufficient consideration for this Guaranty.

The Guarantor further represents and warrants that the execution, delivery and performance of this Guaranty has been fully authorized and that all necessary consents and approvals for the same have been obtained.

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IN WITNESS WHEREOF, this Guaranty has been executed by a duly authorized officer of the Guarantor as of February 28, 2000.

WESTAR CAPITAL, INC.

By

Lee Wages, President

SPECIMEN

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[EXHIBIT A Customer Account Criteria](#)

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