VIRTRA SYSTEMS INC
Form 10KSB
March 22, 2005

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-KSB

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

For the Fiscal Year Ended December 31, 2004

or

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

For the transition period from _____ to _____

Commission File Number 000-28381

VIRTRA SYSTEMS, INC.

(Exact name of Registrant as specified in its Charter)

Texas	93-1207631
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
440 North Center, Arlington, TX	76011
(Address of principal executive offices)	(Zip Code)

(817) 261-4269

(Registrant's telephone number, including area code)

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE SECURITIES EXCHANGE ACT OF 1934:

None

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE SECURITIES EXCHANGE ACT OF 1934:

Common Stock, par value $.005 per share

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. YES |_| NO |X|

Indicate by check mark whether Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES |X| NO |_|

The aggregate market value of the voting stock held by non-affiliates of Registrant at March 1, 2005 was approximately $15,500,272. The number of shares of Registrant's common stock outstanding on March 1, 2005 was 60,859,064. Revenue for the most recent fiscal year was $1,328,180.

Part I

Item 1. Description of Business

BUSINESS OVERVIEW

Our principal business began in 1993 with the organization of Ferris Productions, Inc. Ferris designed, developed, distributed, and operated virtual reality products for the entertainment, simulation, promotion, and education markets.

Virtual reality is a generic term associated with computer systems that create a real-time visual/audio/haptic (touch and feel) experience. Virtual reality immerses participants into a three-dimensional real-time synthetic environment generated or controlled by one (or several) computer(s). In September of 2001, Ferris merged into GameCom, Inc., a publicly held Texas company whose principal business at the time was the development and marketing of an internet-enabled video game system. Our historic areas of application have included the entertainment/amusement, advertising/promotion, and training/simulation markets.

Our *immersive virtual reality™"* devices are computer-based, and allow participants to view and manipulate graphical representations of physical reality. Stimulating the senses of sight, sound, touch, and smell simultaneously, our virtual reality devices envelop the participant in dynamic filmed or computer-generated imagery, and allow the participant to interact with what he or she sees using simple controls and body motions. Virtual reality products have traditionally employed head-mounted displays that combine high-resolution miniature image source monitors, wide field-of-view optics, and tracking sensors in a unit small and light enough to be worn on the head. These products usually surround the participant with dynamic three-dimensional imagery, allowing the user to change perspective on the artificial scenes by simply moving his or her head. Virtual reality devices have in the past been used primarily in connection with electronic games, as, by surrounding the player with the sights, sounds, and smells he or she would experience in the real world, play is made far more realistic than it would be if merely presented in a two-dimensional flat screen display.

We maintain our corporate office at 440 North Center, Arlington, Texas 76011, and our telephone number is (817) 261-4269. We also maintain engineering, technical, and production offices, and a demonstration facility, at 5631 South 24th Street, Phoenix, Arizona 85040, with a phone number of (602) 470-1177.

Entertainment/Amusement

The entertainment/amusement market was the original market for our products. Our *"immersive virtual reality™"* devices were designed to produce a highly-realistic experience at a significantly lower cost than traditional virtual reality technology. Historically, the software for virtual reality games and other applications was separately created for each application. Our systems were developed using our patented Universe Control Board™, which, when installed in an ordinary PC, makes it possible to quickly adapt PC games for the arcade market, permitting easy conversion of PC games to behave as coin-operated arcade games, and allows the operator to change from one game to another without expensive hardware replacement.

Within the entertainment/amusement market, we installed and operated virtual reality entertainment centers known as VR Zones in over a dozen theme parks and high-traffic visitor locations, such as:

- Six Flags,
- Paramount Parks,
- Busch Gardens, and
- Carnival Cruise Lines.

These VR Zones were equipped with systems we developed and manufactured, and were operated by our employees on a revenue-share basis with the theme park locations. We sold our VR Zones and effectively left this market in the spring of 2003, in order to more fully focus on the advertising/promotional and training/simulation markets.

Advertising/Promotion

We entered the advertising/promotion market, our second, with our 2000 “Drive With Confidence Tour™” for Buick, featuring a virtual reality “test-drive” of a Buick LeSabre with PGA professional Ben Crenshaw accompanying the participant. This project led us to additional projects within this market, such as:

· a virtual reality bi-plane experience for Red Baron® Pizza,

· a virtual reality ski jump promotional program for Chevrolet in conjunction with its *“Olympic Torch City Celebration Tour™,”*

· an interactive promotional project for Shell Oil Product’s Pennzoil® division’s *“Vroom Tour™*”, which featured Jay Leno “inside” an automobile engine demonstrating how oil functions inside an automobile engine, and ended with the visitor driving Pennzoil’s Formula One car around the Las Vegas Motor Speedway at speeds in excess of 220 miles per hour,

· a 50-seat, 3-D immersive theater for Red Baron® Pizza’s *“3-D Flying Adventure™,”* which featured special glasses, Dolby® 5.1 sound, and special effects that literally “jump” off the screen, and

· a virtual reality recruitment tool for the United States Army, in which participants ride in an Army Black Hawk helicopter performing an exciting rescue mission.

2004 advertising/promotion projects included a new 3-D immersive theater project for Sea-Doo® using our 3-D technology for 2-D to 3-D video conversion and 3-D computer animation, for 1) a motion simulator utilizing polarized glasses, 2) a theater-style presentation utilizing anaglyph (cyan-blue) glasses, and 3) a web-suitable version utilizing 3-D anaglyph glasses, all in connection with Bombardier's launch of its new 2004 Sea-Doo® 3D™ personal watercraft.

The year 2004 also saw our completion of a strategic move from headset-based to projection-based technology, evidenced by the development and launch of our patented Immersa-Dome™, featuring a domed-shaped screen which surrounds the seated viewer and delivers a high-definition resolution virtual reality experience.

The May 3, 2004, launch of the Immersa-Dome product was rapidly followed by several new projects:

· a mobile promotional experience for Buick's new Terraza™ and LaCrosse™ vehicles, using four Immersa-Dome units installed in two of Buick's event-marketing trailers. This was our second collaboration with Buick's event marketing agency, Momentum Detroit,

· a sale of three Immersa-Domes to the United States Army Recruiting Command in Fort Knox, Kentucky, for installation in mobile recruiting trailers traveling the United States to major events, high schools, and universities in connection with the Army's recruiting efforts, and

· the installation of three Immersa-Domes at the new Red Baron® Museum in Marshall, Minnesota, providing the visual experience of flying an acrobatic bi-plane with the Red Baron® Pizza Squadron™ in an 180-degree multisensory experience.

Over the last quarter, as a result of our recent Immersa-Dome mobile promotional tour, we have several proposals currently under submission to a number of advertising/promotional agencies, Fortune 500 companies, and governmental agencies in conjunction with pending advertising/promotional campaigns.

Training/Simulation

In 2004, we unveiled our IVR™ line of projection-based training simulators for judgmental use-of-force, situational awareness, combat-readiness, and tactical judgment objectives. The two IVR product lines provide the law enforcement, military, and security markets with 360-degree immersive training environments.

Our IVR HD™ series, designed primarily for law enforcement objectives, was completed in January of 2004, and was publicly debuted to the domestic law enforcement market in late March of 2004, at the industry's Trexpo West trade show in Long Beach, California.

Our military-oriented IVR 4G™ system, designed to train soldiers for fourth generation warfare, was debuted at the industry-leading I/ITSEC trade show in Orlando, Florida in December of 2004. Fourth generation warfare, as discussed in the October, 1988 *Marine Corps Gazette,* is characterized by transnational groups without territorially-based armies, engaging in highly irregular practices such as guerilla warfare, terrorist tactics, and low-intensity, close quarter conflict, enabling groups that are weaker militarily to defeat larger, stronger forces. Fourth-generation battlefields may include the whole of the enemy's society, where small, well-trained, highly maneuverable forces may tend to dominate

We announced our initial sale in this market in September of 2003, and, as of December 31, 2004, we had sold 29 systems, all variations of the IVR series, to the United States Air Force, the United States Army, a classified Department of Defense customer, and state police and security organizations in Mexico and India. Our initial IVR series installation was accomplished in March of 2004. We have recently received several confidential purchase commitments, and we have several additional confidential proposals currently under review.

Virtual Reality Products

Our *"immersive virtual reality™"* products include:

Training/Simulation Products

The IVR HD™ and IVR 4G series, designed for law enforcement and military use, respectively, are projection-based, multi-screened, high-definition resolution, combat-readiness and judgmental use-of-force firearms training simulators. The IVR™ series simulators use company-produced high-definition filmed content as well as our Hybrid-CGI™ content. Our Hybrid-CGI software combines film content with computer-generated images, allowing users to create their own customized 360-degree training scenarios by combining green-screen video, panoramic photorealistic images, computer-generated images, and 3-D sound. Green-screen filming is the technique of filming actors and other visual elements in the foreground against an evenly-colored green background, and subsequently extracting the actors and other visual elements and placing them onto a new panoramic background specifically suited to the user s needs and locale.

The IVR systems use off-the-shelf computer equipment, extremely-accurate laser-based weapons tracking, 360-degree video and audio, and ultra-high resolution interactive graphics. The systems deliver both photorealistic and computer-generated imagery -based video for training scenarios. The systems support one to six users, and have the option to be reconfigured into a 20-lane, military-approved, virtual shooting range for realistic marksmanship training.

Trainees step into the simulator, and then interact with a training scenario selected by the instructor, using their weapon of choice. The training scenarios teach combat-readiness, situational awareness, fourth-generation warfare tactics, and judgmental use-of-force with both lethal and non-lethal weapons currently used by military, law enforcement, and security agencies.

The IVR 4G military series of simulator products are offered in four different configurations:

· the IVR 4G-base™ is a single-screen model, and its compact size offers portability and supports one to four trainees.

· the IVR 4G-180™ offers an 180-degree field-of-view for more realistic combat training and marksmanship. It supports one to four trainees.

· the IVR 4G-300™ delivers 300-degree field-of-view for more realistic combat scenarios and marksmanship training, and supports one to five trainees.

· the IVR 4G-360™ offers a 360-degree field-of-view for combat and marksmanship training, and supports one to six trainees.

The IVR HD law enforcement series is offered in four different configurations:

· the IVR HD-base™ is a single-screen model, offering portability, and supports one to four trainees.

· the IVR HD-180™ offers an 180-degree field-of-view for more realistic training and target tracking. It supports one to four trainees.

· the IVR HD-300™ delivers 300-degree use-of-force scenarios, and supports one to five trainees.

· the IVR-360™ HD offers 360-degree firearms training, and supports one to six trainees.

We also have developed and market proprietary training accessories for use with both our IVR product lines, as well as those manufactured by third-parties:

· the wireless Threat-Fire™ belt permits the simulator's instructor to deliver an electric "stun" to the trainee, simulating the sensation of being shot, thus enhancing the multi-directional experience of our IVR simulators by increasing the seriousness and stress of training scenarios.

· our Hybrid-CGI™ scenario creation software integrates "green-screen" video, panoramic photorealistic images, computer-generated images, and 3-D sound, decreasing both cost and time of scenario production. Our Hybrid-CGI software offers the end-user more custom scenario options than traditional scenario production methods and other forms of training software.

· a wireless/tetherless drop-in recoil conversion kit, which transforms a live weapon into an accurate and safe training weapon. It features 1) a laser-based tracking mechanism, 2) self-contained, tetherless pneumatic recoil, and 3) instructor-controlled weapon malfunction capability to simulate a jammed weapon in the field. The system provides no possibility of chambering a live bullet while in training mode.

· laser-based pneumatic recoil conversion kits for most military and law enforcement handguns, assault rifles, and shotguns.

· less-lethal, laser-based training tools, including Taser® and canister OC pepper spray.

· TMaR (Trainee Monitor and Recording) debriefing product, which records and plays back the trainee's actions in the simulator, allowing systematic review of the trainee's performance.

Advertising/Promotional Products

· the Immersa-Dome™ is a patented projection-based virtual reality system, which uses a domed-shaped screen to surround the viewer. The Immersa-Dome offers photorealistic environments with 180-degree field-of-view and high-definition resolution. The system is composed of the dome's base, the viewer's seat, and a separate projector/mirror stand.

· the 3-D Multisensory Theater™ is a portable-seat, high-capacity (50-100 viewers) 3-D theater with special effects packages, including fog, wind, and simulated lighting, among others. This theater system features 3-D, high-resolution imagery on a large projected screen. Participants wear polarized glasses, which facilitate 3-D depth in the screen images. This system also features time-triggered smells, wind simulation, and a Dolby® 5.1 sound system. The 3-D Multisensory Theater uses a silver

screen and two projectors. Three-dimensional filming techniques are used and processed to finalize the 3-D experience. Computer-generated 3-D imagery is an alternative development method to 3-D filming.

· the 360-degree headset-based virtual reality system delivers photorealistic content. In addition, the user, while seated, is tracked in 360 degrees. The multisensory system incorporates off-the-shelf computer equipment, gyroscopic head-tracking, stereo sound, wind simulation, and smell. The system comes standard for one user.

Competition

Competition within each of our markets is intense.

There are several large competitors in the general field of high-tech simulation. For instance, the January 7, 2002 edition of Forbes magazine contains a feature story on L3 Communications, Inc., a company purportedly doing in excess of $5 billion in business with the United States government in this market. L3 has so far focused on other types of simulators (such as aircraft motion simulators) and to-date we have never directly competed against L3, and may never compete with them regarding our IVR simulators. Other companies have made essentially the same single-screen style simulator for the past 15 years or longer.

As our virtual reality experiences are usually custom applications, and we deal primarily with advertising agencies, or directly with the client, it is difficult to quantify the competition. Sometimes companies are able to penetrate one or two particular high-tech promotions. With over 12 years in the marketplace, we currently are not aware of any other virtual reality-based advertising/promotion company with similar products similar to ours.

Some general competitors within the virtual reality industry that promote substitute and similar technologies are as follows:

· **Straylight**--since 1992, Straylight has focused on the exploitation of virtual reality in the promotions and conventions market, basing its original customized systems on expensive Silicon Graphics computers. Most recently, it launched the stand-up 3DXTC system, offering a headset-based, lightweight system utilized within the advertising/promotional market.

· **Advanced Interactive Systems, Inc. (AIS)--**has been a provider of interactive simulation systems designed to provide training for law enforcement, military, and security agencies since 1993. Its line of products uses primarily video production in judgmental training scenarios. AIS also markets to anti-terrorist and other special application training facilities for military and special operations groups. Its systems have historically been based using single screen technology.

· **Firearms Training Systems, Inc. (FATS)--**claims to have over 4,000 training systems installed worldwide by military, law enforcement, and commercial customers. FATS is a full service training/simulation company that also uses video scenarios and single-screen technology with an optional video-training scenario authoring system. AIS and FATS are similar in many respects, although FATS has been in the market longer.

· **L3 Communications, Inc.**--a supplier of intelligence, surveillance and reconnaissance products, secure communications systems and products, avionics and ocean products, training products, microwave components and telemetry, instrumentation, space, and wireless products. Its customers include the Department of Defense, selected U.S. government intelligence agencies, aerospace prime contractors, commercial telecommunications, and wireless customers. L-3 s product mix includes; secure communication systems, training systems, microwave components, avionics and ocean systems, telemetry, instrumentation, space, and wireless products. L3 is a large company with a very diverse range of products and services geared towards defense related activities. It has a division for simulation and training with several products currently deployed. One of these simulators projects images on multiple screens using computer-generated graphics. L3 systems consist of computer generated graphics, and currently do not use video or film for its

content, to the best of our knowledge, nor does it produce complete 360-degree projected or head-mount display systems. Due to the size and strength of L3 within the defense industry and other governmental agencies, it could become a very formidable competitor if it chose to enter the 360-degree, photorealistic, virtual reality simulation market.

· **IES Interactive Training, Inc. (IES)**--a supplier of basic simulation equipment to law enforcement. Having fielded several hundred single screen systems in the law enforcement with little emphasis on military, it is in the competitive landscape. Our recent patent application may hamper or halt potential plans by IES or others to compete with our IVR multi-screen systems.

· **Cubic Defense Applications** performing in a wide range of industries, including military simulation, Cubic currently produces a product which is mainly a marksmanship training system, with limited combat training capabilities. Due to its size and strength, Cubic could become a formidable competitor if it chose to focus on firearms training.

The above summary of competition is by no means exhaustive, since this is a fluid and rapidly-expanding industry.

Marketing

Marketing within the training/simulation market is conducted primarily through trade shows, trade journal advertisements, search engine strategies, and one-on-one demonstrations. We recently completed and publicly unveiled the IVR HD™ series of law enforcement-focused advanced training simulators at the Trexpo West trade show in March of 2004, and we publicly unveiled the military-oriented IVR 4G™ fourth generation warfare simulators at the I/ITSEC trade show in December of 2004. We have demonstrated the IVR simulators to high-level officers in the United States military, the Department of Defense, as well as to municipal, state, and federal agencies both domestically and internationally. In addition to our 22 announced sales to foreign governmental agencies, we have also sold seven systems to domestic military and law enforcement agencies, and we have been advised that our IVR simulators are in the budgeting stages for branches of the United States Armed Forces, municipal and state law enforcement agencies, and several foreign governments. Of the 29 IVR™ systems we have sold, four have been fully installed, two have been shipped and are awaiting installation, and the remainder are contracted for future delivery.

Marketing within the advertising/promotional market is conducted primarily by web-based search engine strategies and by the face-to-face sales efforts of our vice-president of advertising and promotion. Our Immersa-Dome demonstration unit uses high-definition content from our projects for Pennzoil, Buick, Red Baron® Pizza, Chevrolet,

and the U.S. Army. Marketing within this industry is conducted primarily by one-on-one appointments and demonstrations of our technology to agencies and qualified corporations. We also attend industry tradeshows to generate leads and to garner further market exposure.

Employees

At March 1, 2005, we employed 13 people. None of our employees are members of a union, and we consider relations with our employees to be satisfactory.

Trademarks/Patents

We have obtained a patent for our Universe Control Board™, and various federal trademarks. We have also filed for federal registration of our "Immersive Virtual Reality™" and "IVR™" trademarks.

On March 15, 2004, we applied for a patent on our IVR™ series of advanced training simulators, seeking a patent for our multiple screen simulation system and method for situational response training.

On May 3, 2004, we announced that we had obtained an exclusive license to the patented technology behind the Immersa-Dome.

On December 3, 2004, in advance of industry demonstration at the industry-leading Interservice/Industry Training and Simulation Education Conference in Orlando, Florida, we submitted three separate patent applications for innovations in the field of firearms training. These included: 1) the Threat-Fire™ Belt, 2) our Hybrid-CGI™ software, and 3) a "drop-in" kit and magazine for wireless recoil in real weapons.

First, the Threat-Fire Belt permits the simulator's instructor to deliver an electric "stun" to the trainee, simulating the sensation of being shot, thus enhancing the multi-directional experience associated with our IVR simulators.

Second, the Hybrid-CGI software integrates "green-screen" video, panoramic images, computer-generated images, and 3-D sound. Green-screen filming is the technique of filming actors and other visual elements in the foreground against an evenly-colored green background, and subsequently extracting the actors and other visual elements and placing them onto a new panoramic background specifically suited to the user s needs and locale. Hybrid-CGI software decreases both cost and time of scenario production, and provides more scenario options to the end user than traditional production methods.

Third, the "drop-in" kit and magazine is non-permanent, and delivers wireless recoil to a real weapon. The magazine is refillable, and the aiming laser features hyper-accurate collinear placement for both immersive combat training and marksmanship qualification. Use of untethered training weaponry is highly desirable in firearms simulators.

There can be no assurance that patents or trademarks will issue on these applications, or that, if issued, they will be sufficiently broad to provide meaningful protection

Item 2. Description of Property

Our executive offices are located in Arlington, Texas, at the offices of Jones & Cannon, P.C. See "Certain Relationships and Related Transactions." Jones & Cannon, P.C. began charging us $1,500 per month for our office space on June 15, 2000, but to date only $9000 has been paid, all in 2002. There is no assurance that these offices will remain sufficient for our use, or that the nature of this relationship will continue.

Our production offices are located in Phoenix, Arizona, in an office building owned by Ferris Holdings, L.L.C. See Certain Relationships and Related Transactions. Ferris Holdings has charged us $7,772.00 per month for our office space since August of 2000. We have a 25 1/2-year lease with Ferris Holdings.

Item 3. Legal Proceedings

On May 8, 2003, we filed a declaratory judgment lawsuit in the 348th state district court of Tarrant County, Texas against Legg Mason Wood Walker Incorporated and the Depository & Clearing Corporation, now pending as cause number 348-198792-03. In this suit, we refer to the district court s prior ruling that our cancellation of shares of the company s common stock formerly in the name of William E. K. Hathaway II c/o Olympic Holdings, L.L.C. was proper, and in this suit we seek a further judicial determination that Hathaway s subsequent endorsement of his certificate to these companies was ineffective, as the certificate was no longer genuine and could not be registered, and, further due to other alleged irregularities, resulting in our having no liability to these companies. We subsequently dismissed Depository and Clearing Corporation from the lawsuit without prejudice. On July 2, 2003, Legg Mason counterclaimed against us for the sum of $277,855, representing the costs Legg Mason endured when required to purchase 700,000 shares of our stock on the open market to cover its short position resulting from our transfer agent s confiscation of the certificate originally issued to Mr. Hathaway. On March 16, 2005, the court granted Legg Mason s motion for summary judgment, and entered judgment in favor of Legg Mason against us for $277,855. We plan to file a motion for new trial, and, if denied, we will appeal the decision to the Fifth Circuit Court of Appeals.

On December 3, 2003, suit was filed against us in the 61st Judicial District Court of Harris County, Texas, in cause number 2003-65857, styled *Gloria Howden v. VirTra Systems, Inc.*, seeking payment of the sum of $240,000 in

equipment leases allegedly entered into by Ms. Howden with the former Ferris Productions, Inc. in 2001. We have contested the allegations. The case has been referred to mediation, to be held in March of 2005.

On December 4, 2003, former director and shareholder, John F. Aleckner, Jr., and his wife Barbara, demanded immediate payment of $274,500.00 in demand promissory notes we had previously executed. We filed suit against the Aleckners on January 14, 2004, in the 348th Judicial District Court of Tarrant County, Texas, in case number 348-203761-04, styled *VirTra Systems, Inc. v. John F. Aleckner, Jr. and Barbara H. Aleckner.* This lawsuit seeks cancellation of 2,191,694 shares of our common stock issued as consideration for such promissory notes, claiming illegal usury under Texas law. Further, we further seek cancellation/forfeiture of these promissory notes, as the alleged usury allegedly exceeds more than twice the lawful rate of interest under Texas law. We intend to aggressively prosecute this litigation, which is currently in the pre-trial discovery stage. Mr. Aleckner has counterclaimed against us and our chief executive officer, L. Kelly Jones, for fraud, negligence, and negligent misrepresentation. All parties have filed motions for summary judgment. Our and Mr. Aleckner s motions were denied, and Ms. Aleckner s subsequently argued, is under advisement. The case has been referred to mediation, to be held in March of 2005.

On January 20, 2004, we filed suit against VR Films, Inc., a Nevada corporation, and its officers John F. Aleckner, Jr. and Lance Loesberg, former directors and officers of our company, for its announced intent to compete with us, its allegedly improper contact with our customers, and for breach of contract, misappropriation, conversion, breach of fiduciary duty, unfair competition, and we are seeking punitive damages. VR Films has counterclaimed against us, seeking an unspecified amount of damages, and has brought suit against our chief executive officer and president, L. Kelly Jones, and Bob Ferris, respectively, claiming fraud. We intend to aggressively prosecute this lawsuit in order to protect our corporate opportunities, trade secrets, proprietary subject matter, and confidential business information. The case is currently in the pre-trial discovery phase.

On July 2, 2004, suit was filed against president Bob Ferris and his wife, Nichieli, by VR Films, Inc. for breach of contract. The lawsuit is currently pending in the federal district court in Phoenix, cause number CV04-1361PHXSMM. We intend to aggressively defend this litigation which is currently in the pre-trial discovery stage. Per agreement of the parties and order of the court, this case has been held in abeyance pending resolution of our Texas lawsuit against VR Films, Inc.

On February 6, 2004, suit was filed against us in County Court at Law No. 4 of Harris County, Texas, in cause number 810288, styled *Barbara Nedry v. VirTra Systems, Inc.*, seeking payment of the principal sum of $6,000, plus accrued interest, in equipment leases allegedly entered into by Ms. Nedry with the former Ferris Productions, Inc. in 2001. We have contested the allegations. The case is currently in the pre-trial discovery phase.

On May 13, 2004, suit was filed against us in the federal district court of South Carolina, in cause number 04CP402455, styled *Garland and Leota Slagle v. VirTra Systems, Inc.*, seeking payment of the principal sum of

$90,000, plus accrued interest, in equipment leases allegedly entered into by the Slagles with the former Ferris Productions, Inc. in 2001. We have contested the allegations. The parties are currently in settlement discussions.

On December 30, 2004, suit was filed against us in the federal district court of North Carolina, in cause number 4:04-CV-199-H2, styled *Edward and Linda Strickland v. VirTra Systems, Inc.*, seeking payment in the principal sum of $72,000, plus accrued interest, in equipment leases allegedly entered into by Mr. Strickland with the former Ferris Productions, Inc. 2001. We have contested the allegations. The parties have agreed that we shall not be required to file an answer until March 21, 2005, while the parties explore settlement.

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

No matters were submitted to a vote of security holders during the last quarter of the period covered by this report.

Part II

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

Market Information`

Our common stock is quoted under the symbol "VTSI" on the OTC Electronic Bulletin Board. The following table sets forth the high and low bid prices for shares of our common stock for the periods noted, as reported by the OTC Electronic Bulletin Board. Quotations reflect inter dealer prices, without retail markup, mark down, or commission, and may not represent actual transactions.

		BID PRICES	
YEAR	PERIOD	HIGH	LOW
2002			
	First Quarter	0.32	0..17
	Second Quarter	0.42	0.18
	Third Quarter	0.455	0.12
	Fourth Quarter	0.18	0.09
2003			
	First Quarter	0.14	0.085
	Second Quarter	0.145	0.055
	Third Quarter	0.289	0.071
	Fourth Quarter	0.469	0.21
2004			
	First Quarter	0.35	0.20
	Second Quarter	0.43	0.24
	Third Quarter	0.42	0.28
	Fourth Quarter	0.46	0.28

As of March 1, 2005, the reported bid price for our common stock was $0.322 per share.

Shareholders

As of March 1, 2005, we had 60,859,064 shares of common stock outstanding, held by 161 shareholders of record.

Dividends

We have not paid cash dividends on our common stock in the past and we do not anticipate doing so in the foreseeable future.

Item 6. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion contains certain forward-looking statements that are subject to business and economic risks and uncertainties, and our actual results could differ materially from those forward-looking statements. The following discussion regarding our financial statements should be read in conjunction with the financial statements and notes to those financial statements.

Overview

Our principal business began in 1993 with the organization of Ferris Productions, Inc. Ferris designed, developed, distributed, and operated virtual reality products for the entertainment, simulation, promotion, and education markets. In September of 2001, Ferris merged into GameCom, Inc., a publicly held Texas company whose principal business at the time was the development and marketing of an internet-enabled video game system. We subsequently adopted our present name.

Prior to the merger of Ferris and GameCom, both companies had incurred substantial debt, much of which was eliminated in December of 2004 in a debt for equity conversion. However, there can be no assurances that we will be able to successfully implement our expansion plans. As we enter the training/simulation market, we face all of the risks, expenses, and difficulties frequently encountered in connection with the expansion and development of a new business, difficulties in maintaining delivery schedules if and when volume increases, the need to develop support arrangements for systems at widely-dispersed physical locations, and the need to control operating and general and administrative expenses.

Critical Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect reported amounts and related disclosures. Actual results could differ from those estimates.

Revenue Recognition

Revenue from custom application contracts are recognized on a percentage-of-completion basis, measured by the percentage of costs incurred to date to total estimated costs for each contract. Contract costs include all direct material and labor costs, and those indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs, and depreciation costs. General and administrative costs are charged to expense as incurred.

Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined. Changes in job performance, job conditions, and estimated profitability may result in revisions to costs and income, and are recognized in the period in which the revisions are determined. An amount equal to contract costs attributable to claims is included in revenue when realization is probable and the amount can be reliably estimated.

Costs and estimated earnings in excess of billings on uncompleted contracts represent revenue recognized in excess of amounts billed. Billings in excess of costs and estimated earnings on uncompleted contracts represent amounts billed in excess of revenue recognized.

Stock-Based Compensation

We account for our stock compensation arrangements under the provisions of Accounting Principles Board (APB) No. 25 Accounting for Stock Issued to Employees. We provide disclosure in accordance with the disclosure-only provisions of Statement of Financial Accounting Standard (SFAS) No. 123 Accounting for Stock-Based Compensation.

Results of Operations

Fiscal year ended December 31, 2004 compared to fiscal year ended December 31, 2003.

Total revenue for the year ended December 31, 2004 was $1,328,180, compared to total revenue of $984,490 for the year ended December 31, 2003. This increase of $343,690, or 35%, resulted primarily from our initial IVR™ simulator sales to the U.S. military in the training/simulation market.

Cost of sales and services increased $203,262, or 31%, to $860,065, for the year ended December 31, 2004, from $656,803 for the year ended December 31, 2003. This increase is relatively proportionate to the change in revenue.

General and administrative expenses increased by $1,904,348, or 208%, to $2,820,650 for the year ended December 31, 2004, from $916,302 for the year ended December 31, 2003. The increase is primarily due to incentive compensation granted to senior management, trade show and other costs associated with roll-out of the IVR™ series of advanced training simulators, indirect costs associated with the debt-for-equity conversion completed in December of 2004, and a reserve for the Legg Mason lawsuit..

Interest expense and finance charges increased by $7230, or 0.7%, to $957,912 for the year ended December 31, 2004, from $950,682 for the year ended December 31, 2003.

During 2004, we presented an exchange offer to the holders of certain of our notes payable and obligations under product financing arrangements, whereby the debtholders were allowed to convert their principal and accrued interest to our common stock under one of three options. Under Option A, the debtholder could receive common stock equal to 0.6 shares per dollar of principal amount he or she was owed, and was not required to lock up any of the shares he or she received in the exchange. Under Option B, each debtholder could receive common stock equal to 0.9 shares per dollar of principal amount he or she was owed, but could not sell any of the shares for a period of six months, after which the shares could be sold in six equal monthly installments. Under Option C, each debtholder could receive common stock equal to 1.2 shares per dollar of principal amount he or she was owed, but could not sell any of the shares for a period of one year, after which the shares could be sold in six equal monthly installments. As of December 31, 2004, we had issued 5,303,258 shares of our common stock in exchange for $183,500 in principal and $49,069 of accrued interest outstanding on our notes payable, $615,531 in principal and $155,475 of accrued interest outstanding on our notes payable to stockholders, and $5,792,176 of principal and interest outstanding on our obligations under product financing arrangements. Of the total shares issued, 316,080 shares were issued to debtholders electing Option A, 274,500 shares to debtholders electing Option B, and 4,712,678 shares to debtholders electing Option C. As a result of this debt exchange, we recorded $4,621,415 of forgiveness of debt income in the statement of operations for the year ended December 31, 2004.

In addition to the forgiveness of debt income resulting from the debt-to-equity conversion discussed above, we also reversed accruals on certain notes and accounts payable upon which the statute of limitations had run. Included in forgiveness of debt income in the statement of operations for the year ended December 31, 2004 is $301,085 related to these settlements and write-offs.

Liquidity and Plan of Operations

As of December 31, 2004, our liquidity position was extremely precarious. We had current liabilities of $4,692,164, including $819,900 in obligations remaining under the lease financing for the old Ferris Productions virtual reality systems, $2,228,064 in accounts payable and accrued liabilities, and short-term notes payable of $1,644,200, some of which were either demand indebtedness or were payable at an earlier date and were in default. As of December 31, 2004, there was only $221,826 in current assets available to meet those liabilities.

To date we have met our capital requirements by acquiring needed equipment under the Ferris Productions non-cancelable leasing arrangements, through capital contributions, loans from principal shareholders and officers, certain private placement offerings, and through our convertible debentures and equity line financing with Dutchess Private Equities Fund, L.P.

For the year ended December 31, 2004, our net income was $1,566,091. After taking into account the non-cash items included in that profit, our cash requirements for operations were approximately $878,083. In addition, we made capital expenditures of $83,754, had capitalized development costs connected with the IVR 4G simulator of $196,223, and repaid notes in the amount of $278,326. To cover these cash requirements, we issued notes for $277,500, and issued 4,294,707 shares of our common stock for net cash proceeds of $1,238,421.

The opinion of our independent auditor for the year ended December 31, 2004 expressed substantial doubt as to our ability to continue as a going concern. We will need substantial additional capital or new lucrative custom application projects to become profitable. In July of 2002, we entered into a financial contract with Dutchess Private Equities Fund, L.P. Under this arrangement, Dutchess is to purchase under an equity line up to $5 million of our common stock over a two-year period. The number of shares we may sell to Dutchess is based upon the trading volume of our stock. Dutchess and several other investors also participated in a private placement of $450,000 in convertible debentures, which has been repaid in full. In February of 2005, we entered into a new financial contract with Dutchess, under which Dutchess is to purchase under a new equity line up to $6 million of our common shares, similar to the 2002 agreement, which will soon be expiring. Additionally, in February of 2005 we completed a private placement with Dutchess of $750,000 in convertible debentures. Based on recent increases in the stock's trading volume following our entry into the training/simulation market, management believes that this equity line will allow us to continue our operations for at least the next twelve months.

Item 7. Financial Statements

VIRTRA SYSTEMS, INC.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of

VirTra Systems, Inc.

We have audited the accompanying balance sheet of VirTra Systems, Inc. (the Company) as of December 31, 2004, and the related statements of operations, stockholders deficit and cash flows for the years ended December 31, 2004 and 2003. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of VirTra Systems, Inc. as of December 31, 2004, and the results of its operations and its cash flows for the years ended December 31, 2004 and 2003 in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. As discussed in Note 2 to the financial statements, the Company has suffered recurring losses from operations and at December 31, 2004 is in a negative working capital position and a stockholders deficit position. These factors raise substantial doubt about the Company s ability to continue as a going concern. Management s plans in regard to these matters are also described in Note 2. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As discussed in Note 3 to the financial statements, in 2004 the Company changed its method of accounting for variable interest entities.

Houston, Texas

March 15, 2005

VIRTRA SYSTEMS, INC.

BALANCE SHEET

December 31, 2004

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ASSETS

Current assets:	
Cash and cash equivalents	$ 160,566
Accounts receivable	9,430
Costs and estimated earnings in excess of billings on uncompleted contracts	51,830
Total current assets	221,826
Property and equipment, net	1,034,917
Capitalized development cost, net	196,223
Total assets	$1,452,966

LIABILITIES AND STOCKHOLDERS DEFICIT

Current liabilities:	
Notes payable	$1,349,700
Obligations under product financing arrangements	819,900
Notes payable-stockholders	294,500
Accounts payable	1,038,870
Accrued liabilities	1,189,194
Total current liabilities	4,692,164
Redeemable common stock, 406,458 shares at $.005 par value	2,032

Commitments and contingencies	
Stockholders deficit:	
Common stock, $.005 par value, 100,000,000 shares authorized,	
60,438,152 shares issued and outstanding	302,191
Additional paid-in capital	8,210,395
Accumulated deficit	(11,753,816)
Total stockholders deficit	(3,241,230)
Total liabilities and stockholders deficit	$1,452,966

See accompanying notes to financial statements.

VIRTRA SYSTEMS, INC.

STATEMENT OF OPERATIONS

for the years ended December 31, 2004 and 2003

	2004	2003
Revenue:		
Custom applications		
Training/simulation	$986,816	$142,260
Advertising/promotion	296,864	813,170
Other	44,500	29,060
Total revenue	1,328,180	984,490
Cost of sales and services	860,065	656,803
Gross margin	468,115	327,687
General and administrative expenses	2,820,650	916,302
Loss from operations	(2,352,535)	(588,615)
Other income (expenses):		
Forgiveness of debt income	4,922,500	-
Interest income	16	-
Interest expense and finance charges	(957,912)	(950,682)
Other income	500	2,628
Total other income (expenses)	3,965,104	(948,054)
Net income (loss) from continuing operations	1,612,569	(1,536,669)

Income (loss) from discontinued operations	-	(53,453)
Net income (loss) before accounting change	1,612,569	(1,590,122)
Cumulative effect of accounting change	(46,478)	-
Net income (loss)	$ 1,566,091	$(1,590,122)
Weighted average shares outstanding - basic	51,675,342	42,415,964
Weighted average shares outstanding - diluted	52,450,576	42,415,964
Basic net income (loss) per share:		
Net income (loss) per share before accounting change and discontinued operations	$ 0.03	$ (0.04)
Cumulative effect of accounting change	(0.00)	-
Income (loss) from discontinued operations	-	(0.00)
Net income (loss) per share	$ 0.03	$ (0.04)
Diluted net income (loss) per share:		
Net income (loss) per share before accounting change and discontinued operations	$ 0.03	$ (0.04)
Cumulative effect of accounting change	(0.00)	-
Income (loss) from discontinued operations	-	(0.00)
Net income (loss) per share	$ 0.03	$ (0.04)

See accompanying notes to financial statements.