

FORCE PROTECTION INC  
Form 10-K/A  
June 27, 2007

## UNITED STATES

## SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

### FORM 10-K/A

(Mark One)

☒ **ANNUAL REPORT UNDER SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**FOR THE FISCAL YEAR ENDED DECEMBER 31, 2005**

☐ **TRANSITION REPORT UNDER SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**FOR THE TRANSITION PERIOD FROM      TO**

Commission File No. 001-33253

## FORCE PROTECTION, INC.

(Exact name of issuer as specified in its charter)

**Nevada**

(State or other jurisdiction of  
incorporation or organization)

**84-1383888**

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

**9801 Highway 78, Building No. 1, Ladson, SC**

(Address of principal executive offices)

**29456**

(Zip Code)

Registrant's telephone number, including area code: **(843) 740-7015**

Securities registered under Section 12(b) of the Exchange Act:

**None.**

Securities registered under Section 12(g) of the Exchange Act:

**Common stock, par value \$0.001 per share.**

(Title of class)

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. ☐ Yes ☐ No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes ☐ No ☒ Yes

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past twelve months (or such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐ Yes

Indicate by check mark if disclosure of delinquent filers in response to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained in this form, and no disclosure will 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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. (Check one).

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☒ Yes

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒ Yes

The aggregate market value of the voting and non-voting common equity held by non-affiliates as of December 31, 2005 was \$22,353,816 based on a total of 28,658,739 shares of our common stock held by non-affiliates on December 31, 2005 at the closing price of \$0.78 per share.

We had 36,114,217 shares of common stock outstanding as of December 31, 2005.

Documents incorporated by reference: None.

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FORCE PROTECTION, INC. FORM 10-K/A

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## EXPLANATORY NOTE

### OVERVIEW

We are filing this amendment to our Annual Report on Form 10-K for the year ended December 31, 2005 to amend and restate financial statements and other information for the years 2005, 2004 and 2003. The restatement adjusts our accounting for preferred stock and warrants issued to investors, accounting for stock-based compensation to employees and non-employees and accounting for rent expense on a straight-line basis. Following is a general summary of each accounting restatement followed by a summary of the cumulative change in our net loss for the years ended December 31, 2005, 2004 and 2003.

### RESTATEMENT OF ACCOUNTING FOR PREFERRED STOCK AND WARRANTS ISSUED TO INVESTORS

We have reviewed our accounting for Preferred Stock and Warrants Issued to Investors taking into account, where applicable, Financial Accounting Standards Board Statements No. 150 (SFAS 150), and No. 133 (SFAS 133), EITF 98-5, EITF 00-19, EITF 00-27, EITF Topic No. D-98 and Accounting Series Release No. 268 (ASR 268):

- Series B and Series C Convertible Preferred Stock are recorded as equity at fair value using the Black-Scholes Method at the time of issuance using a one year holding period.
- A Beneficial Conversion Feature (BCF) treated as equity is created when the value received for each issuance is less than the fair value from the Black-Scholes calculation. Changes in conversion rates of Preferred Stock into Common Stock also can create a Beneficial Conversion Feature if the Preferred Stock can be converted into more common shares than at issuance or last amendment.
- The Series D Preferred Stock falls outside the scope of SFAS No. 150 but the guidance in Rule 5-02.28 of Regulation S-X, Accounting Release No. 268 and EITF Topic D-98: Classification and Measurement of Redeemable Securities are applicable. As such, we have recorded the Series D Preferred as mezzanine equity on the accompanying balance sheet.
- Series D 6% Convertible Preferred Stock is recorded at fair value equaling the net cash proceeds from issuance minus the fair value of Warrants issued in conjunction with the Series D 6% Convertible Preferred Stock. Dividends for Series D 6% Convertible Preferred Stock were distributed either in common stock shares or cash.
- The Warrants issued in conjunction with the Series D 6% Convertible Preferred Stock were initially recorded at fair value as a liability, as liquidating damages were paid due to a late SEC registration of the underlying Common Stock. The Black-Scholes Method was used to determine the fair value at issuance using a three year holding period. These Warrants were adjusted each reporting period to the new fair value using the Black-Scholes Method until the registration statement was declared effective by the SEC. At that point, the fair value using the Black-Scholes Method was reclassified into Equity. A realized gain on derivative liability in the amount of \$2,830,791 was recorded in 2005 as a result of the change in fair value from issuance to reclassification to equity for these Warrants.
- Other warrants are recorded at fair value using the Black-Scholes Method.

### RESTATEMENT OF ACCOUNTING FOR STOCK-BASED COMPENSATION

We have reviewed our accounting for stock based compensation issued for services and compensation during 2005, 2004 and 2003 taking into account, where applicable, Financial Accounting Standards Board's Statement of Financial Accounting Standard No. (SFAS) 123. Stock based compensation issued for services and compensation were valued at the market price at the time of issuance. As a result of valuation, we recorded additional expense of \$565,055, \$1,627,985 and \$2,721,657 in 2005, 2004 and 2003, respectively.

We have reviewed the Financial Accounting Standards Board's Statement of Financial Accounting Standard No.123 (Revised) and we adopted SFAS 123(R) as of July 1, 2005. We recorded stock option expense of \$92,671 for 2005.

*RESTATEMENT OF ACCOUNTING FOR OPERATING LEASE COMMITMENTS*

We have reviewed the Financial Accounting Standards Board's Statement of Financial Accounting Standard No. 13 and has determined that in 2005, 2004 and 2003 our accounting for rent expense was not recorded on a straight-line basis over the term of our operating lease commitments. Several of our operating leases in effect during 2005, 2004 and 2003 included certain terms that provided for several months at the beginning of the lease term whereby rents were not due. Additionally, we identified certain rent escalation clauses included within certain operating leases that, previous to this filing, had deferred rent expense improperly over the course of the leases. We calculated the necessary adjustments for 2005, 2004 and 2003 in order to restate our financial statements and record rent expense associated with operating lease commitments for 2005, 2004 and 2003. We recorded additional rent expense for 2005, 2004 and 2003 in the amount of \$12,039, \$79,985 and \$44,588, respectively.

RESTATEMENT OF EARNINGS PER SHARE

We have reviewed the Financial Accounting Standards Board's Statement of Financial Accounting Standard No. 128 Earnings Per Share (EPS) and determined that income available to common shareholders did not include the accretion related to preferred stock and the weighted average number of common shares outstanding used to calculate diluted earnings per share did not give effect to common shares issued upon conversion for the entire year. The impact to 2005 EPS was a decrease of \$0.06 per share.

## AMENDMENT TO FORM 10-K

The following sections of this Form 10-K/A have been revised to reflect restatement: Part 1: Item 1, Business; Part II: Item 6, Selected Financial Data; Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations; Item 8, Financial Statements; and Item 9A, Controls and Procedures. Except to the extent relating to the restatement of our financial statements and other financial information described above, the financial statements and other disclosures in this Form 10-K/A do not reflect events that occurred after the Form 10-K was initially filed on April 13, 2006.

In light of the restatement, readers should not rely on previously filed financial statements and other financial information for the years and for each of the quarters in the years 2005, 2004 and 2003.

## EFFECTS OF RESTATEMENT

Effects on Income Statement	2005	2004	2003
Increase in cost of sales	2,012,989		
Decrease in gross profit	(2,012,989 )		
Increase in general and administrative expense	669,745	1,707,970	2,766,245
Increase in operating loss	669,745	1,707,970	2,766,245
Decrease in non recurring warranty expense	(2,012,989 )		
Increase in realized gain	2,830,791		
Increase (decrease) in loss from continuing operations before tax	(2,161,046 )	1,707,970	2,766,245
Increase/(decrease) in net loss	(2,161,046 )	1,707,970	2,766,245
Increase (decrease) in earning per share			
basic	(0.02 )	(0.09 )	(0.34 )
diluted	(0.02 )	(0.09 )	(0.34 )

Effects on Balance Sheet	2005	2004	2003
Decrease in accounts receivables	(367,223 )		
Decrease in total assets	(367,223 )		
Increase in other accrued liability	279,569	124,575	44,589
Decrease in contract liabilities	(367,223 )		
Increase (decrease) in total liabilities	(87,654 )	124,575	44,589
Increase in mezzanine equity_Series D preferred stock	7,901,438		
Decrease in Series D preferred stock	(12,597,390 )		
Increase in warrants	5,780,952	2,602,800	4,862,765
Increase in beneficial conversion feature		19,102,306	282,890

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Decrease in accumulated deficit	(1,722,968 )	(23,078,732 )	(2,563,321 )
Decrease in shareholders equity	(8,181,007 )	(124,573 )	(44,589 )
Increase/(decrease) in total liabilities and shareholders equity	(367,223 )		

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## **PART I**

### **ITEM 1. DESCRIPTION OF BUSINESS**

#### *HISTORY*

We organized under the laws of the State of Colorado in November 1996 as Boulder Capital Opportunities III. Effective June 30, 1998, we acquired all assets and assumed all liabilities of Sonic Jet Performance, LLC, a California limited liability company in the business of producing and marketing recreational boats, jet boats, trailers, and related accessories. On November 4, 1998, we changed our name to Sonic Jet Performance, Inc. In 2000 and 2001, we emphasized building recreational boats and generated gross revenues of approximately one million dollars while sustaining operating losses. In 2002, we relocated our corporate headquarters, assembly, and prototyping facility to Stanton, California and shifted focus to design and production of fire and rescue boats.

In June 2002, we acquired the shares of Technical Solutions Group, Inc., a development stage manufacturer of ballistic and blast protected vehicles based in Charleston, South Carolina. Technical Solutions Group was originally formed in 1997 as a Nevada corporation to supply specialty vehicles to military and law enforcement agencies worldwide. The vehicles are used to transport personnel in hostile areas that may include landmines, and to locate and remove landmines.

In July 2003, we shifted our principal focus to the production of armored vehicles and moved our corporate headquarters to South Carolina. In August 2003, we changed our name to Force Protection, Inc. to reflect our focus on protected vehicles. In October 2003, we negotiated and finalized an agreement with investors to divest all assets related to our Fire Rescue Boat Business, focusing our primary business operations on the manufacture of armored vehicles. Effective January 1, 2005, we reincorporated from Colorado to Nevada, and we changed the name of our wholly owned subsidiary Technical Solutions Group, Inc. to Force Protection Industries, Inc.

#### *BUSINESS OVERVIEW*

We design and manufacture ballistic and blast-protected military vehicles using proprietary technology derived from South African vehicle development programs carried out from 1972 through 1994. We incorporated further design developments with information from U.N. and other humanitarian mine clearance operations after 1994 into our vehicles, improving their protection and functionality. At December 31, 2005, we had more than 325 employees and we occupy three buildings with a combined floor area of more than 240,000 square feet in a secure manufacturing facility in Ladson, South Carolina.

Our common stock is publicly traded on the NASD Over the Counter Bulletin Board under the ticker symbol FRPT.OB.

#### *HOW TO CONTACT US*

Our address is 9801 Highway 78, Building No. 1, Ladson, SC 29456. Our phone number is (843) 740-7015. Our website address is [www.forceprotection.net](http://www.forceprotection.net). Information contained on our website does not constitute part of this report and our address should not be used as a hyperlink to our website.

#### *INDUSTRY OVERVIEW*

Mine Protected Vehicles were initially developed in Rhodesia and South Africa in response to the landmine problems arising from the wars in Southern Africa. The vehicles were designed to protect personnel during transport, removal of unexploded ordnance, route clearance, humanitarian de-mining, and other missions that require protection from landmines and hostile fire. The technology has been developed and used in several parts of the world, principally Africa, over the last 20 years in response to the intense use of landmines in that region. We believe the world market for mine-protected vehicles is growing rapidly. Landmines and Improvised Explosive Devices, or IEDs, are weapons of choice for terrorists and insurgent groups because they are highly effective yet relatively low cost. Rising populations in heavily mined regions and the need to utilize and develop such areas means the problem can no longer be ignored. With increasing world tensions, we believe there is a need for vehicles that can provide a level of protection against these threats during a variety of missions. Such missions include troop transport in and around unexploded ordnance or mine threat areas as well as route clearance and humanitarian de-mining which require entrance into known mine fields or areas of known terrorist activities.

Mine protected vehicles have been purchased worldwide, principally in Africa, with additional purchases by several NATO allied countries. Troop movements in overseas operations face a continuous threat because of the use of land mines or the possibility of ambush and enemy fire. Vehicles that move troops or ordnance economically and provide significant protection against ballistic, incendiary, landmine hazards, and IEDs are useful in these situations. This is a pressing issue for the U.S. and its allies throughout the world.



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We believe the world market for blast and ballistic protective vehicles is growing rapidly as regional instability becomes an increasing issue. Typical missions for our vehicles include troop transport in and around unexploded ordnance, areas of risk for IEDs, mine threat areas, humanitarian de-mining and route clearance. Most of these missions require operating in areas of known terrorist activities and have traditionally been accomplished using light weight wheeled utility vehicles, including for example the High Mobility Multi Wheeled Vehicle ( HMMWV or Humvee ). However, Humvees were never designed to sustain high

powered explosive blasts and these un-armored utility vehicles are vulnerable to enemy fire and offer a prime target for attack. In response to the increasing number of casualties from IEDs and other explosive during Operation Iraqi Freedom, the U.S. has sought to rapidly increase the armor and blast protection of many of its vehicle fleet, including the Humvee, by retrofitting heavy armor to the hulls of these normally lightly armored vehicles. The results have not been satisfactory due in part to the high costs of retrofitting armor into the body of the vehicles and the increased mechanical wear caused by the added weight.

One alternative to using up-armored Humvees was heavy weight troop transport and offensive armor such as the Bradley Fighting Vehicle or the M1A1 Abrams Tank. Conventional armored vehicles such as the Bradley and the Abrams tank do offer some protection from ballistic and blast threats. However, even these are too often no match for the latest batch of powerful IEDs. Further, these vehicles are expensive, and require substantial resources to maintain. They are large and difficult to maneuver in crowded urban environments. Their intimidating offensive weapon systems are not well suited to peacekeeping missions.

Our armored vehicles offer protection against mines and IED blasts. As the U.S. military increases its focus on providing the best equipment available to its troops, we anticipate an increasing market demand for our products.

## *PRODUCTS*

We currently produce two blast-protected vehicles with different mission capabilities: (1) the Buffalo and (2) a lighter vehicle, the Cougar. We are also moving a third vehicle, the Mine-protected Utility Vehicle/Rapid Deployable, or MUV-R, through the proto-type and development phase. This vehicle was previously referred to as the Lion.

### *The Buffalo*

The Buffalo is our heaviest vehicle weighing 22 tons and is designed principally for route clearing activities. It integrates a blast resistant capsule with an American-made truck engine and drive train. We believe that a key aspect of mine protected-vehicle design is the management of hot gasses and concussive energy released by a mine or IED blast. The Buffalo is designed to deflect and dissipate the explosive blast away from the passenger compartment, thus protecting the occupants from harm. Utilizing our advanced technology, the Buffalo is able to withstand even a major explosion. Competing vehicles without benefit of such an advanced V-hull design such as up-armored Humvees rely solely on retrofitting heavy armor plates to absorb blast energy as just one aspect of its use. The Buffalo design emphasizes blast and ballistic protection as the vehicle's primary mission.

We believe that the geometric, V-hull design, along with the materials used, the components selected, our relationship with critical component suppliers and the overall manufacturing process makes our vehicles a desirable solution for blast and ballistic protected vehicles.

The U.S. Army tested the Buffalo at the Aberdeen Proving Grounds to determine its measure of survivability i.e. the ability of the Buffalo's blast capsule to effectively protect the occupants and the critical automotive components from the effects of explosive blasts. Following such tests, the U.S. Army has ordered and deployed more than fifty Buffalos for service in Afghanistan and Iraq, and has announced its desire to use the Buffalo in the newly established Route Clearance Companies being developed as part of the IED Defeat Task Force. This real-world experience has demonstrated the Buffalo's ability to withstand blasts without injury to the occupants. We believe that the Buffalo fills a niche in the U.S. Army's route clearance systems and that used in this capacity, the Buffalo currently has no direct competition. We are currently developing our infra-structure and manufacturing capacity to produce four Buffalo vehicles per month to meet anticipated near term demand.

### *The Cougar*

The Cougar first launched in 2004. We designed the Cougar to serve a broader market and mission range than the Buffalo. Its missions include urban patrol, route clearance support, utility transport and special unit activities. Like the Buffalo, the Cougar employs the geometric V-Hull design to deflect blast energy along with an armored steel capsule affording ballistic protection, and while the Cougar, at 14 tons, is lighter than the Buffalo, it offers a similar level of blast protection. Like the Buffalo, the Cougar uses a standard American automotive drive train and control components which allow service and maintenance similar to that of a commercial truck, making servicing the Cougar less expensive and easier to service. We have produced approximately fifty Cougars to date, all of which have been deployed in active service in Iraq. We are currently developing our infra-structure and manufacturing capacity to produce twenty or more Cougar vehicles per month to meet anticipated near term demand.

### *Mine-protected Utility Vehicle/Rapid Deployable (MUV-R)*

We are currently well into the development of a third vehicle, the MUV-R (pronounced Mover). The MUV-R will be the smallest of our vehicles weighing seven tons or less. Management positioned the MUV-R for use by security services and other agencies requiring blast and

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ballistic protection for personnel transport in high threat and insurgent-hostile regions. We did not specifically position the vehicle as a replacement for the two-decade old armored Humvee, however Department of Defense efforts to up-armor Humvees already deployed to the Army and Marines have proven less than effective. The added weight of the armor strains the vehicle's engine and drive-train and the method of armor plating is vulnerable to blast energy. The MUV-R's geometric V-hull design conducts this energy out the sides, protecting the occupants. Being specifically designed for blast and ballistic protection, the MUV-R protects vital engine components to allow continuing vehicle operations even after surviving a blast from a landmine, an IED or a roadside bomb. The U.S. military has recently undertaken market studies to develop a fleet of new Joint Light

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Tactical Vehicles specifically intended to replace the Humvees and we believe that the MUV-R can effectively compete for a share of this newly evolving opportunity. The vehicle is still in its developmental stage and will require further work before it is ready for production.

### *CUSTOMER ACTIVITY*

During 2005, we depended on two principal customers, the United States Army and the United States Marine Corps. In the twelve months ended December 31, 2005, approximately 40% of our revenues were derived directly or indirectly from the U.S. Army and approximately 60% from the U.S. Marine Corps. We expect to continue to depend upon contracts with governmental agencies for a substantial portion of our revenue for the foreseeable future.

Government contracts and subcontracts typically involve long purchase and payment cycles, competitive bidding, qualification requirements, delays or changes in funding, extensive specification development, price negotiations and milestone requirements. Each government agency also maintains its own rules and regulations with which we must comply and which can vary significantly among agencies. Governmental agencies also often retain some portion of fees payable upon completion of a project and collection of these fees may be delayed for several months or even years, in some instances.

In addition, an increasing number of government contracts are fixed price contracts which may prevent us from recovering costs incurred in excess of our budgeted costs. Fixed price contracts require us to estimate the total project cost based on preliminary projections of the project's requirements. The financial viability of any given project depends in large part on our ability to estimate such costs accurately and complete the project on a timely basis. In the event actual costs exceed the fixed contractual cost, we may not be able to recover the excess costs.

Some government contracts are also subject to termination or renegotiation at the convenience of the government, which could result in a large decline in revenue in any given quarter. Although government contracts have provisions providing for the reimbursement of costs associated with termination, the termination of a material contract at a time when our funded backlog does not permit redeployment of staff could result in reductions of employees. In addition, the timing of payments from government contracts is also subject to significant fluctuation and potential delay, depending on the government agency involved. Any such delay could result in a temporary shortage in working capital.

The following chart illustrates our product deliveries in the last two calendar years and our current backlog:

Vehicle	2004	2005	Backlog
Buffalo	9	31	41
Cougar HEV	5	22	1
Cougar JERRV	0	18	104
Total	14	71	146

### *COMPETITIVE POSITIONING*

We are subject to significant competition from companies that market products that perform similar functions to our products. This competition could harm our ability to win business and increase the price pressure on our products. The firms we compete against include large, multinational vehicle, defense and aerospace firms such as BAE Land Systems, Textron, Stewart & Stevens, Australian Defense Industries and General Dynamics. Most of our competitors have considerably greater financial, marketing and technological resources than we do which may make it difficult to win new contracts and we may not be able to compete successfully. Certain competitors operate fabrication facilities and have longer operating histories and presence in key markets, greater name recognition, larger customer bases and significantly greater financial, sales and marketing, manufacturing, distribution, technical and other resources. As a result, these competitors may be able to adapt more quickly to new or emerging technologies and changes in customer requirements. They may also be able to devote greater resources to the promotion and sale of their products.

We believe our competitive advantages include:

- The level of blast and ballistic protection incorporated into our vehicles;
- Our vehicles are currently deployed in Iraq and Afghanistan and are creating a track record of performance;
- Our ability to innovate;

- The high level of supportability of our vehicles;
- Our Made in America status;
- Our excellent manufacturing facilities; and
- The prior testing and acceptance of our designs by the U.S. Military.

We believe our products are superior to other vehicles currently in use by the U.S. military for mine and blast protection. Existing military vehicles include Humvees and other non-armored utility support vehicles, or heavy-weight troop transport and offensive armor such as the Bradley Fighting Vehicle or the M1A1 Abrams Tank. The un-armored utility vehicles offer a prime target for

attack and efforts to up-armor these vehicles have not been totally successful due to the high costs associated with retrofitting armor onto the body of the vehicle and the increased mechanical wear caused by the weight of the armor. Conventional armored vehicles such as the Bradley and the Abrams offer protection from ballistic and blast threats, but are expensive, require substantial resources to maintain, are large and difficult to maneuver in crowded urban environments and are not well-suited to peace keeping missions due to their intimidating offensive weapon systems.

As recent events have shown, there is also an increasing concern over death or injury of U.S. military personnel during operations such as Operation Iraqi Freedom and Operation Enduring Freedom, particularly to reservists and or civilian contractors who are not expected to face front line combat, but who increasingly have become the target of insurgents and terrorists. These concerns have led the U.S. military to adopt armor protection as a base requirement for many of its transport vehicles and to look for ways to defeat the threat of IEDs and other booby trap devices, including developing route clearance and other explosive detection and removal teams.

#### *PRODUCTION*

Our manufacturing process includes production and/or assembly of all critical components of our vehicles as follows:

- We utilize proprietary technology and skilled welders to create ballistic and blast protected vehicle capsules which we believe are capable of withstanding the explosive effect of landmines, IEDs and other blast threats encountered in wars, insurgency and urban conflicts.
- We integrate commercial American-made automotive drive-trains and other components onto the capsules to produce vehicles that have a high level of commonality with the existing U.S. military fleet and can be repaired and maintained by traditional truck mechanics.

Our Ladson facility has sufficient floor space, ample electrical and other utilities and an abundance of existing crane capacity. We have also secured sufficient tools and equipment, and have access to a local pool of labor, including many skilled welders and skilled automotive mechanics. We maintain a dedicated staff of engineers to provide in-house engineering support and utilize various manufacturing approaches to increase efficiency and product quality. We source steel and other raw materials from various key vendors in the United States and overseas, and secure our automotive components from a variety of U.S. suppliers including:

- Caterpillar;
- Mack Trucks, a member of the Volvo Group; and
- Allison Transmission.

#### *SALES AND MARKETING*

Our employees, including senior management and the Vice President of Sales, conduct our primary sales and marketing efforts. Currently our primary sales staff resides in South Carolina and Connecticut, but we also have an agreement for an exclusive marketing agent in Israel.

We actively participate in shows involving countermine operations and technology, military vehicle, law enforcement technology and military force protection including the Association of the U.S. Army Annual Conference and Winter Symposium, Marine Expo, and Tactical Wheeled Vehicle conferences. Additionally, our marketing efforts include our web site, some advertising focused on the military community and brochures. We do not use independent referral sources to assist in identifying opportunities for our products and services and we do not pay any referral fees or sales commissions.

#### *RESEARCH AND DEVELOPMENT*

In 2005, 2004, and 2003 we spent \$1,657,918, \$1,230,290 and \$102,439, respectively, on research and development.

#### *INTELLECTUAL PROPERTY*

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We are party to two long term intellectual property agreements covering technology used in the production of our ballistic and blast protected vehicles. One agreement is with the CSIR Defencetek, a division of the Council for Scientific and Industrial Research, a statutory council established in accordance with the Laws of the Republic of South Africa. The other is with Mechem, a division of Denel Pty Ltd, a company established in accordance with the Laws of the Republic of South Africa. We pay a specific vehicle fee upon the sale of certain vehicles utilizing the technology and specific intellectual property covered under these particular agreements.

### *PERSONNEL*

As of December 31, 2005, we had 327 employees in the U.S. and 2 consultants, 1 located in South Africa and 1 located in Israel. Employees can be broken down into 198 hourly employees and 129 salaried employees. We are not a party to any collective bargaining agreement. We believe our relations with employees are good.

#### ENVIRONMENTAL MATTERS

We are subject to federal, state, local and foreign laws and regulations regarding protection of the environment, including air, water, and soil. Our manufacturing business involves the use, handling, storage, and contracting for recycling or disposal of hazardous or toxic substances or wastes, including environmentally sensitive materials, such as batteries, solvents, lubricants, degreasing agents, gasoline and resin. We must comply with certain requirements for the use, management, handling, and disposal of these materials. We, however, do not maintain insurance for pollutant cleanup and removal. If we are found responsible for any hazardous contamination, any fines or penalties we may be required to pay, or any clean up we are required to perform, could be very costly. Even if we are charged, and later found not responsible, for such contamination or clean up, the cost of defending the charges could be high. If either of the foregoing occurs, our business, results from operations and financial condition could be materially adversely affected. We do not believe we have any material environmental liabilities or that compliance with environmental laws, ordinances, and regulations will, individually or in the aggregate, have a material adverse effect on our business, financial condition, or results of operations.

#### OTHER REGULATORY MATTERS

Our operations and products are subject to extensive government regulation, supervision, and licensing under various federal, state, local and foreign statutes, ordinances and regulations. Certain governmental agencies such as the Environmental Protection Agency, or EPA, and the Occupational Safety and Health Administration, or OSHA, monitor our compliance with their regulations, require us to file periodic reports, inspect our facilities and products, and may impose substantial penalties for violations of the regulations.

While we believe that we maintain all requisite licenses and permits and are in compliance with all applicable federal, state, local and foreign regulations, there can be no assurance that we will be able to maintain all requisite licenses and permits. The failure to satisfy those and other regulatory requirements could have a material adverse effect on our business, financial condition, and results of operations.

#### ITEM 1A. RISK FACTORS

An investment in our common stock involves a high degree of risk. You should carefully consider the following risk factors, other information included in this Form 10-K. If any of the following risks actually occur, our business, financial condition or results of operations could be materially and adversely affected, and you may lose some or all of your investment.

##### *RISKS RELATED TO OUR BUSINESS*

***We had losses since our inception and expect losses to continue in the future. We may never become profitable.***

We have historically generated substantial losses, which, if continued, could make it difficult to fund our operations or successfully execute our business plan, and could adversely affect our stock price. We experienced net losses of \$8,087,869 for the year ended December 31, 2003, \$11,953,803 for the year ended December 31, 2004, and \$14,404,622 for the year ended December 31, 2005. We have generated significant net losses in recent periods, and experienced negative cash flows from operations in the amount of \$3,403,504 for the year ended December 31, 2003, \$12,053,361 for 2004, and \$18,495,319 for 2005. In recent years, some of the losses were incurred as a result of investments in new product development, inefficiencies while we built up our operations and marketing costs. While we have increased our investments, most notably in inventory, we anticipate that we will continue to generate net losses and we may not be able to achieve or sustain profitability on a quarterly or annual basis in the future. In addition, because large portions of our expenses are fixed, we generally are unable to reduce expenses significantly in the short-term to compensate for any unexpected delay or decrease in anticipated revenues. As a result, we may continue to experience net losses, which will make it difficult to fund our operations and achieve our business plan, and could cause the market price of our common stock to decline.

***We have a limited operating history and may never achieve or sustain profitable operations.***

We are an early stage production company. We acquired our subsidiary, Force Protection Industries Inc. (formerly Technical Solutions Group, Inc.) in July 2002 and have only recently begun generating significant revenues. We generated revenues from our current products of \$6,247,285 for the year ended December 31, 2003, \$10,272,757 for 2004, and \$49,712,829 for 2005. The sale of our mine protected vehicles and associated spare parts accounted for 100% of the sales, 100% of the cost of goods sold and 100% of the loss in 2004 and 2005. The loss for 2003 included a loss of \$2,932,179 from discontinued operations. Our ability to successfully commercialize our products will depend on, among other things, successful completion of our ongoing development activities, geo-political events, ability to cost effectively manufacture and distribute our products, and the relative cost to the customer of our system as compared to alternative competitive products. Because we focus on emerging markets, market reaction can be difficult to predict. Many of our planned products incorporate technologies or approaches that have not yet achieved broad market acceptance. In addition, we have a limited history of competing in the intensely competitive defense industry. Our



technology may not be successfully commercialized or marketed. As a result, we may never achieve or sustain profitable operations.

***Our independent accountants have issued a Going Concern Opinion and, if we do not generate enough cash from operations to sustain our business, we may have to liquidate assets or curtail our operations.***

The accompanying financial statements have been prepared assuming we will continue as a going concern. During the year ended December 31, 2003, we incurred a net loss of \$8,087,869, during the year ended December 31, 2004 we incurred a net loss of \$11,953,803 and during the year ended December 31, 2005 we incurred a net loss of \$14,404,622. Conditions exist which raise substantial doubt about our ability to continue unless we are able to generate sufficient cash flows to meet our obligations and sustain our operations. The financial statements do not include any adjustment that might result from the outcome of this uncertainty, except that an allowance has been recorded for 100% of deferred tax assets.

***If we can not access sufficient funds when needed, we may not be able to meet our contractual obligations to deliver our products and our business may fail.***

We believe we have sufficient cash resources to continue operations at our current capacity, however in the event of an unanticipated change of circumstances, or if we secure additional orders, we could face liquidity constraints and we could require external financing to fund operations. Until we generate cash flow from operations that will be sufficient to satisfy our cash requirements, we will continue to seek alternative means for financing our operations and capital expenditures and/or postpone or eliminate certain investments or expenditures. Potential alternative means for financing may include leasing capital equipment, lines of credit, or obtaining additional debt or equity financing. When needed, additional financing may not be available, or available on acceptable terms. The inability to obtain additional financing or generate sufficient cash from operations could require us to reduce or eliminate expenditures for capital equipment, research and development, production or marketing of our products, or otherwise curtail or discontinue its operations, which could have a material adverse effect on our business, financial condition and results of operations. Furthermore, if we raise funds through the sale of additional equity securities, the common stock currently outstanding will be further diluted.

***We depend on our suppliers and if we can not obtain certain components for our products, we might have to develop alternative designs that could increase our costs.***

We depend upon a number of suppliers for components of our products. There is an inherent risk that certain components of our products will be unavailable for prompt delivery or, in some cases, discontinued. We have only limited control over any third-party manufacturer as to quality controls, timeliness of production, deliveries and various other factors. Should the availability of certain components be compromised, it could force us to develop alternative designs using other components, which could add to the cost of goods sold and compromise delivery commitments. If we are unable to obtain components in a timely manner, at an acceptable cost, or at all, we may need to select new suppliers, redesign or reconstruct process we use to build the hulls and/or the vehicles, which management believes would take a minimum of one-year. We may not be able to manufacture any vehicles for a period of time, which could materially adversely affect our business, results from operations, and financial condition.

***We market our products to a limited customer base and if we do not find acceptance of our products within that customer base, our business may fail.***

Our government business depends on a limited number of customers, and if any of these customers terminate or reduce their contracts, or if we cannot obtain additional government contracts in the future, our revenues will decline and our results of operations will decrease. Because most of our consolidated revenues were derived directly or indirectly from government contractors, this risk can significantly affect our business, results of operations and financial condition. For the twelve months ended December 31, 2005, 100% of our revenues were derived directly or indirectly from two governmental agencies, the U.S. Army and the U.S. Marine Corps.

We expect to continue to be dependent upon contracts with governmental agencies and their contractors for a substantial portion of revenue for the foreseeable future. Because we currently depend on government contracts and subcontracts, we face certain risks, including budget restraints and fixed price contracts. General political and economic conditions, which are difficult to accurately predict, directly and indirectly affect the quantity and allocation of expenditures by government agencies. Even the timing of incremental funding commitments to existing, but partially funded, contracts can be affected by these factors. Therefore, cutbacks or re-allocations in the U.S. or other government budget could have a material adverse impact on our results of operations as long as research and development contracts remain an important element of the business.

Obtaining government contracts may also involve long purchase and payment cycles, competitive bidding, qualification requirements, delays or changes in funding, budgetary constraints, political agendas, extensive specification development, price negotiations and milestone requirements. Each government agency also maintains its own rules and regulations with which we must comply and which can vary significantly among agencies. Governmental agencies also often retain some portion of fees payable upon completion of a project and collection of these fees may be delayed for several months or even years, in some instances. In addition, an increasing number of government contracts are fixed price contracts which may prevent us from recovering costs incurred in excess of its budgeted costs. Fixed price contracts require us to

estimate the total project cost based on preliminary projections of the project's requirements.

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The financial viability of any given project depends in large part on our ability to estimate such costs accurately and complete the project on a timely basis. In the event actual costs exceed the fixed contractual cost, we may not be able to recover the excess costs. Some government contracts are also subject to termination or renegotiation at the convenience of the government, which could result in a large decline in revenue in any given quarter. Although government contracts have provisions providing for the reimbursement of costs associated with termination, the termination of a material contract at a time when our funded backlog does not permit redeployment of staff could result in reductions of employees. In addition, the timing of payments from government contracts is also subject to significant fluctuation and potential delay, depending on the government agency involved. Any such delay could result in a temporary shortage in working capital.

***Some of our product components are manufactured in South Africa or other foreign countries and if they become unstable or changes government regulations our costs may increase or we may become unable to source certain parts.***

Some of our product components are manufactured in South Africa and supplied from other foreign countries. If import tariffs or taxes increase for any reason, our cost of goods would increase. Our financial performance may be affected by changes in political, social and economic environment. The role of the central and local governments in the economy is significant. Policies toward economic liberalization, and laws and policies affecting foreign companies, foreign investment, currency exchange rates and other matters could change, resulting in greater restrictions on our ability to do business with suppliers based in other countries. The government could impose surcharges, increase tax rates, or revoke, terminate or suspend operating licenses without compensating us. Also, South Africa and other countries, from time to time, experience instances of civil unrest and hostilities. Confrontations have occurred between the military, insurgent forces, and civilians. If for these or any other reason, we lose our ability to sub-contract or manufacture the components to its products, or the cost of doing business increases, our business, financial condition, and results of operations would be materially and adversely affected.

***We may be subject to personal liability claims for our products and if our insurance is not sufficient to cover such claims, our expenses may increase substantially.***

We may be subject to personal liability claims and our insurance may not be adequate to cover such claims. As a result, a significant lawsuit could adversely affect our business. We may be exposed to liability for personal injury or property damage claims relating to the use of the products. Any future claim against us for personal injury or property damage could materially adversely affect the business, financial condition, and results of operations and result in negative publicity. Even if we are not found liable, the costs of defending a lawsuit can be high. We do not currently maintain insurance for this type of liability. Additionally, even if we do purchase insurance, we may experience legal claims outside of our insurance coverage, or in excess of our insurance coverage, or that insurance will not cover.

***We are subject to substantial competition and we must continue research and development to remain competitive.***

We are subject to significant competition that could harm our ability to win business and increase the price pressure on our products. We face strong competition from a wide variety of firms, including large, multinational vehicle, defense and aerospace firms. Most of our competitors have considerably greater financial, marketing and technological resources than we do which may make it difficult to win new contracts and we may not be able to compete successfully. Certain competitors operate fabrication facilities and have longer operating histories and presence in key markets, greater name recognition, larger customer bases and significantly greater financial, sales and marketing, manufacturing, distribution, technical and other resources, as a result, these competitors may be able to adapt more quickly to new or emerging technologies and changes in customer requirements. They may also be able to devote greater resources to the promotion and sale of their products. Moreover, we may not have sufficient resources to undertake the continuing research and development necessary to remain competitive.

***Competitors may attempt to independently develop similar designs or duplicate our products or designs.***

We or our competitors may intentionally or unintentionally infringe upon or misappropriate products or proprietary information. In the future, litigation may be necessary to enforce intellectual property rights or to determine the validity and scope of the proprietary rights of others. Any such litigation could be time consuming and costly. Currently we have no patents. Any patent or patents sub-licensed to us relating to current or future products may be challenged, invalidated, or circumvented or the rights granted there-under will may not be held valid if subsequently challenged. Our products are based on technological innovation. Consequently, the life cycles of our products can be relatively short. Our success depends significantly on our ability to establish and maintain a competitive position in this field. Our products may not remain competitive in light of technological developments by others. Our competitors may succeed in discovering and developing technology before we do that would render our technology, and hence our products, obsolete and noncompetitive.

***We must comply with environmental regulations or we may have to pay expensive penalties or clean up costs.***

We are subject to federal, state, local and foreign laws, and regulations regarding protection of the environment, including air, water, and soil. Our manufacturing business involves the use, handling, storage, and contracting for recycling or disposal of, hazardous or toxic substances or

wastes, including environmentally sensitive materials, such as batteries, solvents, lubricants, degreasing agents, gasoline and resin. We must comply with certain requirements for the use, management, handling, and disposal of these materials. We do not maintain insurance for pollutant cleanup and removal. If we are found responsible for any hazardous contamination, we may have to pay expensive fines or penalties or perform costly clean-up. Even if we are charged, and later

found not responsible, for such contamination or clean up, the cost of defending the charges could be high. If we do not comply with government regulations, we may be unable to ship our products or have to pay expensive fines or penalties. We are subject to regulation by county, state and federal governments, governmental agencies, and regulatory authorities from several different countries. If we fail to obtain regulatory approvals or suffer delays in obtaining regulatory approvals, we may not be able to marketing our products and services, and generate product and service revenues. Further, we may not be able to obtain necessary regulatory approvals. Although we do not anticipate problems satisfying any of the regulations involved, we cannot foresee the possibility of new regulations, which could adversely affect our business. Further our products are subject to export limitations and we may be prevented from shipping our products to certain nations or buyers.

***We rely on proprietary designs and rights and if we have to litigate those rights, our expenses could substantially increase.***

Our success and ability to compete depend, in part, on the protection of our designs and technology. In addition, our technology could infringe on patents or proprietary rights of others. We have not undertaken or conducted any comprehensive patent infringement searches or studies. If any third parties hold any conflicting rights, we may be required to stop making, using or selling our products or to obtain licenses from and pay royalties to others. Further, in such event, we may not be able to obtain or maintain any such licenses on acceptable terms, if at all. We may need to engage in future litigation to enforce intellectual property rights or the rights of customers, to protect trade secrets or to determine the validity and scope of proprietary rights of others, including customers. This litigation could result in substantial costs and diversion of resources and could materially and adversely affect our results of operations.

***Insiders can exert significant control over our policies and affairs and they may assert control in a manner that does not favor minority shareholders.***

As of December 31, 2005, our Directors and Executive Officers in the aggregate, beneficially owned shares equal to 17.6% of our outstanding common stock. These shareholders, if acting together, would be able to exert substantial influence over all matters requiring shareholder approval, including amendments to our Articles of Incorporation, fundamental corporate transactions such as mergers, acquisitions, the sale of the company, and other matters involving the direction of our business and affairs. As a result, although other shareholders may vote their shares, they may have only limited influence on our business and management.

***We depend on management and other key personnel and we may not be able to execute our business plan without their services.***

Our success and our business strategy depend in large part on our ability to attract and retain key management and operating personnel. Such individuals are in high demand and are often subject to competing employment offers. We depend to a large extent on the abilities and continued participation of our executive officers and other key employees. We do not presently maintain key man insurance on any employees. We believe that, as our activities increase and change in character, additional, experienced personnel will be required to implement our business plan. Competition for such personnel is intense and we may not be able to hire them when required, or have the ability to attract and retain them.

#### ***RISKS RELATED TO OUR STOCK***

***Penny Stock rules may make buying or selling our securities difficult.***

Trading in our securities is subject to the Securities and Exchange Commission's penny stock rules and it is anticipated that trading in our securities will continue to be subject to the penny stock rules for the foreseeable future. The Securities and Exchange Commission has adopted regulations that generally define a penny stock to be any equity security that has a market price of less than \$5.00 per share, subject to certain exceptions. These rules require that any broker-dealer who recommends our securities to persons other than prior customers and accredited investors must, prior to the sale, make a special written suitability determination for the purchaser and receive the purchaser's written agreement to execute the transaction. Unless an exception is available, the regulations require the delivery, prior to any transaction involving a penny stock, of a disclosure schedule explaining the penny stock market and the risks associated with trading in the penny stock market. In addition, broker-dealers must disclose commissions payable to both the broker-dealer and the registered representative and current quotations for the securities they offer. The additional burdens imposed upon broker-dealers by such requirements may discourage broker-dealers from recommending transactions in our securities, which could severely limit the liquidity of our securities and consequently adversely affect the market price for our securities.

***Our securities have been thinly traded on the over-the-counter bulletin board, which may not provide liquidity for our investors.***

Our securities are quoted on the Over-the-Counter Bulletin Board. The Over-the-Counter Bulletin Board is an inter-dealer, over-the-counter market that provides significantly less liquidity than the NASDAQ Stock Market or national or regional exchanges. Securities traded on the Over-the-Counter Bulletin Board are usually thinly traded, highly volatile, have fewer market makers and are not followed by analysts. The Securities and Exchange Commission's order handling rules, which apply to NASDAQ-listed securities, do not apply to securities quoted on the

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Over-the-Counter Bulletin Board. Quotes for stocks included on the Over-the-Counter Bulletin Board are not listed in newspapers. Therefore, prices for securities traded solely on the Over-the-Counter Bulletin Board may be difficult to obtain and holders of our securities may be unable to resell their securities at or near their original acquisition price, or at any price.

***Investors must contact a broker-dealer to trade over-the-counter bulletin board securities. As a result, you may not be able to buy or sell our securities at the times that you may wish.***

Even though our securities are quoted on the Over-the-Counter Bulletin Board, the Over-the-Counter Bulletin Board may not permit our investors to sell securities when and in the manner that they wish. Because there are no automated systems for negotiating trades on the Over-the-Counter Bulletin Board, they are conducted via telephone. In times of heavy market volume, the limitations of this process may result in a significant increase in the time it takes to execute investor orders. Therefore, when investors place market orders an order to buy or sell a specific number of shares at the current market price it is possible for the price of a stock to go up or down significantly during the lapse of time between placing a market order and its execution.

***We do not intend to pay dividends in the foreseeable future; therefore, you may never see a return on your investment.***

We do not anticipate the payment of cash dividends on our common stock in the foreseeable future. We anticipate that any profits from our operations will be devoted to our future operations. Any decision to pay dividends will depend upon our profitability at the time, cash available and other factors. Therefore, you may never see a return on your investment. Investors who anticipate a need for immediate income from their investment should not purchase the company's securities.

***Our stock price is volatile and you may not be able to sell your shares for more than what you paid.***

Our stock price has been subject to significant volatility, and you may not be able to sell shares of common stock at or above the price you paid for them. The trading price of our common stock has been subject to wide fluctuations in the past. From January 2005 to December 2005, our common stock has traded at prices as low as \$0.69 per share and as high as \$3.60 per share (using post-reverse-split share prices). The market price of the common stock could continue to fluctuate in the future in response to various factors, including, but not limited to: quarterly variations in operating results; our ability to control costs and improve cash flow; announcements of technological innovations or new products by us or our competitors; changes in investor perceptions; and new products or product enhancements by us or our competitors. The stock market in general has continued to experience volatility which may further affect our stock price. As such, you may not be able to resell your shares of common stock at or above the price you paid for them.

## **ITEM 2. PROPERTIES**

We lease space in three buildings located on a single campus in Ladson, South Carolina for our executive offices and manufacturing facilities, designated Building #1, Building #2 and Building #3.

We lease a portion of Building #1 for use as our executive offices. The term of the lease is three years starting September 1, 2005, with an option to renew for an additional five years. Annual rent is \$119,880 plus utilities, taxes and maintenance. The base rent is subject to an annual escalation at the rate of 3% per year. We have 7,190 square feet of office space and 9,139 square feet of warehouse space in Building #1.

We lease all of Building #2. The term of the lease is five years starting July 15, 2004, with an option to renew for another five years. Annual rent is \$439,500 for the first year plus utilities, taxes and maintenance, and \$439,500 base rental for the next four years, which may be adjusted by increases to the Consumer Price Factor by three to seven percent.

We lease all of Building #3. The term of the lease is five years starting October 15, 2003. Annual rent is \$215,000 for the first year plus utilities, taxes and maintenance, and \$258,000 base rental for the next four years. We have 84,800 square feet of space in Building #3.

## **ITEM 3. LEGAL PROCEEDINGS**

On May 12, 2005, Atlantis Partners, Inc. filed a complaint against us in the Circuit Court for the 15th Judicial Circuit, Palm Beach County Florida for alleged breach of terms related to a finder's fee agreement dated March 28, 2003. The complaint alleged damages of at least \$400,000 in fees, plus costs and interest.

We may be involved from time to time in ordinary litigation that will not have a material effect on our operations or finances. Other than the litigation described above, we are not aware of any pending or threatened litigation against the company or our officers and directors in their capacity as such that could have a material impact on our operations or finances.

## **ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**



None.

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**PART II****ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS***MARKET FOR OUR COMMON STOCK*

Our common stock began trading on the OTC Bulletin Board on December 29, 1998 under the symbol SJET.OB . Our common stock currently trades on the OTC Bulletin Board under the symbol FRPT.OB . Before our listing on the OTC Bulletin Board none of our securities were traded in the public market. Bid and ask quotations for our common shares are routinely submitted by registered broker dealers who are members of the National Association of Securities Dealers on the NASD Over-the-Counter Electronic Bulletin Board. These quotations reflect inner-dealer prices, without retail mark-up, markdown or commission and may not represent actual transactions. The following table shows, for the periods indicated, the high and low closing sales prices per share of our common stock. Effective February 4, 2005, we effected a reverse split of our common stock in the ratio of 12 pre-split shares for every 1 post-split share (12:1).

	<b>High Prior to Reverse Split</b>	<b>Low</b>	<b>High Restated for Reverse Split</b>	<b>Low</b>
<b>2004</b>				
First Quarter	\$ 0.71	\$ 0.07	\$ 8.52	\$ 0.84
Second Quarter	\$ 0.43	\$ 0.13	\$ 5.16	\$ 1.56
Third Quarter	\$ 0.25	\$ 0.13	\$ 3.00	\$ 1.56
Fourth Quarter	\$ 0.40	\$ 0.14	\$ 4.80	\$ 1.68
<b>2005</b>				
First Quarter			\$ 3.60	\$ 1.75
Second Quarter			\$ 2.30	\$ 1.28
Third Quarter			\$ 1.80	\$ 1.28
Fourth Quarter			\$ 1.39	\$ 0.69

*SHAREHOLDERS*

As of December 31, 2005, there were 330 shareholders of record of our common stock.

*DIVIDEND POLICY*

We have never declared or paid a cash dividend on our common stock. We currently intend to retain all of our future earnings, if any, for use in our business and therefore we do not anticipate paying any cash dividends on our common stock in the foreseeable future. Any future determination to pay cash dividends will be at the discretion of our board of directors and will depend upon our financial condition, operating results, capital requirements, restrictions contained in our agreements and other factors which our board of directors deems relevant.

On January 19, 2005 we issued 15,800 shares of Series D 6% convertible preferred stock. The Series D Certificate of Designation provides for the payment of a dividend at the rate of 6% simple interest per annum for so long as the Series D shares are outstanding. Dividend payments are semi-annual due March 1 and September 1 and are payable in cash or shares of common stock. On March 3, 2005 we issued 57,186 shares of common stock valued at \$100,075 as a dividend payment to the holders of the Series D 6% Convertible Preferred Stock. On September 1, 2005 we paid \$318,355 and issued 224,511 shares of common stock valued at \$330,143 as a dividend payment to the holders of the Series D stock.

*RECENT SALES OF UNREGISTERED SECURITIES*

We did not sell unregistered (restricted) securities during the three months ended December 31, 2005.

**ITEM 6. SELECTED FINANCIAL DATA**

	2005 Restated	2004 Restated	2003 Restated	2002	2001
<b>Results of Operations</b>					
Net Sales	\$ 49,712,829	\$ 10,272,757	\$ 6,247,285	\$ 2,606,634	\$ 1,199,047
Loss from continuing operations	(14,404,622 )	(11,953,803 )	(5,155,690 )	(5,373,377 )	(1,437,818 )
Net Loss	(14,404,622 )	(11,953,803 )	(8,087,869 )	(5,373,377 )	(1,437,818 )
<b>Per Common Share</b>					
Loss from continuing operations					
Basic	(0.51 )	(0.62 )	(0.63 )	(1.58 )	(0.08 )
Assuming dilution	(0.51 )	(0.62 )	(0.63 )	(1.58 )	(0.08 )
Common Stock Dividends	0.00	0.00	0.00	0.00	0.00
<b>Financial Position at Year-End</b>					
Property plant and equipment, net	2,138,703	1,036,994	309,068	336,523	1,221,313
Total assets	39,776,535	13,627,196	1,620,114	2,615,451	2,113,779
Total debt	7,500,000	4,360,975	713,123	549,486	
Shareholders' Equity	(6,496,761 )	2,558,483	(305,595 )	803,450	1,174,915

**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION**
**2005, 2004 AND 2003 RESTATEMENT**

As discussed in the explanatory note to this Form 10-K/A and in Note 1 to our financial statements included herein, we are restating our financial statements and other financial information for the years ended 2005, 2004 and 2003, and financial information for each of the quarters in those years. The restatement adjusts our accounting for preferred stock and warrants issued to investors, accounting for stock-based compensation to employees and non-employees and accounting for rent expense on a straight-line basis.

The following tables set forth the effects of the error in accounting for the valuation of preferred stock and warrants issued to investors, accounting for stock-based compensation to employees and accounting for rent expense on a straight-line basis.

	(Increase)/Decrease in Net Loss					
	2005		2004		2003	
Total adjustment	\$ 2,161,046		\$ (1,707,970 )		\$ (2,766,245 )	
Previously reported net loss	\$ (16,565,668 )		\$ (10,245,833 )		\$ (5,321,624 )	
Percent variation from previously reported net loss	13.0	%	-16.7	%	-52.0	%

	(Increase)/Decrease in net loss							
	2005							
Quarter	4th Qtr.		3rd Qtr.		2nd Qtr.		1st Qtr.	
Total adjustment	\$ (46,309 )		\$ (61,272 )		\$ (777,977 )		\$ 3,046,604	
Previously reported net loss	\$ (7,108,180 )		\$ (5,605,211 )		\$ 130,633		\$ (3,982,910 )	
Percent variation from previously reported net loss	0.7	%	1.1	%	-595.5	%	-76.5	%

	(Increase)/Decrease in net loss							
	2004							
Quarter	4th Qtr.		3rd Qtr.		2nd Qtr.		1st Qtr.	
Total adjustment	\$ (375,754 )		\$ (649,028 )		\$ 34,159		\$ (717,347 )	
Previously reported net loss	\$ (3,854,612 )		\$ (3,236,792 )		\$ (1,957,990 )		\$ (1,196,439 )	

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Percent variation from previously reported net loss	9.7	%	20.1	%	-1.7	%	60.0	%
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Quarter	(Increase)/Decrease in net loss							
	2003							
	4th Qtr.		3rd Qtr.		2nd Qtr.		1st Qtr.	
Total adjustment	\$	(720,718 )	\$	(254,946 )	\$	(420,309 )	\$	(1,370,272 )
Previously reported net loss	\$	(1,748,243 )	\$	183,246	\$	(1,972,958 )	\$	(1,783,669 )
Percent variation from previously reported net loss	41.2	%	-139.1	%	21.3	%	76.8	%

## CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS

This Report contains forward-looking statements, including, without limitation, statements concerning possible or assumed future results of operations and those preceded by, followed by or that include the words believes, could, expects, intends, anticipates, or similar expressions. Actual results could differ materially from these anticipated in the forward-looking statements for many reasons including our ability to raise capital when necessary; availability of parts and raw materials for our products; continued customer acceptance of our products; on-going success of our research and development efforts and other risks described elsewhere in this report. Although we believe the expectations reflected in the forward-looking statements are reasonable, they relate only to events as of the date on which the statements are made, and our future results, levels of activity, performance or achievements may not meet these expectations. We do not intend to update any of the forward-looking statements after the date of this document to conform these statements to actual results or to changes in our expectations, except as required by law.

## SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Securities and Exchange Commission, or SEC, issued Financial Reporting release No. 60, Cautionary Advice Regarding Disclosure About Critical Accounting Policies, or FRR 60, suggesting companies provide additional disclosure and commentary on their most critical accounting policies. In FRR 60, the SEC defined the most critical accounting policies as the ones that are most important to the portrayal of a company's financial condition and operating results, and require management to make its most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. The methods, estimates and judgments we use in applying these most critical accounting policies have a significant impact on the results we report in our financial statements.

As a general rule, financial information is accounted for and based on cost, not current market value. Revenues and gains should be matched using the accrual method with the expenses giving rise to the revenues and gains to determine earnings for the period. Expenses are necessarily incurred to produce revenue. Expenses are then matched in the same accounting period against the revenue generated. Revenues are recognized when they are earned and expenses are recognized in the same period as the related revenue (matching or using a systematic and rational allocation or expensing in the period in which they expire), not necessarily in the period in which we receive or expend cash.

We believe the following critical accounting policies and procedures, among others, affect our more significant judgments and estimates used in the preparation of our consolidated financial statements:

- Revenue recognition;
- Inventory cost and Associated Reserves; and
- Allocation of direct and indirect cost of sales.

*Revenue Recognition:* The Company's revenue is derived principally from the sale of its vehicles and associated spare parts and training services. Revenue from product sales and spare part sales, net of an allowance for contractual adjustments, is recognized when the products or spare parts are delivered to and formally accepted by the customer. The Company defines formal acceptance as taking place when a representative of the United States government signs the United States Form DD250 entitled Material Inspection and Receiving Report which under the Federal Acquisition Regulations signifies contractual inspection and acceptance of the work performed by the contractor. It also acts as the contractual invoice creating payment liability on the United States Government. In accordance with standard industry practice, there is a representative from the United States Defense Contractor Manufacturing Agency (DCMA) acting as a contractual representative of the United States Government present at the Company's facilities. This DCMA representative inspects each vehicle as it is delivered by the Company and upon confirmation of the vehicle's conformity with the contractual specifications the inspector signs the Form DD250 and formally accepts delivery of the vehicle. The Company only recognizes revenues arising from its U.S. Government contracts upon execution of the Form DD250 by the DCMA inspector. Under some of the Company's U.S. Government contracts, it receives performance based payments based on completion of specific milestones stipulated under the contract (for example, delivery of raw material to our Ladson facility). These payments are recorded as deferred revenue and

carried on the Company's balance sheet as until the final delivery of the products and formal acceptance by the U.S. Government pursuant to the Form DD250. Upon acceptance of the products and the execution of the Form DD250, the Company recognizes the full sale price of the product as revenue.

Revenues from services provided are recorded in accordance with specific contractual terms. Services have historically consisted of the Company providing on-site personnel on an as-needed basis in a timely manner, and have generally been provided in foreign locations.

The Company negotiates contracts with its customers which may include revenue arrangements with multiple deliverables, as outlined by Emerging Issues Task Force No. 00-21 (EITF 00-21). The Company's accounting policies are defined such that each deliverable under a contract is accounted for separately. Historically, the Company has negotiated and signed contracts with its customers which outline the contract amount and specific terms and conditions associated with each deliverable. Allowance for contractual adjustments is recorded as a reduction to revenue.

*Stock-Based Compensation:* In December 2004, the FASB issued SFAS No. 123 (revised 2004) (SFAS No. 123(R)), *Share-Based Payment*, which replaced SFAS No. 123, *Accounting for Stock-Based Compensation*, and superseded Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*. SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values. The pro forma disclosures previously permitted under SFAS No. 123 will no longer be an alternative to financial statement recognition. Under SFAS No. 123(R), we must determine the appropriate fair value method to be used for valuing share-based payments, the amortization method of compensation cost and the transition method to be used at the date of adoption. In April 2005, the Securities Exchange Commission (SEC) amended Rule 401(a) of Regulation S-X to delay the effective date for compliance with SFAS No. 123(R). Based on the amended rule, we are required to adopt SFAS No. 123(R) as of July 1, 2005. We have evaluated the requirements of SFAS No. 123(R) and will adopt SFAS No. 123(R) on July 1, 2005.

*Principles of Consolidation:* The consolidated financial statements include the accounts of Force Protection, Inc., and our two wholly owned subsidiaries, Force Protection Industries, Inc. (formerly Technical Solutions Group, Inc.) and TSG International, Inc. for the years ended December 31, 2005, 2004 and 2003, respectively. All inter-company balances and transactions are eliminated in consolidation.

*Cash Equivalents:* For purposes of reporting cash flows, we consider all highly liquid debt instruments purchased with maturity of three months or less to be cash equivalents.

*Inventories:* Inventories are stated at the lower of cost or market. The cost is determined under the first-in, first-out, or FIFO, base valuation method. The Company maintains an allowance for obsolete or excess inventory. The Company determines an appropriate balance in this account based on historical data and specific identification of certain inventory items.

In November 2004, the FASB issued Statement No. 151, *Inventory Costs*, to amend the guidance in Chapter 4, *Inventory Pricing*, of the FASB Accounting Research Bulletin No. 43, *Restatement and Revision of Accounting Research Bulletins*, which will become effective for us in fiscal year 2006. Statement No. 151 clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted materials. The Statement requires that those items be recognized as current-period charges. Additionally, Statement No. 151 requires that allocation of fixed production overhead to the costs of conversion be based on normal capacity of the production facility. We are currently following Statement No. 151 and do not believe that Statement No. 151 will have a significant impact on our financial condition and results of operations.

*Property, Plant and Equipment:* Property and equipment are stated at cost or at the value of the operating agreement. We capitalize additions and improvements which include all material, labor and engineering cost to design, install or improve the asset. Routine repairs and maintenance are expensed as incurred. Depreciation and amortization are computed using the straight-line method over the following estimated useful lives:

Building and improvements	20 years
Furniture and fixtures	3 years
Machinery and equipment	7 years
Tooling and molds	7 years
Vehicles	5 years

*Goodwill:* Under SFAS No. 142, *Goodwill and other Intangible Assets*, all goodwill amortization ceased effective January 1, 2002. Rather, goodwill is now subject to only impairment reviews. A fair-value based test is applied at the reporting level. This test requires various judgments and estimates. A goodwill impairment loss will be recorded for any goodwill that is determined to be impaired. We follow SFAS 142, *Goodwill and Intangible Assets*, which requires us to test goodwill for potential impairment annually. When the carrying value exceeds fair value, the impairment is the difference between the carrying value of goodwill and the implied value. The implied value of goodwill is the

difference between the fair value for the unit as a whole and the value of individual assets and liabilities using an as-if purchase price.

*Gain/Loss per Share:* We utilize SFAS No. 128, Earnings per Share. Basic gain/loss per share is computed by dividing gain/loss available to common stockholders by the weighted-average number of common shares outstanding. Diluted gain/loss per share is computed similar to basic gain/loss per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potential common shares had been issued and if the additional common shares were dilutive. Since we have had a loss from continued operations for the periods ending December 31, 2003, 2004 and 2005, in accordance with SFAS No 128 we treat our earnings per share on a fully diluted basis as equal to the earnings per share for our outstanding common stock (the reasoning provided under SFAS No 128 for such treatment is that the inclusion of additional potential common shares is anti-dilutive).

*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 the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.



*Dividend Policy:* We have never declared or paid a cash dividend on our common stock, and we do not anticipate paying any cash dividends on our common stock in the foreseeable future. Any future determination to pay cash dividends on our common stock will be at the discretion of our board of directors and will depend upon our financial condition, operating results, capital requirements, restrictions contained in our agreements and other factors which our board of directors deems relevant. Under the terms of the Certificate of Designation for our Series D 6% Convertible Preferred stock, we are obligated to pay a 6% dividend in cash or shares of common stock on the outstanding shares of Series D stock.

*RESTATED FINANCIAL CONDITION AND RESULTS OF OPERATIONS*

*Overview:* The twelve month period ending December 31, 2005 has been a period of extraordinary growth for us, as we increased our production capacity by more than 407% from the same period ending December 31, 2004 and increased our sales 384%. During this period we completed our vehicle production backlog from 2004 and secured a major new contract for the production of the new Cougar Joint EOD Rapid Response vehicles ( JERRV ) under Contract M67854-05-D-5091 for the United States Marine Corps. During the twelve month period ending December 31, 2005 we also announced a new order received from the U.S. Marine Corps for the purchase of four Buffalo vehicles (with associated spares, service and training) for a total contract price of \$3,852,026. We delivered all four of these Buffalo vehicles under such contract during 2005. Sales for this period from all sources generated gross revenue of \$49,712,829, against which we incurred total cost of goods of \$46,828,615 generating a gross profit of \$3,284,214. We incurred general and administrative expenses, including research and development, in the total amount of \$18,914,277 resulting in an operating loss of \$14,404,622. In 2005 we delivered a total of 71 vehicles (31 Buffalos, 22 Cougar HEV and 18 Cougar JERRV), and made substantial progress in our infrastructure build-up toward our current targeted steady production capacity of twenty Cougars per month and 4 Buffalos per month.

The following table sets forth our consolidated statements of operations for the twelve month period ended December 31, 2005 and 2004, respectively. The discussion and analysis that follows should be read in conjunction with our consolidated financial statements and related notes included elsewhere in this report.

**Consolidated Statement of Operations**

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	2005 Restated	2004 Restated	\$ Change Restated	% Change Restated	
Revenues	49,712,829	10,272,757	39,440,072	383.93	%
Cost of Sales	46,428,615	11,266,998	35,161,617	312.08	%
Gross Profit	3,284,214	(994,241 )	4,278,455	430.32	%
G.P.%	7	% -10%			
G&A Expense	17,256,359	9,614,052	7,642,307	79.49	%
R&D Expense	1,657,918	1,230,290	427,628	34.76	%
Total G&A	18,914,277	10,844,342	8,069,935		
Operating Loss	(15,630,063 )	(11,838,583 )	(3,791,480 )	32.03	%
Interest Expense	(1,708,291 )	(684,980 )	(1,023,311 )	149.39	%
Other Income/(Expense)	102,941	569,760	(466,819 )	-81.93	%
Realized gain on derivative liability	2,830,791		2,830,791		
Total	1,225,441	(115,220 )	1,340,661	-1163.57	%
Net Loss	(14,404,622 )	(11,953,803 )	(2,450,819 )	20.50	%

*Revenue:* Revenue for the twelve month period ended December 31, 2005 was \$49,712,829 representing an increase of \$39,440,072 compared to the same period in 2004. The increase during this period was due to the increased level of vehicle production we have achieved compared with last year. Our revenue is derived from the sale of our Buffalo and Cougar vehicles and the sale of spare parts and other support services, however we do not record any income until our products are formally accepted by our customers. The revenue we received during this twelve month period thus includes amounts we previously carried on our balance sheet as deferred revenue pending acceptance of the final products by the U.S. Army and the U.S. Marines. During the twelve month period ended December 31, 2005, we received approximately \$44,844,704 from vehicle sales and \$4,868,125 from the sale of spare parts and other support services. The revenue from the sale of spare parts continues to increase, driven by the increasing number of our vehicles delivered and deployed to areas of operations. We intend to continue to develop this spare parts business as an increasingly important part of our revenue base.

*Cost of Sales:* Cost of sales for the twelve month period ended December 31, 2005 was \$46,428,615, representing an increase of \$35,161,617 compared to the same period in 2004. The increase during this period was due to the increased level of vehicle production, and the corresponding increased cost of direct and indirect labor and material associated with our manufacturing activities. The cost of sales for the twelve month period ended December 31, 2005 was 93% of gross revenues for such twelve month period representing an 7% gross profit for this period, compared with cost of sales of 110% of gross revenues for the same period in 2004, representing a 10% negative gross profit for 2004. This improvement in our gross profit is the result in part of increasing efficiency of our manufacturing operations. As we continue to expand our production capacity, we expect to achieve increased cost efficiency from volume purchasing, improvements in our manufacturing processes and the allocation of indirect costs across a broader production base, resulting in a projected decrease in the cost of sales as a percentage of gross revenue.

*General and Administrative Expenses:* General and Administrative expenses for the twelve month period ended December 31, 2005 were \$18,914,277 representing an increase of \$8,069,935 compared to the same period in 2004. This increase included \$427,628 in research and development expense, \$551,322 attributable to relocation and recruiting costs for new employees, \$4,703,460 for salaries and employee benefits, \$1,107,972 for commission and settlement related expenses, \$256,994 for employee training and \$922,559 for consulting services. We expect our General and Administrative expenses to increase over time as we continue to expand our production capacity to meet increasing sales demand, however we expect the percentage of our General and Administrative expenses in relation to gross revenues to decrease as we achieve greater efficiencies in our operations. Thus for example, during the twelve month period ending December 31, 2005 our General and Administrative expense was 38% of our gross revenue as compared with 106% for the same period in 2004.

*Net Loss:* Net Loss for the twelve month period ended December 31, 2005 was \$14,404,622 representing an increased loss of \$2,450,819 as compared to the net loss of \$11,953,803 incurred during the same period in 2004. This increase reflects the costs associated with the intensive infra-structure development program we carried out during 2005, coupled with an expected temporary decline in vehicle production and delivery levels during the third and fourth quarters following the completion of our contract backlog and the commencement of our production under the JERRV contract. This increased loss also includes the non-recurring expense reserve of \$2,012,989 for the cost of configuration upgrades to certain Cougar HEV vehicles discussed above. During this twelve month period, we incurred substantial expenses associated with our infrastructure expansion but have not been in a position to fully realize revenue from our increased capacity. As such, we do not believe that the financial results for this twelve month period are fully representative of our projected future results.

*Backlog:* On April 23, 2004 we announced a contract award to deliver Cougar Hardened Engineer Vehicles ( HEV ) to the United States Marine Corps, of which fourteen were initially funded under the contract. On March 8, 2005 the U.S. Marine Corps exercised its option to increase the number of HEV vehicles by fourteen, for a total of twenty-eight vehicles. As of December 31, 2005 we delivered a total of twenty-seven HEV vehicles, and have a remaining backlog of one Cougar HEV vehicle to be delivered under this contract, with a value of approximately \$400,000. On May 17, 2004 we announced the award of a contract to deliver twenty-one Buffalo vehicles to the U.S. Army and in October 2004 we were awarded a separate contract by the U.S. Army for an additional fifteen Buffalo vehicles. Initial deliveries under these two Buffalo contracts began during 2004 and 2005, and as of December 31, 2005 we have delivered all thirty-six Buffalo vehicles, leaving no backlog under these two contracts with the U.S. Army. During the second quarter of 2005 we announced the award of a new contract by the U.S. Marine Corps for delivery of one hundred twenty-two Cougar Joint EOD Rapid Response Vehicles ( JERRV ) to be delivered during 2005 and 2006, with a total value (with associated spares parts and training) of approximately \$93,000,000. As of December 31, 2005 we delivered eighteen JERRV vehicles and have a remaining backlog of one hundred four vehicles under the JERRV contract with an approximate value of \$75,000,000 (including associated spares and support). During the twelve month period ended December 31, 2005 we also announced a new order from the U.S. Marine Corps. for the purchase of four Buffalo vehicles (with associated spares, service and training) for a total contract price of \$3,852,026. We delivered all four of these Buffalo vehicles under such contract during 2005.

On February 3, 2006 we announced the award of a Letter Contract from the U.S. Army for the delivery of 19 Buffalo Vehicles with an option for an additional 27 vehicles. The Army subsequently reduced the number of the additional vehicles from 27 to 22, for a total of 41. The Letter Contract is subject to definitization of terms.

*Future Results:* During the upcoming calendar year 2006 we expect to have incurred the majority of our presently anticipated infrastructure expansion costs and to achieve a substantially increased level of vehicle production capacity, resulting in increased revenues and profitability for such upcoming period. Set out below is a table showing actual and projected deliveries of our vehicles during 2004 and 2005.

*Vehicle Deliveries 2004 & 2005*

	Actual 2004	Q1-2005	Q2-2005	Q3-2005	Q4-2005
Buffalo	9	2	22	3	4
Cougar HEV	5	8	2	8	4
Cougar JERRV	0	0	0	2	16
Total	14	10	24	13	24

*TRENDS, RISKS AND UNCERTAINTIES*

The results of our operations for the period ended December 31, 2005 reflect the costs associated with our extraordinary growth, as we evolve from a start up enterprise to become a full scale manufacturing facility. During 2004 we were awarded contracts by the U.S. Army for a total of thirty six Buffalos and by the U.S. Marines for twenty eight Cougars. We were able to build only 14 vehicles during 2004, but during the twelve month period ending December 31, 2005, we increased our total capacity to 71 vehicles, an increase of 407%, including all the 2004 backlog vehicles (apart from one HEV Cougar). At the same time we were working to complete the 2004 backlog, we also undertook the work necessary to increase our production capacity to meet the expected demand for our vehicles under the JERRV contract for one hundred twenty-two Cougars and potential follow-on orders. This included substantial vehicle and automotive engineering work, manufacturing engineering development, hiring and training

workforce and the expansion of our manufacturing and administrative facilities. While the JERRV contract reflects a broader, growing demand for our vehicles, we continue to face the challenge of expanding our manufacturing capacity to fully exploit this opportunity. During 2005 we have moved aggressively to meet this challenge by expanding our facilities, improving our operating systems and refining our manufacturing processes. These activities have required a significant commitment of short term resources, but we expect the long term benefits will be substantial.

We recognize there are risks associated with our on-going expansion activities. We continue to rely upon the U.S. Army and the U.S. Marine Corps for 100% of our sales, and if either customer elected not to issue further orders to us it would have a dramatic impact upon our financial performance. In addition, if we are delayed in meeting the delivery schedule under the JERRV contract, we may be obligated to pay liquidated damages for any delayed vehicle, and in the event of any substantial failure to perform, the customer could cancel the contract and/or claim additional damages. Payment of liquidated damages could negatively impact our future liquidity, and since we are incurring significant costs associated with our expansion program based on the expectation of future contract revenues, loss of the JERRV contract would have a dramatic impact on both our liquidity and our financial performance. We currently do not have any reason to expect that our customers will choose to stop buying our vehicles or that the JERRV contract would be cancelled.

In the past, we have encountered some difficulties in securing the necessary components for our vehicles, for example armor steel, truck chassis, axle sets and ballistic glass. To mitigate this risk, we have identified multiple vendors for certain components to ensure we have alternate sources of supply if necessary. Additionally, we have implemented a program of advance purchasing and stockpiling critical materials. For example, we currently have pre-purchased steel and truck parts to ensure availability of material needed for current and potential future orders. While we do not currently expect the potential non-availability of parts or raw materials to materially affect our operations, there is a possibility that delays or increased costs could negatively impact our financial performance if circumstances change. Apart from the foregoing, the main uncertainty about our future operations is whether we will continue to receive additional orders for our vehicles. It is impossible to predict with certainty whether such future orders will be placed by existing or new customers. If we do not receive future orders, it is unlikely that our business will continue. However, we believe our vehicles provide proven blast and ballistic protection, and that for so long as there is a risk of bodily harm to service personnel from explosive blasts, there will be a market for our products. A number of recent market surveys and requests for information issued by the U.S. military, for armored vehicles with characteristics substantially similar to ours, support this view.

#### *LIQUIDITY AND CAPITAL RESOURCES*

*Current Liquidity:* For the twelve month period ending December 31, 2005, we had a starting cash balance of \$2,264,406 and an ending cash balance of \$1,217,509 representing a net decrease in our cash position for such period of \$1,046,897. During this period we incurred negative cash flows from operations of \$18,495,319 due to the increased spending associated with our substantial infra-structure expansion needed to support our increased production capacity. As part of this expansion, we also invested \$1,511,337 in software, machinery and equipment. To meet our cash needs during this period, we raised a net total of \$18,896,988 through various financing activities, including \$15,305,965 from the sale of 15,800 shares of our Series D Convertible Preferred Stock, \$513,991 from the sale of our common stock and \$7,500,000 from the sale of a secured Note pursuant to a Subscription Agreement dated November 18, 2005 with Longview Fund, LP and Longview Equity Fund, LP. During this period we paid \$4,000,000 to settle the principal amount outstanding under our July 2004 Bridge Facility with GC Financial Services, and incurred commissions and other fees associated with the foregoing financing transactions.

*Future Liquidity:* During the twelve month period ending December 31, 2005 we experienced negative cash flows from operations of \$18,495,319 and needed to rely on outside sources of working capital to meet our cash flow requirements. Our ability to factor our U.S. Government receivables under the Purchase and Sale Agreement with GC Financial Services, Inc. allowed us to receive payment within 24-48 hours of vehicle deliveries and reduced the impact of the government contract payment cycle on our short term liquidity however we needed to regularly manage our accounts payable to maintain liquidity during 2005. During the upcoming period ending December 31, 2006 we expect the infra-structure expenses we have incurred in connection with our production ramp-up will begin to level off or decline and that we will begin to experience positive cash flow from operations as we increase the volume of vehicle production. As our expenses level out and our revenues increase, we expect to achieve positive cash flow from operations during the first half of 2006. Nonetheless, given our limited available cash, we may need to consider outside sources of financing to support our continued development and growth.

*Contract Liabilities:* Our sales contracts generally include a warranty such that our products are free from defects in design, material, and workmanship for a period of 1 year from the acceptance date. The warranty does not apply to any damage or failure to perform caused by the misuse or abuse of the vehicle, combat damage, fair wear and tear items (brake shoes, track pads, wiper blades, etc.), or by the customer's failure to perform proper maintenance or service on the supplies.

We routinely review our exposure for warranty costs and determines warranty and pricing reserves based on historical data and known events. Below is a table detailing our accruals for warranty-related costs as of December 31, 2005 and 2004:

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Accruals for contract liabilities include the following:

	2005	2004	2003
General warranty	\$ 1,686,062	\$ 167,950	\$ 180,384
Loss contingency		501,331	
Other		60,180	
	\$ 1,686,062	\$ 729,461	\$ 180,384

**Vehicle Fees:** We are party to a Memorandum of Understanding with Mechem, a division of Denel PTY, a South African company pursuant to which Mechem agreed for a period of five years to work exclusively with us and not to cede, dispose or transfer to any third party other than us any of our technology, IPR or other proprietary information relating to our armored vehicles systems including, but not limited to, designs, drawings, full technical specifications, test data, hardware and software designs and technologies, supplier's list, know-how and all and every piece of information and data relevant to such systems. In exchange for such exclusivity, we agreed to pay Mechem a vehicle fee, for every Buffalo and Tempest we manufacture and sell. We are not obligated to pay a vehicle fee in respect of other vehicles we manufacture and sell. On September 13, 2006, we executed a new Memorandum of Agreement with Mechem, extending the period of exclusivity for an additional five years, and adding a provisions that Mechem would upon request by us provide expertise and know-how on a work for hire basis to advise, assist and support us in our marketing activities. We also agreed to make a one time payment of \$394,500 to Mechem, representing vehicle fees in respect of Cougar vehicles previously delivered and sold by us during 2005 and 2006. The agreement with Mechem expires in September 2011.

We are also party to an agreement with CSIR Defencetek (a division of the Council for Scientific and Industrial Research) a statutory council established in accordance with the Laws of the Republic of South Africa, pursuant to which we are obligated to pay the CSIR a similar vehicle fee. The agreement with the CSIR expires in March 2007.

The following table is a summary of the vehicle fees to be paid per vehicle:

	Mechem	CSIR
Buffalo	\$ 5,000	\$ 3,000
Cougar	\$ 1,500	\$ 0
Tempest	\$ 3,000	\$ 1,500
Cheetah	\$ 0	\$ 0

**Table of Contractual Obligations:**

The following is a table outlining our actual and projected significant contractual obligations as of December 31, 2005:.

	For the Years Ended					
	2006	2007	2008	2009	2010	Total
Operating Lease Commitments	\$ 777,092	\$ 831,426	\$ 492,844	\$ 18,305	\$	\$ 2,119,667
Notes Payable Longview, principal	\$ 7,500,000	\$	\$	\$	\$	\$ 7,500,000
Notes Payable Longview, interest	\$ 843,288	\$	\$	\$	\$	\$ 843,288
Raw Material Purchase Commitments	\$ 8,289,132	\$	\$	\$	\$	\$ 8,289,132
Mechem - Vehicle Fees (1)	Variable	Variable	Variable	Variable	Variable	
CSIR Vehicle Fees (2)	Variable	Variable	\$	\$	\$	
Total	\$ 17,409,512	\$ 831,426	\$ 492,844	\$ 18,305	\$	\$ 18,752,087

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- (1) Refer to the Mechem vehicle fee agreement detailed above in Footnote 8, Commitments and Contingencies, Vehicle Fees.
- (2) Refer to the CSIR vehicle fee agreement detailed above in Footnote 8, Commitments and Contingencies, Vehicle Fees.

*Uncertainties:* The amount of working capital that we will require depends on several factors, including without limitation, the extent and timing of sales of our products, future inventory costs, the timing and costs associated with the expansion of our manufacturing, development, engineering and customer support capabilities, the timing and cost of our product development and enhancement activities and our operating results. The realization of a major portion of the assets shown on our balance sheet is dependent upon the success of such future operations. During 2006 we expect to be able to generate cash flows from operations sufficient to satisfy our cash requirements, but if we are unable to do so, we may need to seek alternative sources of cash. Potential sources of such cash could include senior debt facilities, new lines of credit, or additional sales of our securities. If we raise funds through the sale of securities, the common stock currently outstanding could be diluted. There is a risk that such additional financing may not be available, or may not be available on acceptable terms, and the inability to obtain additional financing or generate sufficient cash from operations could require us to reduce or eliminate expenditures for capital equipment, research and development, production, or marketing of our products, or otherwise curtail or discontinue our operations, which could have a material adverse effect on our business, financial condition and results of operations.

On October 18, 2005 our Chief Financial Officer resigned. The resignation of our Chief Financial Officer has not had a material negative impact upon on our operations. On November 15, 2005, R. Scott Ervin, a member of the Company's board of directors,



accepted the position of Interim Chief Financial Officer. The Company is in the process of identifying candidates to become the Company's next Chief Financial Officer.

#### *INFLATION AND MATERIAL COST*

We do not believe that inflation has had or is likely to have any significant impact on our revenues, and we currently are not facing any material shortages of raw materials or parts. We currently have enough steel on hand or on order to meet our existing contractual requirements, and we continue to purchase steel anticipating future requirements. If the price of steel increases significantly, the cost of our products could increase, and we may not be able to pass on this cost under our current contracts. As a result, if the cost of our raw materials increases our profitability on such current contracts, if any, could decrease.

### **ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

#### *COMMODITY PRICES*

We are exposed to market risk from changes in commodity prices. If the price of steel increases significantly, the cost of our products could increase. It is unlikely we will be able to pass on this cost under our current contracts. As a result, if the cost of our raw materials increases, our profitability, if any, could decrease.

#### *FOREIGN CURRENCY*

The majority of our business is denominated in U.S. dollars and as such, movement in the foreign currency markets will have a minimal direct impact on our business.

#### *INTEREST RATES*

As we do not have a trading portfolio and our current financing is at a fixed rate, we are not currently directly at risk of interest rate fluctuations. As our financing needs change in the future, interest rate risk may become a more significant issue for us.

To date, we have not used any derivative financial instruments for the purpose of reducing our exposure to adverse fluctuations in interest rates, foreign currency exchange, or commodity prices. We are not a party to leveraged derivatives nor do we hold or issue financial investments for speculative purposes.

## ITEM 8. FINANCIAL STATEMENTS

### REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

#### To the Board of Directors and Stockholders of Force Protection, Inc.

We have audited the accompanying consolidated balance sheets of Force Protection, Inc. and subsidiary as of December 31, 2005 and 2004, and the related consolidated statements of income, stockholders' equity and comprehensive income, and cash flows for each of the years in the two-year period ended December 31, 2005. 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. The December 31, 2003 financial statements of Force Protection, Inc. and subsidiary were audited by another auditor who has ceased operations. That auditor expressed an unqualified opinion on those financial statements in his report dated March 2, 2004.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 Force Protection Inc., and subsidiary as of December 31, 2005 and 2004, and the results of its operations and its cash flows for each of the years in the two-year period ended December 31, 2005 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the financial statements, certain errors resulting in adjustments to the Company's accounting for preferred stock and warrants issued to investors, accounting for stock-based compensation to employees and non-employees and accounting for rent expense on a straight-line basis as of December 31, 2005 and 2004, were discovered by management of the Company during the current year. Accordingly, the 2005 and 2004 financial statements have been restated to correct these errors.

As discussed above, the financial statements of Force Protection Inc., and subsidiary as of December 31, 2003, and for the year then ended were audited by other auditors who have ceased operations. As described in Note 1, these financial statements have been restated. We audited the adjustments described in Note 1 that were applied to restate the 2003 financial statements. In our opinion, such adjustments are appropriate and have been properly applied. However, we were not engaged to audit, review, or apply any procedures to the 2003 financial statements of the Company other than with respect to such adjustments and, accordingly, we do not express an opinion or any other form of assurance on the 2003 financial statements taken as a whole.

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. As discussed in Note 2, conditions exist which raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also discussed in Note 2. The financial statements do not include any adjustments that might result from this uncertainty.

/s/ Jaspers + Hall, PC

Denver, Colorado

March 17, 2006 (except as to the restatement discussed in Note 1 to the consolidated financial statements as to which the date is as of April 16, 2007)

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Stockholders of Force Protection, Inc. and subsidiary

We have audited the accompanying consolidated balance sheets of Force Protection, Inc., and subsidiary (formerly known as Sonic Jet Performance, Inc.) as of December 31, 2003 and 2002, and the related consolidated statements of operations, stockholders' equity (deficit) and cash flow for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the 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 Force Protection, Inc. and subsidiary, at December 31, 2003 and 2002, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the financial statements, the Company's recurring losses from operations and its difficulties in generating sufficient cash flow to meet its obligation and sustain its operations raise substantial doubt about its ability to continue as a going concern. Management's plans concerning these matters are also described in Note 1. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Michael Johnson & Co., LLC  
Michael Johnson & Co., LLC  
Denver, Colorado  
March 2, 2004

**FORCE PROTECTION, INC. AND SUBSIDIARY**  
**CONSOLIDATED BALANCE SHEETS**  
**DECEMBER 31, 2005, 2004 and 2003**

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	2005 Restated	2004 Restated	2003 Restated
<b>ASSETS</b>			
Current Assets:			
Cash	\$ 1,217,509	\$ 2,264,406	\$ 278,777
Accounts receivable, net of allowance for contractual adjustments of \$1,018,051 for 2005, \$0 for 2004 and 2003	3,666,358	1,053,973	144,932
Inventories	32,486,776	9,029,913	827,337
Other current assets	267,189	241,910	60,000
Total current assets	37,637,832	12,590,202	1,311,046
Investment in Xtreme Companies, Inc., net of valuation allowance			
Property and equipment, net	2,138,703	1,036,994	309,068
<b>Total Assets</b>	<b>\$ 39,776,535</b>	<b>\$ 13,627,196</b>	<b>\$ 1,620,114</b>
<b>LIABILITIES &amp; SHAREHOLDERS EQUITY</b>			
<b>LIABILITIES</b>			
Current Liabilities:			
Accounts payable	\$ 14,688,855	\$ 1,867,363	\$ 715,066
Other accrued liabilities	1,898,020	1,354,466	75,500
Contract liabilities	1,686,062	729,461	180,384
Loans payable	7,500,000	360,975	536,162
Line of Credit		4,000,000	176,961
Deferred revenue	12,598,921	2,645,716	209,175
Total Current Liabilities	38,371,858	10,957,981	1,893,248
Long-term debt:			
Other long term liabilities		110,732	32,461
<b>Total Liabilities</b>	<b>38,371,858</b>	<b>11,068,713</b>	<b>1,925,709</b>
Preferred stock series D, \$0.001 par value, authorized: 20,000 shares, issued and outstanding: 2005, 13,004 shares; 2004, 0 shares; 2003, 0 shares	7,901,438		
<b>SHAREHOLDERS EQUITY</b>			
Preferred stock: \$0.001 par value, authorized: 10,000,000 shares			
Preferred stock Series A, \$0.001 par value, authorized: 1,600 shares issued and outstanding: 2005, 0 shares; 2004, 0 shares; 2003, 0 shares			
Preferred stock series B, \$0.001 par value, authorized: 25 shares, issued and outstanding: 2005, 0 shares; 2004, 19.5 shares; 2003, 10 shares			
Preferred stock series C, \$0.001 par value, authorized: 150 shares, issued and outstanding: 2005, 0 shares; 2004, 0 shares; 2003, 130 shares			
Common stock, \$0.001 par value \$0.001, authorized: 300,000,000, issued and outstanding: 2005, 36,144,216 shares; 2004, 19,357,938 shares; 2003, 10,190,021 shares	36,114	19,358	10,190
Warrants	5,780,952	2,602,800	4,862,765
Beneficial Conversion Feature	0	19,102,306	282,890
Additional Paid-in Capital	38,714,893	35,874,565	18,805,887
Accumulated deficit	(51,028,720)	(55,040,546)	(24,267,327)
<b>Total Shareholders Equity</b>	<b>(6,496,761)</b>	<b>2,558,483</b>	<b>(305,595)</b>
<b>Total Liabilities and Shareholders Equity</b>	<b>\$ 39,776,535</b>	<b>\$ 13,627,196</b>	<b>\$ 1,620,114</b>

The accompanying Notes are an integral part of these financial statements.

**FORCE PROTECTION, INC. AND SUBSIDIARY**  
**CONSOLIDATED INCOME STATEMENT**  
**For the Years Ended December 31, 2005, 2004 and 2003**

	<b>2005 Restated</b>	<b>2004 Restated</b>	<b>2003 Restated</b>
<b>Net sales</b>	\$ 49,712,829	\$ 10,272,757	\$ 6,247,285
Cost of sales	46,428,615	11,266,998	4,442,418
Gross profit	3,284,214	(994,241 )	1,804,867
General and administrative expense	18,914,277	10,844,342	4,861,584
<b>Operating loss</b>	(15,630,063 )	(11,838,583 )	(3,056,717 )
Other income	102,941	569,760	41,668
Interest expense	(1,708,291 )	(684,980 )	(222,894 )
Realized gain on derivative liability	2,830,791		
Impairment losses goodwill			(1,917,747 )
<b>Loss from continuing operations before taxes</b>	(14,404,622 )	(11,953,803 )	(5,155,690 )
Loss from discontinued operations			(2,932,179 )
<b>Net loss</b>	\$ (14,404,622 )	\$ (11,953,803 )	\$ (8,087,869 )
Net loss	\$ (14,404,622 )	\$ (11,953,803 )	\$ (8,087,869 )
Accretion of Series D 6% convertible preferred stock	(2,041,697 )		
Preferred stock dividends	(778,530 )		
<b>Net loss available to common shareholders</b>	\$ (17,224,849 )	\$ (11,953,803 )	\$ (8,087,869 )
Basic loss per common share before discontinued operations	\$ (0.51 )	\$ (0.62 )	\$ (0.63 )
Basic loss per common share from discontinued operations			(0.36 )
<b>Basic loss per common share</b>	\$ (0.51 )	\$ (0.62 )	\$ (0.99 )
Diluted loss per common share before discontinued operations	\$ (0.51 )	\$ (0.62 )	\$ (0.63 )
Diluted loss per common share from discontinued operations			(0.36 )
<b>Diluted loss per common share</b>	\$ (0.51 )	\$ (0.62 )	\$ (0.99 )
<b>Weighted-average shares used to compute:</b>			
Basic loss per share	33,926,573	19,357,939	8,185,153
Diluted loss per share	33,926,573	19,357,939	8,185,153

The accompanying Notes are an integral part of these financial statements.

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FORCE PROTECTION, INC. AND SUBSIDIARY  
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY  
For the Years Ended December 31, 2005, 2004 and 2003

	Series B Preferred Stock		Series C Preferred Stock		Common Stock						
	Shares	Par \$.001	Shares	Par \$.001	Shares	Par \$.001	Warrants	BCF	Additional Paid-in Capital	Accumulated Deficit	Total
<b>Balance, December 31, 2002</b>	10	\$	32	\$	5,963,202	\$ 5,963	\$ 2,210,577	\$ 199,598	\$ 14,483,478	\$ (16,096,166)	\$ 803,450
Issuance of common stock for cash					2,429,272	2,429	2,652,188		312,083		2,966,700
Issuance of common stock for conversion of debt					264,804	265			377,185		377,450
Issuance of common stock for services					738,791	740			1,232,169		1,232,909
Issuance of common stock for settlement					139,441	139			133,724		133,863
Issuance of common stock for compensation					166,065	166			272,856		273,022
Issuance of common stock for director compensation					75,000	75			130,425		130,500
Issuance of common stock for financing placement					109,279	109			(109 )		
Revaluation of TSG acquisition									720,000		720,000
Issuance of preferred stock for cash			14						140,000		140,000
Issuance of preferred stock for conversion of debt			28						280,000		280,000
Issuance of preferred stock for interest			1						9,064		9,064
Issuance of preferred stock for services			50						661,720		661,720
Issuance of preferred stock for compensation			12						103,596		103,596
Redemption of preferred stock			(5 )						(50,000 )		(50,000 )
Change in Beneficial Conversion Feature							83,292			(83,292 )	
Common shares to be cancelled					304,167	304			(304 )		
Net loss										(8,087,869 )	(8,087,869 )
	10	\$	132	\$	10,190,021	\$ 10,190	\$ 4,862,765	\$ 282,890	\$ 18,805,887	\$ (24,267,327)	\$ (305,595)

Balance, December  
31, 2003

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	Series B Preferred Stock		Series C Preferred Stock		Common Stock						
	Shares	Par \$.001	Shares	Par \$.001	Shares	Par \$.001	Warrants	BCF	Additional Paid-in Capital	Accumulated Deficit	Total
<b>Balance, December 31, 2003</b>	10	\$	132	\$	10,190,021	\$ 10,190	\$ 4,862,765	\$ 282,890	\$ 18,805,887	\$ (24,267,327)	\$ (305,595 )
Issuance of common stock for cash					2,982,717	2,983			7,200,234		7,203,217
Issuance of common stock for third party services					163,501	163			496,793		496,956
Issuance of common stock for compensation - directors & employees					616,682	617			1,431,187		1,431,804
Issuance of common stock for cash (Warrant net change)					2,757,618	2,758	(2,259,965 )		6,352,054		4,094,847
Cancellation of common shares					(304,167 )	(304 )			304		
Issuance of common shares for debt					20,421	20			124,956		124,976
Conversion of preferred stock to common stock	(1 )		(80 )		2,931,145	2,931			(2,931 )		
Conversion between preferred Series B and Series C	11		(105 )								
Change in Beneficial Conversion Feature								18,819,416		(18,819,416 )	
Issuance of preferred stock for cash			1						10,000		10,000
Issuance of preferred stock for compensation			38						1,316,081		1,316,081
Issuance of preferred stock for conversion of debt			20						200,000		200,000
Rescission and redemption of preferred stock			(6 )						(60,000 )		(60,000 )

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Net loss											(11,953,803 )	(11,953,803 )
Balance, December 31, 2004												
20	\$	\$	19,357,938	\$	19,358	\$	2,602,800	\$	19,102,306	\$	35,874,565	\$ (55,040,546) \$ 2,558,483

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	Series B Preferred Stock		Series C Preferred Stock		Common Stock						
	Shares	Par \$.001	Shares	Par \$.001	Shares	Par \$.001	Warrants	BCF	Additional Paid-in	Accumulated Capital Deficit	Total
<b>Balance, December 31, 2004</b>	20	\$		\$	19,357,938	\$ 19,358	\$ 2,602,800	\$ 19,102,306	\$ 35,874,565	\$ (55,040,546)	\$ 2,558,483
Issuance of common stock for cash					185,321	185			513,806		513,991
Issuance of common stock for compensation					51,616	52			125,357		125,409
Issuance of common stock for settlement agreements					53,467	53			144,842		144,895
Issuance of common stock for interest					14,876	15			20,626		20,641
Issuance of common stock for Series D dividends					281,697	282			418,148	(418,430)	
Issuance of common stock to round up post split shares					3,079	3			6,075		6,078
Issuance of common stock for cash-warrants					114,376	114	(122,903)		334,418		211,629
Warrant issued for Series D placement							200,071		(200,071)		
Conversion of Series D preferred stock to common stock					1,331,429	1,331			1,440,694		1,442,025
Accretion of Series D preferred stock									(2,041,697)		(2,041,697)
Reclassification of Series D warrants from liability							5,173,409				5,173,409
Cash dividends for Series D										(100,020)	(100,020)
Dividends for Series D accrued										(260,080)	(260,080)
Conversion of Series B preferred stock to common stock	(20)				14,803,750	14,804			(14,804)		
Change in Beneficial Conversion Feature								(19,102,306)		19,102,306	
Common share grants cancelled					(83,333)	(83)			(209,916)		(209,999)
Stock based compensation (SFAS 123)										92,671	92,671
Warrants-net (expired & issued) not including Series D							(2,072,425)		2,302,850		230,425
Net loss										(14,404,621)	(14,404,621)
<b>Balance, December 31, 2005</b>		\$		\$	36,114,216	\$ 36,114	\$ 5,780,952	\$	\$ 38,714,893	\$ (51,028,720)	\$ (6,496,761)

**FORCE PROTECTION, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003**

	<b>2005</b>	<b>2004</b>	<b>2003</b>
	<b>Restated</b>	<b>Restated</b>	<b>Restated</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net loss	(14,404,622 )	(11,953,803 )	(8,087,869 )
Loss from discontinued operations			2,932,179
Loss from continuing operations	(14,404,622 )	(11,953,803 )	(5,155,690 )
<b>Adjustments to reconcile net loss to net cash (used in) provided by operating activities:</b>			
Depreciation and amortization	386,152	207,271	104,334
Realized gain on derivative liability	(2,830,791 )		
Impairment loss goodwill			1,634,873
Stock issued for services and compensation	(84,590 )	3,244,841	1,636,931
Stock issued for settlement	144,895		133,863
Stock based compensation	92,671		
Stock issued for interest	20,641		
<b>Change in assets and liabilities:</b>			
Decrease (increase) in accounts receivable	(2,612,385 )	(909,041 )	21,310
Decrease (increase) in inventories	(23,456,863 )	(8,202,576 )	(640,874 )
Decrease (increase) in other current assets	(25,279 )	(181,910 )	86,874
Increase (decrease) in accounts payable	12,821,492	1,152,297	(197,168 )
Increase (decrease) in other accrued liabilities	543,554	1,603,942	(47,367 )
Increase (decrease) in contract liabilities	956,601	549,077	(244,563 )
Deferred Revenue	9,953,205	2,436,541	209,175
<b>Net cash used in operating activities</b>	<b>(18,495,319 )</b>	<b>(12,053,361 )</b>	<b>(2,458,802 )</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Purchase of property and equipment	(1,511,337 )	(935,197 )	(76,878 )
Proceeds from sale of assets	62,721		
<b>Net cash used in investing activities</b>	<b>(1,448,566 )</b>	<b>(935,197 )</b>	<b>(76,878 )</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Proceeds from convertible debt			
Issuance of common stock, net	513,991	11,298,064	2,186,350
Issuance of Series D preferred stock, net	15,305,965		
Issuance of Series C preferred stock, net			140,000
Redemption of preferred stock		(50,000 )	(50,000 )
Preferred Stock Dividends paid	(100,020 )		
Issuance of common stock for cash - warrants	211,629		
Proceeds from (Payments on) loans, net	7,139,025	(175,187 )	479,355
Proceeds from (Payments on) Line of Credit, net	(4,000,000 )	3,823,039	(50,453 )
Proceeds from (Payments on) long term liabilities	(110,732 )	78,271	(35,271 )
Payments on Capitalized lease	(62,870 )		
<b>Net cash provided by Financing Activities</b>	<b>18,896,988</b>	<b>14,974,187</b>	<b>2,669,981</b>
<b>Net increase (decrease) in cash</b>	<b>(1,046,897 )</b>	<b>1,985,629</b>	<b>134,301</b>
<b>CASH beginning of period</b>	<b>\$ 2,264,406</b>	<b>\$ 278,777</b>	<b>\$ 144,476</b>
<b>CASH end of period</b>	<b>\$ 1,217,509</b>	<b>\$ 2,264,406</b>	<b>\$ 278,777</b>
<b>Supplemental cashflow information</b>			
Interest Paid	\$ 1,010,160	\$ 454,512	\$ 38,726
Taxes Paid			

The accompanying Notes are an integral part of these financial statements.



**FORCE PROTECTION, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

These notes are an integral part of the Company's financial statements set forth above.

**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (RESTATED)**
**2005, 2004 AND 2003 RESTATEMENT**

As discussed in the explanatory note to this Form 10-K/A and in Note 1 to the Company's financial statements included herein, the Company is restating its financial statements and other financial information for the years ended 2005, 2004 and 2003, and financial information for each of the quarters in the years 2005, 2004 and 2003. The restatement adjusts the Company's accounting for preferred stock and warrants issued to investors, accounting for stock-based compensation to employees and non-employees and accounting for rent expense on a straight-line basis.

The following tables set forth the effects of the error in accounting for the valuation of preferred stock and warrants issued to investors, accounting for stock-based compensation to employees and accounting for rent expense on a straight-line basis.

	(Increase)/Decrease in net loss		
	2005	2004	2003
Total adjustment	\$ 2,161,046	\$ (1,707,970 )	\$ (2,766,245 )
Previously reported net loss	\$ (16,565,668 )	\$ (10,245,833 )	\$ (5,321,624 )
Percent variation from previously reported net loss	13.0	% -16.7	% -52.0

	(Increase)/decrease in net loss			
	2005			
Quarter	4th Qtr.	3rd Qtr.	2nd Qtr.	1st Qtr.
Total adjustment	\$ (46,309 )	\$ (61,272 )	\$ (777,977 )	\$ 3,046,604
Previously reported net income (loss)	\$ (7,108,180 )	\$ (5,605,211 )	\$ 130,633	\$ (3,982,910 )
Percent variation from previously reported net loss	0.7	% 1.1	% -595.5	% -76.5

	(Increase)/decrease in net loss			
	2004			
Quarter	4th Qtr.	3rd Qtr.	2nd Qtr.	1st Qtr.
Total adjustment	\$ (375,754 )	\$ (649,028 )	\$ 34,159	\$ (717,347 )
Previously reported net loss	\$ (3,854,612 )	\$ (3,236,792 )	\$ (1,957,990 )	\$ (1,196,439 )
Percent variation from previously reported net loss	9.7	% 20.1	% -1.7	% 60.0

	(Increase)/decrease in net loss			
	2003			
Quarter	4th Qtr.	3rd Qtr.	2nd Qtr.	1st Qtr.
Total adjustment	\$ (720,718 )	\$ (254,946 )	\$ (420,309 )	\$ (1,370,272 )
Previously reported net loss	\$ (1,748,243 )	\$ 183,246	\$ (1,972,958 )	\$ (1,783,669 )
Percent variation from previously reported net loss	41.2	% -139.1	% 21.3	% 76.8

**Nature of the Business**

Force Protection, Inc. and subsidiaries (the Company) designs, manufactures and markets blast and ballistics armored vehicles for sale to military customers.

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**Principles of Consolidation**



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The consolidated financial statements include the accounts of Force Protection, Inc., and its two wholly owned subsidiaries, Force Protection Industries, Inc. (formerly Technical Solutions Group, Inc.) and TSG International, Inc. All inter-company balances and transactions are eliminated in consolidation.

### General Statement

The Securities and Exchange Commission has issued Financial Reporting release No. 60, Cautionary Advice Regarding Disclosure About Critical Accounting Policies, or FRR 60, suggesting companies provide additional disclosure and commentary on their most critical accounting policies. In FRR 60, the SEC defined the most critical accounting policies as the ones that are most important to the portrayal of a company's financial condition and operating results, and require management to make its most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. The methods, estimates and judgments the Company uses in applying these most critical accounting policies have a significant impact on the results the Company reports in its financial statements.

We believe the following critical accounting policies and procedures, among others, affect our more significant judgments and estimates used in the preparation of our consolidated financial statements:

- Revenue recognition;
- Inventory cost and Associated Reserves; and
- Allocation of direct and indirect cost of sales.
- Valuation of derivative instruments
- Valuation of preferred stock and common stock issuances in lieu of cash compensation

### Revenue Recognition

The Company's revenue is derived principally from the sale of its vehicles and associated spare parts and training services. Revenue from product sales and spare part sales, net of an allowance for contractual adjustments, is recognized when the products or spare parts are delivered to and formally accepted by the customer. The Company defines formal acceptance as taking place when a representative of the United States government signs the United States Form DD250 entitled Material Inspection and Receiving Report which under the Federal Acquisition Regulations signifies contractual inspection and acceptance of the work performed by the contractor. It also acts as the contractual invoice creating payment liability on the United States Government. In accordance with standard industry practice, there is a representative from the United States Defense Contractor Manufacturing Agency (DCMA) acting as a contractual representative of the United States Government present at the Company's facilities. This DCMA representative inspects each vehicle as it is delivered by the Company and upon confirmation of the vehicle's conformity with the contractual specifications the inspector signs the Form DD250 and formally accepts delivery of the vehicle. The Company only recognizes revenues arising from its U.S. Government contracts upon execution of the Form DD250 by the DCMA inspector. Under some of the Company's U.S. Government contracts, it receives performance based payments based on completion of specific milestones stipulated under the contract (for example, delivery of raw material to our Ladson facility). These payments are recorded as deferred revenue and carried on the Company's balance sheet as until the final delivery of the products and formal acceptance by the U.S. Government pursuant to the Form DD250. Upon acceptance of the products and the execution of the Form DD250, the Company recognizes the full sale price of the product as revenue.

Revenues from services provided are recorded in accordance with specific contractual terms. Services have historically consisted of the Company providing on-site personnel on an as-needed basis in a timely manner, and have generally been provided in foreign locations.

The Company negotiates contracts with its customers which may include revenue arrangements with multiple deliverables, as outlined by Emerging Issues Task Force No. 00-21 (EITF 00-21). The Company's accounting policies are defined such that each deliverable under a contract is accounted for separately. Historically, the Company has negotiated and signed contracts with its customers which outline the contract amount and specific terms and conditions associated with each deliverable. Allowance for contractual adjustments is recorded as a reduction to revenue.

### Allowance for Contractual Adjustments

The Company's contracts with the U.S. Government are negotiated as a sole source or open competition bid process. A sole source process is one in which the Company is the sole bidder for the contract. An open competition could involve various bidders. Once a bid is accepted, the

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U.S. Government expects work to commence immediately. An open competition results in a final agreed-upon contract price which the U.S. Government has agreed to. A sole source process results in an agreed-upon contract with the U.S. Government, subject to an adjustment process at a later date, termed the definitization process. The definitization process commences upon delivery of a product, whereby the U.S. Government completes a detailed review of the Company's costs involved in the manufacturing and delivery process. The U.S. Government and the Company then work to

determine an adequate and fair final contract price. As a result of the potential adjustments related to the definization process, the Company maintains an allowance for contractual adjustments account. This account is reviewed on a monthly basis to determine adequate adjustments, if necessary. The allowance is maintained and deemed adequate based on the analysis of historical data and calculation of pro-rata percentages of current contracts in place, which remain subject to the definitization process.

The Company does not maintain an allowance for doubtful accounts. The Company's significant sales for 2005, 2004, and 2003 involved contracts signed with the U.S. Government. The Company does not believe an allowance for doubtful accounts is necessary due to the credit-worthiness of the U.S. Government.

Historically, the Company has not encountered sales returns. The Company does not anticipate sales returns in the future.

## Research and Development

Research, development, and engineering costs are expensed as incurred, in accordance with SFAS No. 2, *Accounting for Research and Development Costs*. Research, development, and engineering expenses primarily include payroll and headcount related costs, contractor fees, infrastructure costs, and administrative expenses directly related to research and development support.

## Cash Equivalents

For purposes of reporting cash flows, the Company considers all highly liquid debt instruments purchased with maturity of three months or less to be cash equivalents.

## Inventories

Inventories are stated at the lower of cost or market. The cost is determined under the first-in-first-out method base (FIFO) valuation method. An allowance for excess or obsolete inventory is maintained by the Company. The Company determines an appropriate balance in this account based on historical data and specific identification of certain inventory items.

## Property, Plant and Equipment

Property and equipment are stated at cost or at the value of the operating agreement. The Company capitalizes additions and improvements which include all material, labor and engineering cost to design, install or improve the asset. Routine repairs and maintenance are expensed as incurred. Depreciation and amortization are computed using the straight-line method over the following estimated useful lives:

Building and improvements	20 years
Furniture and fixtures	3 years
Machinery and equipment	7 years
Tooling and molds	7 years
Vehicles	5 years

## Impairment of Long-Lived Assets

The Company reviews long-lived assets to be held and used for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount of the asset, the Company would recognize an impairment loss based on the estimated fair value of the asset.

## Goodwill

Under SFAS No. 142, Goodwill and other Intangible Assets, all goodwill amortization ceased effective January 1, 2002. Rather, goodwill is now subject to only impairment reviews. A fair-value based test is applied at the reporting level. This test requires various judgments and estimates. A goodwill impairment loss will be recorded for any goodwill that is determined to be impaired. Goodwill is tested for impairment at least annually.

The Company acquired Goodwill, which represents the excess of purchase price over fair value net assets, in the acquisition of Technical Solutions Group, Inc. in June 2002. The Company follows SFAS 142, Goodwill and Intangible Assets, which requires the Company to test for

potential impairment annually. When the carrying value exceeds fair value, the impairment is the difference between the carrying value of goodwill and the implied value. The implied value of goodwill is the difference between the fair value for the unit as a whole and the value of individual assets and liabilities using an as-if purchase price.

#### **Income Taxes**

The Company uses the asset and liability method of accounting for income taxes. The asset and liability method accounts for deferred income taxes by applying enacted statutory rates in effect for periods in which the difference between the book value and the tax bases of assets and liabilities are scheduled to reverse. The resulting deferred tax asset or liability is adjusted to reflect changes in tax laws or rates. Because the Company has incurred losses from operations, no benefit is realized for the tax effect of the net operating loss carry-forward due to the uncertainty of its realization.

**Stock-Based Compensation**

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The Company applied the recognition and measurement principles of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations in accounting for those plans through June 30, 2005.

In December 2004, FASB issued Statement No. 123(R), *Share-Based Payment*, which establishes accounting standards for transactions in which an entity receives employee services in exchange for (a) equity instruments of the entity or (b) liabilities that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of equity instruments. Effective on July 1, 2005, the Company adopted SFAS 123(R), which requires the Company to recognize the grant-date fair value of stock options and equity based compensation issued to employees in the statement of operations. The statement also requires that such transactions be accounted for using the fair-value-based method, thereby eliminating use of the intrinsic method of accounting in APB No. 25, *Accounting for Stock Issued to Employees*, which was permitted under SFAS 123, as originally issued.

### ***Loss per Share***

The Company utilizes SFAS No. 128, *Earnings per Share* to calculate gain/loss per share. Basic gain/loss per share is computed by dividing the gain/loss available to common stockholders (as the numerator) by the weighted-average number of common shares outstanding (as the denominator). Diluted gain/loss per share is computed similar to basic gain/loss per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if all potential common stock (including common stock equivalents) had all been issued, and if such additional common shares were dilutive. Under SFAS No. 128, if the additional common shares are dilutive, they are not added to the denominator in the calculation. Where there is a loss, the inclusion of additional common shares is anti-dilutive (since the increased number of shares reduces the per share loss available to common stock holders). For all periods, the Company has experienced a net loss, and thus common stock equivalents have been excluded from the calculation of diluted loss per share.

### **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 the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Estimates and assumptions are periodically reviewed and the effects of revisions are reflected in the consolidated financial statements in the period they are determined to be necessary.

### **Reclassifications**

Certain reclassifications to the Company's balance sheet and income statement have been made in 2005, in order for the 2004 and 2003 financial statements to conform to the presentation of these financial statements. These reclassifications did not impact the Company's net loss for the years ended December 31, 2005, 2004 and 2003, respectively.

### **Recent Accounting Pronouncements**

In November 2004, the FASB issued Statement No. 151, *Inventory Costs*, to amend the guidance in Chapter 4, *Inventory Pricing*, of the FASB Accounting Research Bulletin No. 43, *Restatement and Revision of Accounting Research Bulletins*, which will become effective for the Company in fiscal year 2006. Statement No. 151 clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted materials. The Statement requires that those items be recognized as current-period charges. Additionally, Statement No. 151 requires that allocation of fixed production overhead to the costs of conversion be based on normal capacity of the production facility. The Company is currently following Statement No. 151 and does not believe that Statement No. 151 will have a significant impact on its financial condition and results of operations.

In March 2005, the FASB issued FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* (FIN 47). FIN 47 provides guidance relating to the identification of and financial reporting for legal obligations to perform an asset retirement activity. The Interpretation requires recognition of a liability for the fair value of a conditional asset retirement obligation when incurred if the liability's fair value can be reasonably estimated. FIN 47 also defines when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. The provision is effective no later than the end of fiscal years ending after December 15, 2005. The Company will adopt FIN 47 beginning the first quarter of fiscal year 2006 and does not believe the adoption will have a material impact on its consolidated financial position or results of operations or cash flows.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections* (SFAS 154) which replaces Accounting Principles Board Opinions No. 20 *Accounting Changes* and SFAS No. 3, *Reporting Accounting Changes in Interim Financial Statements: An Amendment of APB Opinion No. 28*. SFAS 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. It establishes retrospective application, or the latest practicable date, as the required method for reporting a change in accounting principle and the reporting of a correction of an error. SFAS 154 is effective for accounting changes and a correction of errors made in fiscal years beginning after December 15, 2005 and is required to be



adopted by the Company in the first quarter of 2006. The Company is currently evaluating the effect that the adoption of SFAS 154 will have on its results of operations and financial condition but does not expect it to have a material impact.

In June 2005, the Emerging Issues Task Force, or EITF, reached a consensus on Issue 05-6, *Determining the Amortization Period for Leasehold Improvements*, which requires that leasehold improvements acquired in a business combination or purchased subsequent to the inception of a lease be amortized over the lesser of the useful life of the assets or a term that includes renewals that are reasonably assured at the date of the business combination or purchase. EITF 05-6 is effective for periods beginning after July 1, 2005. We do not expect the provisions of this consensus to have a material impact on the financial position, results of operations or cash flows.

## **NOTE 2 GOING CONCERN**

The Company's financial statements have been prepared on a going concern basis, which contemplates continuity of operations, realization of assets and liquidation of liabilities in the normal course of business. The Company had cumulative recurring losses of \$50,668,620 as of December 31, 2005 and negative cash flows from operations during the year ending December 31, 2005 of \$18,495,319. The ability of the Company to operate as a going concern depends upon its ability to obtain outside sources of working capital and/or generate positive cash flow from operations. Management is aware of these requirements and is undertaking specific measures to address these liquidity concerns. Specifically, to increase revenues the Company has focused on increasing its production capacity to maximize revenues from vehicles sales and has continued to expand its integrated logistics support function to meet the increased demand for spare parts and other support services. The efforts by the Company in these regards have been dramatic, as the Company has been able to increase its average monthly vehicle production from four vehicles per month to the current average of 15 vehicles per month, resulting in an annual production increase of 407% from 2004. The Company is also undertaking to increase its gross profitability by reducing the direct costs to manufacture its products, by focusing on continual improvement of manufacturing processes and reducing rework and waste resulting from internal inefficiencies. At the same time, the Company is working to reduce the percentage of its G&A expenses with respect to revenues through workforce balancing and cost planning initiatives. The Company anticipates that these efforts will lead to positive cash flows and profitability during 2006. Finally, to provide additional liquidity, the Company continues to explore various asset-based debt financing options, including long term loans, revolving lines of credit and accounts receivable factoring arrangements. Notwithstanding the foregoing, there can be no assurance that the Company will be successful in obtaining such financing, that it will have sufficient funds to execute its business plan or that it will generate positive operating results. The financial statements do not include any adjustments relating to the recoverability and classification of asset carrying amounts or the amount and classification of liabilities that might result should the Company be unable to continue as a going concern.

## **NOTE 3 CONCENTRATIONS**

The Company's future operations and continued expansion is subject to a significant concentration risk. During the years ended December 31, 2005, 2004 and 2003, the Company's revenues from military units of the U.S. Government accounted for 100% of total revenues, respectively. The Company's accounts receivable from military units of the U.S. Government at December 31, 2005, 2004 and 2003 amounted to 100% of total accounts receivable, respectively. However, the Company currently has a significant backlog and has signed contracts to provide additional products of significant value to the U.S. Government and its first international customer, the British Ministry of Defense.

## **NOTE 4 ACCOUNTS RECEIVABLES DEFINITIZATION**

The majority of the Company's contracts are with the United States Government and as such they are "public sector" contracts subject to the Federal Acquisition Regulations set out at Title 41 of the United States Code (the "FAR"), and may result either from competitive bidding or may be awarded as "sole source" contracts subject to definitization as provided under FAR Section 252.217-7027.

Following the award of a sole source contract, a central component of the definitization process is the negotiation and finalization of the contract price between the contractor and the United States contracting officer. As part of this process, the parties make a mutual determination of the direct material and labor costs for the work based upon the bill of materials and other purchasing information and then the parties mutually agree upon "rates" for the indirect labor costs and the General and Administrative costs and upon a "fee" (or profit). While the direct material costs and labor can be established through objective evidence, the "rates" and fee are more subjective and are based upon an analysis of multiple factors including historical performance data and projected operational factors. The contractor has the right to submit proposed rates and fee, but these are subject to final review and approval by the contracting officer, who may insist on using alternate rates and fee. As provided in section 252.217-7027(c):

*If agreement on a definitive contract action to supersede this undefinitized contract action is not reached by the target date in paragraph (b) of this clause, or within any extension of it granted by the Contracting Officer, the Contracting Officer may, with the approval of the head of the contracting activity, determine a reasonable price or fee in accordance with subpart 15.4 and part 31 of the FAR, subject to Contractor appeal as provided in the Disputes clause.*



Finally, although both parties make an effort to definitize the contract as quickly as possible, the process is time consuming and can take months (or even years) to complete. During the definitization process the contractor is required to perform the contract

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work and to make deliveries under the contract before the final contract price has been established. For this reason, as part of the original letter award, the contractor provides a rough order of magnitude ( ROM ) price to be used for invoicing and accounting purposes pending definitization.

As a result of the potential adjustments related to the definitization process, the Company maintains an allowance for contractual adjustments account. This account is reviewed on a regular basis to determine adequate adjustments, if necessary. The allowance is evaluated and deemed adequate based on the analysis of historical data and calculation of pro-rata percentages of current contracts in place, which remain subject to the definitization process.

Below is a table detailing activity within the allowance for contractual adjustments account for the years ended December 31, 2005, 2004, and 2003 respectively.

	Year Ended Dec. 31, 2005	Year Ended Dec. 31, 2004	Year Ended Dec. 31, 2003
Beginning balance	\$	\$	\$
Additions to allowance	1,018,051		
Reduction to allowance			
Ending balance	\$ 1,018,051	\$	\$

The Company does not maintain an allowance for doubtful accounts. The Company's significant sales for the years ended December 31, 2005, 2004 and 2003 involved contracts signed with the U.S. Government. The Company does not believe an allowance for doubtful accounts is necessary due to the credit-worthiness of the U.S. Government.

Historically, the Company has not encountered sales returns. The Company does not anticipate sales returns in the future.

### NOTE 5 INVESTMENT IN XTREME COMPANIES, INC.

On June 1, 2003, and modified on September 15, 2003, the Company sold the asset associated with its boat business to Rockwell Power Systems, Inc., which subsequently merged with Xtreme Companies, Inc, now called Challenger Powerboats, Inc., a public company traded on the Over the Counter Bulletin Board. As consideration for the sale, the Company received 1/3 of Challenger Powerboats' outstanding common stock, which was distributed directly to the Company's common stock shareholders. Additionally, the Company was to receive 500 shares of Challenger Powerboats Series A preferred stock. The Company has been in communications with Challenger Powerboats but has yet to receive these shares. The Company has elected to account for the investment in Challenger Powerboats' Series A preferred stock under the cost method and has provided for a full valuation allowance against the fair market value of these shares as of December 31, 2005, 2004 and 2003, respectively.

	2005	2004	2003
Challenger Powerboat Inc. Series A preferred stock	\$	\$	\$
Valuation Allowance	( )	( )	( )
Net Investment in Challenger Powerboat Inc.	\$	\$	\$

### NOTE 6 INVENTORIES

Property, Plant and Equipment at December 31, 2005, 2004 and 2003 consisted of the following:

	2005	2004	2003
Raw materials and supplies	\$ 15,222,503	\$ 5,268,798	\$
Work in process	17,762,554	3,756,921	827,337
Finished Goods		4,194	
Less: Allowance for surplus and obsolete	(498,281 )		
Inventories, net	\$ 32,486,776	\$ 9,029,913	\$ 827,337

### NOTE 7 PROPERTY AND EQUIPMENT

Property, Plant and Equipment at December 31, 2005, 2004 and 2003 consisted of the following:

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	2005	2004	2003
Furniture and fixtures	\$ 227,613	\$ 252,608	\$ 61,479
Leasehold improvements	59,928		
Machinery and equipment	2,024,436	983,955	307,490
Test Equipment	16,790	16,790	
Manuals	104,798	104,798	64,095
Vehicles	56,464	10,110	
Demo vehicles	425,845	192,530	192,530
Less depreciation and amortization	(777,171 )	(523,797 )	(316,526 )
Net property and equipment	\$ 2,138,703	\$ 1,036,994	\$ 309,068

Depreciation expense for the years ended December 31, 2005, 2004 and 2003 was \$386,152, \$207,271 and \$104,334 respectively.

**NOTE 8 COMMITMENTS AND CONTINGENCIES****Other Accrued Liabilities**

The Company's other accrued liabilities include the following:

	2005	2004	2003
Compensation and benefits	\$ 1,396,024	\$ 1,195,705	\$ 30,911
Dividends on preferred stock	260,080		
Rents liability	12,039	124,575	44,589
Shares committed to be issued	212,606		
Other	17,271	34,186	
	\$ 1,898,020	\$ 1,354,466	\$ 75,500

**Contract Liabilities**

The Company's sales contracts generally include a warranty such that the Company's products are free from defects in design, material, and workmanship for a period of 1 year from the acceptance date. The warranty does not apply to any damage or failure to perform caused by the misuse or abuse of the vehicle, combat damage, fair wear and tear items (brake shoes, track pads, wiper blades, etc.), or by the customer's failure to perform proper maintenance or service on the supplies.

The Company routinely reviews its exposure for warranty costs and determines warranty and pricing reserves based on historical data and known events. Below is a table detailing the Company's accruals for warranty-related costs as of December 31, 2005 and 2004:

Accruals for contract liabilities include the following:

	2005	2004	2003
General warranty	\$ 1,686,062	167,950	180,384
Loss contingency		501,331	
Other		60,180	
	\$ 1,686,062	\$ 729,461	\$ 180,384

**Vehicle Fees**

The Company is party to a Memorandum of Understanding with Mechem, a division of Denel PTY, a South African company pursuant to which Mechem agreed for a period of five years to work exclusively with the Company and not to cede, dispose or transfer to any third party other than the Company any of its technology, IPR or other proprietary information relating to its armored vehicles systems including, but not limited to, designs, drawings, full technical specifications, test data, hardware and software designs and technologies, supplier's list, know-how and all and every piece of information and data relevant to such systems. In exchange for such exclusivity the Company agreed to pay Mechem a vehicle fee, for every Buffalo and Tempest the Company manufactures and sells. The Company is not obligated to pay a vehicle fee in respect of other vehicles it manufactures and sells.

The Company is also party to an agreement with CSIR Defencetek (a division of the Council for Scientific and Industrial Research) a statutory council established in accordance with the Laws of the Republic of South Africa, pursuant to which the Company is obligated to pay the CSIR a similar vehicle fee. The agreement with the CSIR expires in March 2007.

The following table is a summary of the vehicle fees to be paid per vehicle:

	Mechem	CSIR
Buffalo	\$ 5,000	\$ 3,000
Cougar	\$ 3,000	\$ 1,500



**Table of Contractual Obligations**

The following is a table outlining the Company's actual and projected significant contractual obligations as of December 31, 2005:

	<b>For the Years Ended</b>					
	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>Total</b>
Operating Lease Commitments	\$ 777,092	\$ 831,426	\$ 492,844	\$ 18,305	\$	\$ 2,119,667
Notes Payable Longview, principal	\$ 7,500,000	\$	\$	\$	\$	\$ 7,500,000
Notes Payable Longview, interest	\$ 843,288	\$	\$	\$	\$	\$ 843,288
Raw Material Purchase Commitments	\$ 8,289,132	\$	\$	\$	\$	\$ 8,289,132
Mechem - Vehicle Fees (1)	Variable	Variable	Variable	Variable	Variable	
CSIR Vehicle Fees (2)	Variable	Variable	\$	\$	\$	
<b>Total</b>	<b>\$ 17,409,512</b>	<b>\$ 831,426</b>	<b>\$ 492,844</b>	<b>\$ 18,305</b>	<b>\$</b>	<b>\$ 18,752,087</b>

(1) Refer to the Mechem vehicle fee agreement detailed above in Footnote 8, Commitments and Contingencies, Vehicle Fees.

(2) Refer to the CSIR vehicle fee agreement detailed above in Footnote 8, Commitments and Contingencies, Vehicle Fees.

On April 23, 2004 the Company was awarded a contract to deliver 14 Cougar Hardened Engineer Vehicles ( HEV ) to the U.S. Marine Corps under contract M6785404-D-5099. As of December 31, 2004 we had delivered only 5 of the Cougar HEV vehicles. On March 8, 2005 the U.S. Marine Corps exercised its contractual option to purchase an additional 14 HEV vehicles, for a total of twenty-eight vehicles to be delivered by the Company. As of December 31, 2005, we had delivered a total of twenty seven HEV vehicles, leaving a backlog for 2006 of one HEV vehicle to be delivered under this contract. The Cougar HEV was a new product when the original contract was signed in 2004 and the Company did not have experience with the cost of performance for such vehicle. During 2005, as the Company continued to perform on the HEV contract, the Company experienced certain costs overruns resulting from design changes, material rework and other production inefficiencies inherent in the development of a new product. As of December 31, 2005, based on such operating experience and having completed 96.4% of the vehicles required under the contract the Company made a determination that it would experience a net loss on the HEV contract in the approximate amount of \$501,331 as a result of such inefficiencies. This amount was based upon actual costs incurred for the manufacture of the previous vehicles and an estimation of the costs associated with the manufacture of the then existing backlog.

**Compensation of Executive Officers & Directors**

On January 27, 2005, the Company entered into an agreement with Mr. Gordon McGilton to act as its Chief Quality Officer. Under the terms of such agreement, Mr. McGilton is to receive a base salary of \$180,000 plus an annual bonus of \$180,000 and reimbursement for travel, lodging and other out of pocket expenses incurred during employment. The Company also agreed to provide Mr. McGilton stock options once it adopts a stock option plan. Effective April 18, 2005, the Company appointed Mr. McGilton as its Chief Executive Officer. During 2005 Mr. McGilton received in kind compensation in the amount of \$20,000 in the form of a Vortex jet boat which the Company gave Mr. McGilton title to. Mr. McGilton joined the board of directors on April 18, 2005. Mr. McGilton received no compensation for his services as a director during 2005.

On February 4, 2005, the Company entered into an agreement with Mr. Ted McQuinn to act as President of its subsidiary Force Protection Industries, Inc. Under the terms of such agreement, Mr. McQuinn is to receive compensation of \$180,000 per year, plus an annual grant (for a period of three years) of unregistered common stock valued at \$100,000 and a one time grant of unregistered common stock valued at \$12,910.

On November 15, 2004, the Company entered into an employment agreement with Mr. R. Scott Ervin to act as its General Counsel. Under the terms of such agreement, Mr. Ervin is to receive compensation of \$118,000 per year, plus relocation expenses of \$15,000, plus a grant of unregistered common stock valued at \$75,001. Effective January 1, 2005, the annual compensation under such agreement was increased to \$140,000. On January 27, 2005, Mr. Ervin was appointed by the Board to act as Interim Chief Executive Officer during the Company's search for a Chief Executive Officer. Upon the appointment of the new Company Chief Executive Officer on April 18, 2005, Mr. Ervin ceased to serve as the Interim Chief Executive Officer but continues to serve as General Counsel and a member of the board of directors. Mr. Ervin received no compensation for his services as a director during 2005. On November 14, 2005, the Board appointed Mr. Ervin to serve as the Acting Chief Financial Officer following the resignation of the former CFO.

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On November 8, 2004, the Company entered into an employment agreement with Director Mr. Gale Aguilar to act as the Interim Chief Executive Officer. Under the terms of such agreement, Mr. Aguilar is to receive compensation of \$180,000 per year, plus a grant of 15,099 shares of unregistered common stock vesting on November 18, 2004 valued at \$72,650. Mr. Aguilar's employment agreement was terminated effective January 27, 2005. Mr. Aguilar received no compensation for his services as a director during 2005.

On March 31, 2003, the Company entered into an employment agreement with Mr. Frank Kavanaugh to act as its Vice President of Business Development. Under the terms of such agreement, Mr. Kavanaugh is to receive compensation of \$180,000 per year. In

addition, on December 31, 2004, Mr. Kavanaugh received a one time grant of 10 Series C shares and 41,667 common shares valued at \$460,890. On May 14, 2005, Mr. Kavanaugh resigned from his employment with the Company, but continues to serve on the board of directors as Chairman. In connection with Mr. Kavanaugh's resignation, the Company agreed to pay for 24 months of health coverage valued at \$24,178. Mr. Kavanaugh received no compensation for his services as a director during 2005.

#### **Contract Definitization**

The Company contracts for the sale of its vehicles to the U.S. Government under fixed price sales contracts, subject to the provisions of the U.S. Federal Acquisition Regulations ( FAR ). Under FAR 52.216-25, contract awards may be made subject to future Contract Definitization pursuant to which the contractor agrees to negotiate with the Government following commencement of the contract work to finalize detailed conditions of the contract, including pricing, scheduling and other applicable requirements. As part of such negotiations, the contractor is subject to audit by the U.S. Defense Contract Audit Agency ( DCAA ) of its direct material and labor costs, manufacturing overhead and margin. Based on such audit and the negotiations with the Government, the final definitized contract price may be less than the amount originally established (see additional discussions within Footnote 1 and Footnote 4).

#### **Legal Proceedings**

On May 12, 2005, Atlantis Partners, Inc. filed a complaint against the Company in the Circuit Court for the 15th Judicial Circuit, Palm Beach County Florida for alleged breach of terms related to a finder's fee agreement dated March 28, 2003. The complaint alleges damages of at least \$400,000 in fees, plus costs and interest.

#### **NOTE 9 DEFERRED REVENUE**

The Company only recognizes revenue from the sales of its vehicles upon formal acceptance by its customers. However, the Company does receive performance based payments in accordance with agreed milestones under some of its government contracts. The Company records such performance based payments as deferred revenue and carries them on its balance sheet until formal acceptance by the customer. As of December 31, 2005, 2004 and 2003 the Company had \$12,598,921, \$2,645,716 and \$209,175 respectively as deferred revenue resulting from its contracts with the U.S. Army and the U.S. Marines.

#### **NOTE 10 DEBT**

On November 18, 2005, the Company entered into a Subscription Agreement with Longview Fund, LP and Longview Equity Fund, LP (the Subscribers ) pursuant to which the Company issued to the Subscribers secured promissory notes (the Notes ) having a total face value of \$7,500,000. The Notes mature on February 18, 2006, and pay simple interest payable at the annual rate of 24% if not paid in full at that time. In connection with such purchase, the Company executed a Security Agreement pursuant to which the Subscribers were granted a security interest in certain of the Company's property. As of December 31, 2005, the Company had \$7,500,000 in short-term debt, representing the face value of these Notes. On February 18, 2006 the Company entered into an extension agreement with the holders of the Notes pursuant to which the Company paid \$1,250,000 of the principal amount of the Notes and extended the maturity date of the balance for an additional 60 days.

In June 2005 the Company entered into an agreement with GC Financial Services, Inc. for a Bridge Facility and associated Demand Note with a stated principal amount of \$5,000,000. The Company can draw on such Facility up to the face value of the Note and is obligated to pay interest on any amounts outstanding under such Facility at an annualized interest rate of 48%. Additionally, the Company entered into a Security Agreement covering its accounts, inventory, equipment, general intangibles, and certain other assets as collateral to secure payment of the Demand Note. This Bridge Facility and associated Demand Note was paid off in full on November 18, 2005 from a portion of the proceeds of the Notes issued to Longview Fund and Longview Equity Fund.

As of December 31, 2004, the Company had a Bridge Facility and associated Demand Note with a stated principle amount of \$4,000,000. This debt represented the balance outstanding under the GC Financial Bridge Facility, which carried an annualized interest rate of 48%. The full amount of such outstanding balance was paid off on January 19, 2005.

#### **NOTE 11 FACTORING OF ACCOUNTS RECEIVABLE**

The Company entered into an agreement (the Factoring Agreement ) with GC Financial Services, Inc. (the Factor ) on June 29, 2005, pursuant to which the Company agreed to sell accounts receivables under our JERRV Contract (M67854-05-D-5091) in an





amount not to exceed \$63,000,000. Under the terms of such agreement, the Company receives 98.1% of the value of receivables sold to the Factor within 24-48 hours of delivery of the invoice. The Factor was granted a security interest in the Company's assets and retained the right of full recourse against the Company. During June 2006, the Company exceeded the agreed maximum value of receivable to be factored under the Factoring Agreement. On June 22, 2006, the Factoring Agreement was terminated and no further obligation remained between the Company and GC Financial Services, Inc.

The Company entered into an agreement (the "Factoring Agreement") with GC Financial Services, Inc. (the "Factor") on June 28, 2004, pursuant to which the Company agreed to sell accounts receivables under our Buffalo contracts with the U.S. Army. Under the terms of such agreement, the Company receives approximately 98% of the value of receivables sold to the Factor within 24-48 hours of delivery of the invoice. The Factor was granted a security interest in the Company's assets and retained the right of full recourse against the Company. The Company terminated such agreement in January 2005.

There were no factoring agreements in place during 2003.

The Company's factoring transactions in 2005 and 2004 are summarized below:

	Year Ended December 31, 2005	Year Ended December 31, 2004
Sale of receivables to Factor	\$ 17,170,086	\$ 11,895,363
Payments to Factor	\$ (16,380,214 )	\$ (11,294,319 )
Balance at end of period	\$ 789,872	\$ 601,044-
Charges by Factor	\$ 311,443	\$ 237,907

## NOTE 12 STOCKHOLDERS EQUITY

The Company was originally incorporated on November 27, 1996 as a Colorado corporation. The Company incorporated Force Protection, Inc., a Nevada corporation on December 13, 2004 and effected a merger with Force Protection, Inc., a Colorado corporation, on January 1, 2005. The Colorado Corporation was dissolved upon the merger. The Company has continued its operations as the Nevada Corporation from January 1, 2005 forward. The Company has the authority to issue 310,000,000 shares, in aggregate, consisting of 300,000,000 shares of common stock and 10,000,000 shares of preferred stock, of which 1,600 have been designated Series A, 25 of which have been designated as Series B, 150 of which have been designated as Series C and 20,000 of which have been designated as Series D. At all times through December 31, 2004, the Company stock was all issued at no par value. By shareholder's resolution effective January 1, 2005, all classes of stock were declared to have a par value of \$0.001 per share. For further information regarding Series D 6% Convertible Preferred Stock, please refer to the separate footnote disclosure in Note 13.

The preferred stock has the following characteristics:

**Dividends** Each holder of preferred stock shall be entitled to receive dividends in cash, stock or otherwise, if, when and as declared by the Company's board of directors, with the exception of the preferred stock designated as Series A, which shall not be entitled to receive dividends. However, the Company will not declare or pay a dividend to common stockholders without first declaring and paying a dividend to the preferred shareholders. Each share of Series D Preferred Stock is specifically entitled to 6% cumulative dividends, payable semi-annually in cash or common stock. See Note 13 for further details regarding Series D 6% Convertible Preferred Stock.

**Liquidation** In the event of any voluntary or involuntary liquidation, dissolution or winding-up of the Company, the assets of the Company available for distribution to its stockholders shall be distributed as follows:

- (a) Series A Preferred Stock shall rank senior to Series B Preferred Stock, Series C Preferred Stock, Series D 6% Convertible Preferred Stock and common stock;
- (b) Series B Preferred Stock shall rank junior to Series A Preferred Stock, senior to Series C Preferred Stock, Series D 6% Convertible Preferred Stock and common stock
- (c) Series C Preferred Stock shall rank junior to Series A Preferred Stock, Series B Preferred Stock and senior to Series D 6% Convertible Preferred Stock and common stock;

(d) Series D 6% Convertible Preferred stock shall rank junior to Series A Preferred Stock Series B Preferred Stock, Series C Preferred Stock and senior to common stock; and

(e) Common stock shall rank junior to Series A, B, C and D 6% Convertible Preferred Stock

Additionally, upon a liquidation event, holders of Series A Preferred Stock will receive \$1,000 per share of Series A Preferred Stock. Holders of Series B Preferred Stock will receive the greater of \$2,500 or the pro-rata share of the Company's remaining net assets to be distributed, after rank considerations. Holders of Series C Preferred Stock will receive a 150% return on the face value of the share of Series C Preferred Stock, or \$1,500, after rank considerations. In any event whereby the preceding distributions are unable to be met, the rank considerations outlined above shall be considered and the distribution of the Company's net assets shall be determined according to rank and on a pro-rata basis.

Conversion Series A Preferred Stock shall convert into common stock at a rate of \$4.00 per share, as adjusted accordingly. Each share of Series B Preferred Stock shall convert into 759,167 shares of common stock. Each share of Series C Preferred Stock shall convert into 75,917 shares of common stock. Each share of Series D 6% Convertible Preferred Stock shall convert into common stock at \$2.10 per share.

In connection with the private placement sale of the Company's common stock on January 19, 2005, the Company and the holders of Series B and Series C Preferred Stock agreed to convert all shares of the Series B and Series C Preferred Stock outstanding to shares of the Company's common stock. As a result, all shares of Series B and Series C Preferred Stock were converted into common effective January 19, 2005. The Series D 6% Convertible Preferred Stock issued in connection with the January 19, 2005 private placement remained outstanding following the conversion of the Series B and Series C Preferred Stock. All outstanding shares of the Series D 6% Convertible Preferred Stock were converted in full in 2006, and no shares of the Series D 6% Convertible Preferred Stock remain outstanding as of September 30, 2006. Series D 6% Convertible Preferred Stock has been classified as Mezzanine Equity by the Company. Please refer to Note 13 for further details regarding Series D 6% Convertible Preferred Stock.

On January 18, 2005, the Company's board of directors, acting pursuant to a resolution of the Company's shareholders, approved a reverse split of the Company's stock whereby each 12 shares of common stock outstanding on the date of record, February 4, 2005, would be exchanged for 1 new share of common stock. All references to common stock in the Company's public filings refers to post reverse split shares.

The following disclosures reference accounting guidelines and certain accounting treatments which the Company has used throughout 2005, 2004 and 2003. The Company considers the following terms and definition significant in ensuring the reader of these financial statements understands the accounting treatments applied by the Company:

- The Emerging Issues Task Force ( EITF ) provides accounting guidance and interpretations on emerging issues in business and accounting
- Statements on Financial Accounting Standards ( SFAS ) are a primary source of accounting guidance under which many of the Company's accounting policies are based
- Beneficial conversion feature is a topic addressed in EITF 98-5, *Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios*, EITF 00-19 *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock* and EITF 00-27 *Application of Issue No. 98-5 to Certain Convertible Instruments*, is an accounting term defined in EITF 98-5 that represents a situation in which a convertible security (debt or equity) is convertible into the Company's common stock at a price which is at a discount to the market, at the time the convertible security is issued.
- The Black-Scholes option pricing model (Black-Scholes) is an analytical model used to value an option to purchase a security based on certain market fundamentals such as the volatility of a security, the market for effective interest rates over a period of time and constraints placed on the option to purchase the security such as time horizons or the expiration of the option to purchase the security. The Company utilizes Black-Scholes to value stock options issued to employees, preferred stock issued to employees and service providers, preferred stock purchased by investors and warrants issued to investors.

**During the year ended December 31, 2005, the Company recorded the following transactions within its stockholders' equity accounts:**

#### **COMMON STOCK TRANSACTIONS**

In January 2005, the Company issued a total 188,400 shares of the Company's common stock at an average price of \$2.76 per share, generating \$520,069 in net proceeds pursuant to the Investment Agreement between the Company and Dutchess Private Equities Fund, L.P., dated January 26, 2004.

The following issuances of the Company's common stock during 2005 were valued by the Company using the Company's closing bid price of its common stock as quoted on the OTC Bulletin Board market as of the date of the associated contract or the issuance date if no contract existed.

- 41,666 shares of the Company's common stock valued at \$112,499 were issued to a director, a member of the board of directors, for services rendered to the Company. An expense of \$112,499 was classified as compensation of directors and was recorded in 2005.
- 9,950 shares of the Company's common stock valued at \$12,910, to the Company's former President, for services rendered to the Company. An expense of \$12,910 was classified as officer compensation and was recorded in 2005.
- The Company issued 53,467 shares of the Company's common stock pursuant to the terms of the Company's agreement with certain third parties and were valued at \$144,895. An expense of \$144,895 was classified as settlement expense and was recorded in 2005.

- The Company issued 14,876 shares of the Company's common stock pursuant to the terms of the Company's agreement with GC Financial Services, Inc. were valued at \$20,641. An expense of \$20,641 was classified as interest expense and was recorded in 2005.
- The Company's former Chief Executive Officer, agreed to rescind 83,333 shares of common stock issued in 2004 valued at \$209,999.

A total of 114,376 shares of common stock were issued by the Company for net proceeds of \$211,629 in connection with the exercise of warrants issued through a PIPE offering completed on April 10, 2002.

The Company issued a warrant to purchase 65,833 shares of the Company's common stock on January 19, 2005 to HPC Company. The warrant was valued at \$200,071 using Black-Scholes. The Company recorded a reduction of stockholders' equity associated with services provided as a placement agent for the Company's Series D 6% Convertible Preferred Stock offering, which closed on January 19, 2005. The inputs for this warrant in Black-Scholes are consistent with the inputs for the warrants issued with the Series D 6% Convertible Preferred Stock.

The Company issued warrants to purchase 75,000 shares of the Company's common stock that can be exercised for \$3.75 per share in a settlement agreement with H.C. Wainwright & Co. The value as determined by Black-Scholes was expensed as settlement expense in the amount of \$158,071. The Company also issued a warrant to purchase 41,667 shares of the Company's common stock that can be exercised for \$3.96 per share in a settlement agreement with Westor Online. The value as determined by Black-Scholes was expensed as settlement expense in the amount of \$72,354. The warrants were exercised in 2006. Below is a table depicting the valuation attributes used in Black-Scholes calculations related to these warrants issued in 2005:

#### Warrant Valuation Information

Valuation Assumptions		
Stock price on grant date	\$	2.05-\$3.00
Number of shares of common stock convertible to		116,667
Conversion price	\$	3.75-\$3.96
Expected option term (in years)		1
Vesting term (in years)		N/A
Expected volatility		177.06%
Risk-free interest rate		4.26%
Expected forfeiture rate		0%
Estimated corporate tax rate		0%
Expected dividend yield		0%

Outstanding warrants to purchase 2,143,085 common stock shares expired or were cancelled during 2005. The warrant valuation of \$2,302,850 was added to Additional Paid in Capital accordingly in 2005.

The Company issued 14,803,750 shares of unregistered common stock resulting for the mandatory conversion on February 8, 2005 of all the outstanding shares of the Company's Series B Convertible Preferred Stock. At the time of conversion, the conversion rate for the Series B Convertible Preferred Stock was 2% of fully diluted common stock. The beneficial conversion feature related to the Series B Convertible Preferred Stock in the amount of \$19,102,306 was relieved in full on February 8, 2005.

#### PREFERRED STOCK TRANSACTIONS

##### *Series D 6% Convertible Preferred Stock:*

On January 19, 2005, the Company issued 15,800 shares of the Company's Series D 6% Convertible Preferred Stock for net cash of \$15,305,965. The issuance of the Company's Series D 6% Convertible Preferred Stock was recorded at \$7,301,766 which is the net value of the cash received of \$15,305,965 less the fair value of the associated warrants of \$8,004,200. The Company classified the Series D 6% Convertible Preferred Stock as Mezzanine Equity. Refer to Note 13 for further information regarding Series D 6% Convertible Stock.

On May 23, 2005, 2,796 shares of the Series D Preferred Stock were voluntarily converted into 1,331,429 shares of Common Stock. The conversion value of these shares of common stock based on the conversion price of \$2.10 per share was \$2,796,001.

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During the year ended December 31, 2004, the Company recorded the following transactions within its stockholders' equity accounts:

### *COMMON STOCK TRANSACTIONS*

The Company closed on a private investment in public equity ( PIPE ) offering on March 23, 2004. The PIPE, sold to numerous accredited investors, consisted of the following:

- Common stock issuances, 1,771,874 shares of common stock were issued for \$4,245,000 in net proceeds.

- Issuance of A warrants, 1,771,874 warrants to purchase common stock were issued in 2004, with an original exercise price of \$1.44 per warrant. A total of 219,792 shares of common stock were issued by the Company for net proceeds of \$316,497, in connection with the exercise of A warrants in 2004. The remaining A warrants expired on December 31, 2004.
- Issuance of Green Shoe warrants, 1,771,874 warrants to purchase common stock were issued in 2004, with an original exercise price of \$2.40 per warrant. A total of 674,058 shares of common stock were issued by the Company for net proceeds of \$1,677,713, in connection with the exercise of Green Shoe warrants in 2004. The remaining Green Shoe warrants expired on December 31, 2004.

In November and December 2004, the Company issued a total 1,210,843 common shares generating \$2,958,217 in net proceeds pursuant to the Dutchess Equity agreement.

A total of 1,863,768 shares of common stock were issued by the Company for net proceeds of \$2,100,637 in connection with the exercise of warrants issued through a private investment in public equity ( PIPE ) offering dated April 10, 2002 for Regulation D Section 506 Private Placement Memorandum issued in 2003 to numerous accredited investors.

The following issuances of the Company's common stock during 2004 were valued by the Company using the Company's closing bid price of its common stock as quoted on the OTC Bulletin Board market as of the date of the associated contract or the issuance date if no contract existed.

- 163,501 shares of the Company's common stock valued at \$496,956 were issued to a third party for services rendered to the Company. An expense associated with this issuance of \$496,956 was recorded in 2004.
- 70,833 shares of the Company's common stock valued at \$127,500 were issued to a member of the board of directors, for services rendered to the Company. An expense of \$127,500 was classified as compensation of directors and was recorded in 2004.
- 91,667 shares of the Company's common stock valued at \$231,000 were issued to a member of the board of directors, for services rendered to the Company. An expense of \$231,000 was classified as compensation of directors and was recorded in 2004.
- 208,333 shares of the Company's common stock valued at \$495,000 to the Company's former Chief Executive Officer, for services rendered to the Company. An expense of \$495,000 was classified as officer compensation and was recorded in 2004.
- 125,000 shares of the Company's common stock valued at \$255,000 to the Company's former Chief Financial Officer, for services rendered to the Company. An expense of \$255,000 was classified as officer compensation and was recorded in 2004.
- 41,682 shares of the Company's common stock valued at \$145,054 to an employee, for services rendered to the Company. An expense of \$145,054 was classified as stock-based compensation and was recorded in 2004.
- 79,167 shares of the Company's common stock valued at \$178,250, to various employees for services rendered to the Company. An expense of \$178,250 was classified as stock-based compensation and was recorded in 2004.
- 304,167 shares of common stock issued in error in December 2003 were cancelled in the first week of January 2004.
- The Company issued 20,421 shares of common stock to third parties upon the conversion of existing debts in the amount of \$124,976.



*PREFERRED STOCK TRANSACTIONS*

For information regarding Series D 6% Convertible Preferred Stock, please refer to the separate footnote disclosure in Note 13.

Series B and Series C Convertible Preferred Stock are in the form of shares, and have no conditional or unconditional mandatory redemption provisions obligating the Company in the future other than liquidation or company wind-up provisions. Under SFAS150- *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*, the issuances of Series B and Series C Preferred stock have been classified as equity. The conversion options are not considered derivative liabilities which must be valued at fair value under SFAS 133 or EITF 00-19. The conversion options are indexed to the Company's own stock and the host instrument is classified as equity thus meeting the paragraph 11a scope exception under SFAS No. 133 Accounting for Derivative instruments and hedging activities. The Company determined that there is no intrinsic value of the conversion options for the Series B and Series C Preferred Stock under EITF 00-27.

In accordance with EITF 98-5, Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Rates, the Company records beneficial conversion feature expense when and if the Company issues debt or equity instruments which are convertible into shares of the Company's common stock, at a conversion price which is favorable to the holder of the debt or equity instrument. Valuation of this favorable conversion feature is based on the circumstances of each debt or equity issuance but is generally based on the actual or estimated difference between the fair market

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value of the underlying common stock less the cost of acquiring the common stock or a beneficial increase in conversion rates of preferred shares into common stock.

The Company issued preferred stock shares for services provided as follows:

- 4 shares of the Company's Series C Convertible Preferred Stock were issued to a member of the board of directors, for services rendered. The Company used Black-Scholes to determine the value of the shares as \$137,583.
- 20 shares of the Company's Series C Convertible Preferred Stock were issued to the Company's former Chief Executive Officer, for services rendered. The Company used Black-Scholes to determine the value of the shares as \$692,996.
- 4 shares of the Company's Series C Convertible Preferred Stock were issued to the Company's former Chief Financial Officer, for services rendered. The Company used Black-Scholes to determine the value of the shares as \$138,976.
- 10 shares of the Company's Series C Convertible Preferred Stock were issued to a member of the board of directors, for services rendered. The Company used Black-Scholes to determine the value of the shares as \$346,526.

The Company issued 20 shares of Series C Convertible Preferred Stock in exchange for existing debt in the amount of \$200,000. The Company used Black-Scholes and calculated the value of shares at issuance. A beneficial conversion feature was generated as the value of the issuance using Black-Scholes was greater than the value of the debt converted in the amount of \$385,530.

The Company issued 1 share of the Company's Series C Convertible Preferred Stock for proceeds of \$10,000. The value of this issuance was calculated using Black-Scholes and was greater than the value of the proceeds in the amount of \$22,612. The Company recorded a Beneficial Conversion Feature for this difference.

Below is a table depicting the valuation attributes used in Black-Scholes calculations related to the Series C Preferred Stock issued in 2004:

### Series C Preferred Stock Valuation Information for the Year Ended December 31, 2004

Valuation Assumptions	
Stock price on grant date	\$1.80-\$4.08
Number of shares of common stock convertible to	2,198,276
Conversion price	\$1.80-\$4.08
Expected option term (in years)	1
Vesting term (in years)	N/A
Expected volatility	90.29%-177.06%
Risk-free interest rate	4.00%-4.296%
Expected forfeiture rate	0%
Estimated corporate tax rate	0%
Expected dividend yield	0%

The following transactions of the Company's preferred stock during 2004 were recorded:

- The Company had 5 Shares of Series C Convertible Preferred Stock voluntarily redeemed for \$60,000. A loss on redemption of \$10,000 was recorded. Additionally, the Company recorded a gain on debt extinguishment related to the recapture of beneficial conversion feature expensed in connection with the issuance of the preferred stock in 2002 of \$7,272.
- 1,330,865 shares of the Company's common stock were issued upon the voluntary conversion of 51 shares of Series C Convertible Preferred Stock. The conversion rate at the time of conversion was 0.2% of outstanding common

stock. The Company recorded a gain on debt extinguishment related to the recapture of beneficial conversion feature expensed in connection with the issuance of the preferred stock in the amount of \$389,810.

- 1 share of the Company's Series C Convertible Preferred Stock was voluntarily rescinded. A gain was recognized in the amount of \$83,577 as a result. The gain was calculated using the Company's closing bid price of its common stock as quoted on the OTC Bulletin Board market as of the date the shares were rescinded and the number of shares of common stock for which the preferred stock was convertible into. Additionally, the Company recorded a gain on debt extinguishment related to the recapture of beneficial conversion feature expensed in connection with the issuance of the preferred stock in the amount of \$3,234.
- 1 share of the Company's Series B Convertible Preferred Stock was voluntarily converted to 10 Series C Convertible Preferred Stock. The Company used Black Scholes and calculated a beneficial conversion feature of \$269,044, associated as a result of differences between conversion rates between the two preferred stock classes.
- 416,667 shares of the Company's common stock were issued upon the conversion of 1 share of Series B Convertible Preferred Stock. The conversion rate at the time of conversion was 2% of fully diluted common stock. The Company recorded a gain on debt extinguishment related to the recapture of beneficial conversion feature expensed in connection with the issuance of the preferred stock in of \$16,324.

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The conversion rate for Series C Convertible Preferred Stock changed to 0.2% of fully diluted stock on September 14, 2004. At that time, there were 144 Series C Preferred Stock shares outstanding. The Company used Black-Scholes to calculate the value of this change as \$18,558,870, which represents the beneficial conversion feature for this conversion rate increase for all outstanding Series C Preferred Stock Shares on September 14, 2004. After which, 14,263 shares of the Company's common stock were issued upon the voluntary conversion of 1 share of Series C Convertible Preferred Stock. During October 2004, all outstanding shares of the Company's Series C Preferred Convertible stock were either mandatory converted to Series B Convertible Preferred stock or into shares of common stock. The conversion rate was 10 shares of Series C Convertible Preferred stock for 1 share of Series B Convertible Preferred Stock or 0.2% of fully diluted common stock. In total, 115 shares of Series C Convertible Preferred stock were redeemed for 11.5 shares of Series B Convertible Preferred Stock. 1,169,350 shares of common stock were issued for the conversion of the remaining 28 Series C Convertible Preferred Stock. These transactions resulted in the Company recorded a gain on debt extinguishment related to the recapture of beneficial conversion feature expensed in connection with the issuance of the preferred stock in the amount of \$146,120.

### **During the year ended December 31, 2003, the Company recorded the following transactions within its stockholders' deficit accounts:**

#### **COMMON STOCK TRANSACTIONS**

A private investment in public equity (PIPE) offering dated April 10, 2002 for Regulation D Section 506 Private Placement Memorandum issued in 2003 to numerous accredited investors, consisted of the following:

- Common stock issuances, 2,429,272 shares of common stock were issued for \$2,966,700 in net proceeds.
- Issuance of warrants, each common share included 2,429,272 warrant units valued at \$2,610,372, to purchase common stock were issued in 2003. Each common stock unit consisted of (a) fifty shares of common stock of the Company, (b) one warrant to purchase twenty-five shares of common stock of the Company at an exercise price of \$2.40 per share, and (c) one warrant to purchase twenty-five shares of common stock, at an exercise price of \$3.60 per share which has been reduced to \$0.12 per share by the Company's board of directors on July 15, 2002. No warrants were exercised in 2003. The Company used Black-Scholes to calculate the value of the warrants. The valuation attributes used in the Black-Scholes calculation are as follows:

Valuation Assumptions	
Stock price on grant date	\$1.80
Number of warrants	2,429,272
Exercise price	\$1.20-\$2.40
Expected option term (in years)	1
Vesting term (in years)	N/A
Expected volatility	128.07%
Risk-free interest rate	3.87%
Expected forfeiture rate	0%
Estimated corporate tax rate	40%
Expected dividend yield	0%

The Company issued a warrant to purchase 83,333 shares of the Company's common stock to the Company's former Chief Financial Officer. The warrant has an exercise price of \$1.44 per share of common stock. The warrant was valued at \$41,816 using Black-Scholes and was expensed in full in 2003 as officer compensation expense. The valuation attributes used in the Black-Scholes calculation are as follows:

#### **Warrant Valuation Information for the Year Ended December 31, 2003**

Valuation Assumptions	
Stock price on grant date	\$ 2.16
Number of warrants	83,333
Exercise price	\$ 1.44
Expected option term (in years)	1
Vesting term (in years)	N/A
Expected volatility	128.07%

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Risk-free interest rate	3.87%
Expected forfeiture rate	0%
Estimated corporate tax rate	40%
Expected dividend yield	0%

The Company issued 264,804 shares of restricted common stock to third parties upon the conversion of existing debts in the amount of \$377,450.

The Company issued common stock shares for services provided as follows:

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- 738,791 shares of the Company's common stock to consultants for services rendered to the Company. The Company valued the services rendered at \$1,232,909, using the Company's closing bid price of its common stock as quoted on the OTC Bulletin Board market on at the date of issuance. The consultants were not hired under specific contracts and compensation was determined on a case by case basis by management at the time the services were rendered.
- 166,065 shares of the Company's common stock were issued to employees and were valued at \$273,022 using the Company's closing bid price of its common stock as quoted on the OTC Bulletin Board market on at the date of issuance. The stock-based compensation to employees was determined on a case by case basis by management at various times during the year.
- 75,000 shares of the Company's common stock were issued to the board of directors and were valued at \$130,500 using the Company's closing bid price of its common stock as quoted on the OTC Bulletin Board market on at the date of issuance. The stock-based compensation to the board of directors was determined on a case by case basis by the board of directors at various times during the year.

The Company issued 139,441 shares of the Company's common stock pursuant to the terms of the Company's agreement with Atlantis Aggressive Growth Co. and was valued at \$133,863 using the Company's closing bid price of its common stock as quoted on the OTC Bulletin Board market on the date of the settlement December 8, 2003.

The Company issued 109,279 shares of the Company's common stock to third parties for services rendered in connection with the aforementioned private placements. No value was recorded in accordance with this issuance as the issuance was deemed a financing cost associated with the Company's efforts to raise capital. Therefore, any value allocated to the share issuance would be an offsetting accounting entry to both increase and decrease stockholders' equity in the same value.

The Company increased the TSG acquisition price by \$720,000 as a result of the final resolution with all parties concerned. The original transaction in 2002 was recorded at a value of \$1,200,000 with various matters pending.

#### *PREFERRED STOCK TRANSACTIONS*

The Company's Series B and Series C Convertible Preferred Stock are in the form of shares, and have no conditional or unconditional mandatory redemption provisions obligating the Company in the future other than liquidation or company wind-up provisions. The Company has reviewed SFAS150-*Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*, and has classified the issuances of Series B and Series C Preferred stock as equity instruments. The conversion options are not considered derivative liabilities which must be valued at fair value under SFAS 133 or EITF 00-19. The conversion options are indexed to the Company's own stock and the host instrument is classified as equity thus meeting the paragraph 11a scope exception under SFAS No. 133 *Accounting for Derivative Instruments and Hedging Activities*. The Company also determined that there is no intrinsic value of the conversion options for the Series B and Series C Preferred Stock under EITF 00-27.

In accordance with EITF 98-5, *Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Rates*, the Company records beneficial conversion feature expense when and if the Company issues debt or equity instruments which are convertible into shares of the Company's common stock, at a conversion price which is favorable to the holder of the debt or equity instrument. Valuation of this favorable conversion feature is based on the circumstances of each debt or equity issuance but is generally based on the actual or estimated difference between the fair market value of the underlying common stock less the cost of acquiring the common stock or a beneficial increase in conversion rates of preferred shares into common stock.

The Company issued 14 shares of the Company's Series C Convertible Preferred Stock for cash proceeds of \$140,000. No beneficial conversion feature existed upon the issuance of these shares as the Company used Black-Scholes and calculated the value of the shares issued to be less than the value of the cash proceeds of \$140,000.

The Company issued 28 shares of Series C Convertible Preferred Stock in exchange for existing debt in the amount of \$280,000. A beneficial conversion feature existed as of the date of issuance. The Company used Black-Scholes and calculated the value of the issuance was greater than the value of the debt converted. Accordingly, the Company recorded a beneficial conversion feature in the amount of \$90,564.

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The Company issued 1 share of Series C Convertible Preferred Stock to a member of the board of directors in lieu of interest payments on an outstanding \$50,000 loan. The Company valued the issuance of the share at \$9,064 using Black-Scholes and recorded interest expense on the loan for \$9,064 during 2003.

The Company issued 50 shares of the Company's Series C Convertible Preferred Stock to the Company's former Chief Executive Officer as compensation for consummating the TSG acquisition. The Company used Black-Scholes and calculated a value of the share issuance at \$661,720.

The Company issued 12 shares of the Company's Series C Convertible Preferred Stock to employees for services rendered. The Company valued the share issuance at \$103,596, using Black-Scholes and recorded compensation expense associated with these issuances of \$103,596 during 2003.

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The Company recorded a loss on redemption of preferred stock of \$10,000 associated with the voluntary redemption of 5 Shares of the Company's Series C Convertible Preferred Stock (original payment for preferred was \$50,000). Additionally, the Company recorded a gain on debt extinguishment related to the recapture of beneficial conversion feature expensed in connection with the issuance of the preferred stock in 2002 of \$7,272.

Below is a table depicting the valuation attributes used in Black-Scholes calculations related to the Series C Preferred Stock issued in 2003:

### Series C Preferred Stock Valuation Information for the Year Ended December 31, 2003

Valuation Assumptions	
Stock price on grant date	\$0.96-\$1.44
Number of shares of common stock convertible to	1,448,757
Conversion price	\$0.96-\$1.44
Expected option term (in years)	1
Vesting term (in years)	N/A
Expected volatility	128.07%-236.46%
Risk-free interest rate	3.87%-4.53%
Expected forfeiture rate	0%
Estimated corporate tax rate	0%
Expected dividend yield	0%

304,167 shares of common stock issued in error in December 2003 were cancelled in the first week of January 2004.

### NOTE 13 SERIES D 6% CONVERTIBLE PREFERRED STOCK

On January 19, 2005, the Company issued 15,800 shares of Series D 6% Convertible Preferred Stock (Series D Preferred) at \$1,000 per share pursuant to a purchase agreement (the Purchase Agreement) for gross proceeds of \$15,800,000. Issuance costs of \$494,034 were incurred and treated as a discount to the carrying value which netted to \$15,305,966. The Series D Preferred may convert at any time, at the holder's discretion, into shares of Common Stock. The conversion price is \$2.10 per share. Each share of the Series D Preferred converts into the number of shares of Common Stock equal to \$1,000 divided by the conversion price which is approximately 467.19 shares. Additionally, the Company pays 6% dividends on the Series D Preferred in cash or Common Stock. The Series D Preferred Stock, if not converted to Common Stock, is redeemable for \$1,000 per Series D Preferred share on January 19, 2008.

In the same private placement, the Company issued Warrants to purchase 2,633,333 shares of Common Stock at an exercise price of \$3.75 per share. The Warrants expire on January 19, 2008. These warrants are further disclosed below.

The Series D Preferred falls outside the scope of SFAS No. 150 but the guidance in Rule 5-02.28 of Regulation S-X, Accounting Series Release No. 268 (ASR 268) and EITF Topic D-98: Classification and Measurement of Redeemable Securities are applicable. As such, the Company has recorded the Series D Preferred as mezzanine equity on the accompanying balance sheet.

The difference between the initial recorded amount and redemption value is accreted to retained earnings or, in the absence of retained earnings, additional paid-in capital, over the period from the date of issuance to the earliest redemption date of the security using the interest method thus reducing net income attributable to common shareholders. The accretion from the initial value to the redemption amount has been determined using T-Value based on the following inputs:

1. Rate 8.00% (reasonable rate of interest)
2. Number of payment periods 36 (three years)

The following table summarizes the transactions of the Series D Preferred:

Series D 6% Convertible Preferred stock at issuance		\$ 15,800,000
Less:	Issuance costs	494,034
	Fair value of warrants at issuance (see Warrants)	8,004,200
Subtotal Carrying Value at issuance		\$ 7,301,766
Plus:	Cumulative accretion of discount to redemption value first quarter 2005	420,695



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Cumulative accretion of discount to redemption value second quarter 2005	593,609
Cumulative accretion of discount to redemption value third quarter 2005	508,577
Cumulative accretion of discount to redemption value fourth quarter 2005	518,816
Carrying Value of 2,796 Series D Preferred converted into Common Stock second quarter 2005	\$ 1,442,025
Carrying Value at December 31, 2005	\$ 7,901,438

The Series B Preferred has the following rights, preferences and privileges:

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**Registration Rights**

The Company and the holders of Series D Preferred entered into a Registration Rights Agreement on January 19, 2005. Among other things, the Company was obligated to file a registration statement on Form SB-2 within 75 days of the agreement and use its commercially reasonable efforts to cause such registration statement to become effective. The Securities & Exchange Commission declared the Registration Statement effective on May 11, 2005, pursuant to which the shares of Common Stock issuable upon conversion of the Series D Preferred, as well as the shares of Common Stock issuable upon the exercise of warrants, were registered for resale. The agreement provides for any liquidated damages by the Company to the Series D Preferred holders if the Company is unable to complete the registration, not filing in timely manner or maintain such effectiveness.

**Voting Rights**

Each holder of shares of Series D Preferred shall have no voting rights so long as the Company shall not, without the affirmative vote of the holders of Series D Preferred then outstanding, alter or change the powers, preferences or rights of the holders of Series D Preferred, authorize or create any class of stock ranking as to dividends, redemption, or distribution of assets upon liquidation senior to Series D Preferred, amend corporate documents so as to affect adversely any rights of holders or increase the authorized number of shares of Preferred Stock.

**Dividends**

Cumulative Dividends are payable to all holders of Series D Preferred on March 1 and September 1 beginning with the first such date after the original issue date and on any conversion date. Dividends can be paid in cash unless certain criteria are met (mainly no cash available for payment) which allows the Company to issue shares of Common stock equivalent to the amount due at 85% of the average stock price of the preceding 10 trading days to the dividend payment date. Series D Preferred dividends are recorded as a reduction (increase) to retained earnings (accumulated deficit) and net income (loss) available to common shareholders. Dividends, whether declared or not, are payable at a rate of six percent (6%) of the Stated Value per annum.

In the event dividends are paid on any shares of other Preferred stock or Common Stock, the Company shall pay any amounts due to Series D Preferred holders before such dividend can be paid.

Dividend Transactions (per equity table)	Amount
Dividend Payment March 1, 2005	
57,186 common shares issued	\$ 100,075
Dividend Payment September 1, 2005	
224,511 common shares issued	318,355
Cash payment	100,020
Total Dividend for September 1, 2005	418,375
Dividend Accrued as of December 31, 2005	\$ 260,080

**Conversion**

The Series D Preferred may convert at any time, at the holder's discretion, into shares of Common Stock. The conversion price is \$2.10 per share. Each share of the Series D Preferred converts into the number of shares of Common Stock equal to \$1,000 divided by the conversion price which is approximately 467.19 shares. The Company shall not effect any conversion of the Series D Preferred and the Holder shall not have the right to convert any portion of Series D Preferred to the extent that after giving effect to such conversion, the Holder (including its affiliates) would beneficially own in excess of 4.99% of the number of shares of common stock outstanding immediately after giving effect to such conversion. The Company must reserve and keep available out of its authorized and unissued shares of common stock for the purpose of issuance upon conversion of the Series D Preferred and payments of dividends on the Series D Preferred. The Company may force a conversion of Series D Preferred if the market value of the common stock for 20 consecutive trading days exceeds 180% of the conversion price effective at that time.

**Redemptions**

On the third anniversary of the original issue date, the corporation shall redeem all remaining outstanding Series D Preferred which are not yet converted into common stock at a price equal to the Stated Value. Each holder of Series D Preferred to be so redeemed may, in lieu of redemption, convert such holder's shares of Series D Preferred Stock in whole or in part into shares of Common Stock.

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The Company may be obligated to redeem the outstanding shares of Series D Preferred immediately prior to a change of control, failure to file the registration statement on or prior to 210 days after the original issue date, lapsing of the Registration Statement for more than 60 calendar days in aggregate or failure to have available the sufficient number of authorized and unreserved shares of common stock to issue upon conversion of a holder.

### ***Warrants***

The Warrants represent a liability under EITF 00-19 in that the registration rights agreement contains a liquidated damages clause requiring the Company to pay cash to the holder of the instrument if the Company fails to obtain an effective registration statement timely, an event that is out of the Company's control. (Note: On April 11, 2005, the Company paid \$237,000 in liquidated damages for not filing its registration statement timely). The Warrants would not be classified as equity until the effective registration statement was obtained. As such, in accordance with EITF 00-19, the Warrant Liability is measure at its fair value at

the reporting date, with the change in its fair value from issuance date reporting in the statement of operations. The fair value of the warrants has been determined using the Black-Scholes model using the following inputs:

1. Number of Warrant shares 2,633,333
2. Stock price at issuance date \$3.12 per share
3. Exercise price \$3.75 per share
4. Term 3 years
5. Discount rate 3.42%, representing the three year Treasury at the date of issuance
6. Volatility 259%, based on the stock prices during three years prior to issuance

These inputs yield a fair value of \$8,004,200.

The warrants are measured at fair value both initially and in subsequent periods until the registration statement has been accepted by the Security and Exchange Commission. Subsequent changes in the fair value of the warrants until that time are recognized in current earnings under other income (expense) in the consolidated statements of operations. The decrease in fair value for the three month period ended March 31, 2005 is \$3,431,206. The fair value of the warrants at March 31, 2005 has been determined using the Black-Scholes model using the following inputs:

1. Number of Warrant shares 2,633,333
2. Stock price at reporting date \$1.84 per share
3. Exercise price \$3.75 per share
4. Term 2.75 years
5. Discount rate 3.96%, representing the three year Treasury at the reporting date
6. Volatility 245%, based on the stock prices during three years prior to the reporting date

These inputs yield a fair value of \$4,572,984 at March 31, 2005.

On May 11, 2005, the Company received Form 424B3 from the SEC confirming the registration of 17,008,655 common shares. As a result, the warrant liability is reclassified to equity on this date. The fair value of the warrants has been determined using the Black-Scholes model using the following inputs:

1. Number of Warrant shares 2,633,333
2. Stock price at reporting date \$2.08 per share
3. Exercise price \$3.75 per share
4. Term 2.70 years
5. Discount rate 3.96%, representing the three year Treasury at the reporting date
6. Volatility 245%, based on the stock prices during three years prior to the reporting date

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These inputs yield a fair value of \$5,173,409. The Unrealized Gain on Financial Instrument and Warrant Liability were reduced by \$600,425 accordingly.

### NOTE 14 STOCK OPTIONS

The Company does not have a formal stock option plan. However, the Company has offered its employees stock options. During 2005, the Company issued options to purchase 652,833 shares of its unregistered common stock to certain of its employees at an exercise price of \$1.50 per share. All such options vested in full effective April 15, 2006.

The Company adopted Statement of Financial Accounting Standards No. 123(R) ( SFAS 123(R)) as of July 1, 2005. SFAS 123(R) provides for mandatory expensing of the estimated value of stock options granted to the Company's employees over the period of time the stock options vest. The Company measures the total cost of each stock option grant at the date of grant using the Black Schole option trading model. We recognize the cost of each stock option on a straight line basis over the applicable vesting period.

All stock options issued in 2005 do not carry a designated expiration date and vest over a one year period. Stock option expense recorded for 2005, 2004 and 2003 amounted to \$92,671, \$0 and \$0, respectively. The following table summarizes stock options activity for the year ended December 31, 2005:

#### Stock Option Activity

	Average per share Shares subject to options	Exercise price	Market price
Balance at December 31, 2004		\$	\$
Options granted	652,833	1.50	1.50
Options exercised			N/A
Options terminated	(196,167 )	1.50	N/A
Balance at December 31, 2005	456,666	\$ 1.50	\$ 1.50

The following table summarizes the attributes used in the Company's valuation of stock option grants during 2005:

**Option Valuation Information**

	2005	2004	2003
Fair value per option (a)			
Valuation Assumptions			
Expected option term (in years)	2		
Expected duration from grant to expiration date (in years)	5		
Option vesting term (in years)	1		
Expected volatility	48.61	%	
Risk-free interest rate	3.42	%	
Expected forfeiture rate	5.00	%	
Estimated corporate tax rate	40.00	%	
Expected dividend yield	0.00	%	

(a) Estimated using Black Scholes option pricing model

(b) Not applicable

**NOTE 15 ACQUISITION AND SALE OF ASSETS**

On October 15, 2003 an officer of the Company exchanged an interest in TSG International for 50 shares of the Company's Series C preferred stock. In September 2004, the Directors of TSGI agreed to exchange all shares held by it of Technical Solutions Group Inc for the TSGI shares held by the Company, as a result of which the Company reacquired 100% of the shares of Technical Solutions Group as a wholly owned subsidiary.

Under an agreement dated July 1, 2003, modified on September 15, 2003, the Company sold its right, title and interest in and to the tangible and intangible assets of its Fire & Rescue Boat Division to Rockwell Power Systems Inc. ( "RPSI" ), which subsequently merged with Xtreme Companies, Inc. As part of the consideration for such sale, RPSI caused to be delivered to the Company 1/3 of Xtreme's authorized common stock, which was then distributed to the Company's shareholders of record as at December 5, 2003. In addition, the Company was to receive 500 shares of Xtreme's Series A Preferred stock. The Company has contacted Xtreme Companies regarding the Series A preferred stock but has not yet received the Series A preferred stock.

**NOTE 16 CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

The Company's Chief Executive Officer, Mr. McGilton, is a principle of APT Leadership, a consulting firm the Company hired to provide various business consulting services, training seminars and certain business software. APT Leadership billed the Company \$225,400, \$0 and \$0 for the years ended December 31, 2005, 2004 and 2003, respectively.

**NOTE 17 OTHER COMPREHENSIVE LOSS (RESTATED)**

Other comprehensive loss consists of the following:

	2005 Restated	2004 Restated	2003 Restated
<b>Net Loss</b>	\$ (14,404,622 )	\$ (11,953,803 )	\$ (8,087,869 )
Other Comprehensive Income, net of tax			
<b>Comprehensive Income (Loss)</b>	\$ (14,404,622 )	\$ (11,953,803 )	\$ (8,087,869 )

**NOTE 18 TAXES**

The Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards Number 109 ( "SFAS 109" ). Accounting for Income Taxes, which required a change from the deferred method to the asset and liability method of accounting for income taxes. Under the asset and liability method, deferred income taxes are recognized for the tax consequences of temporary differences by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax basis of existing assets and liabilities.

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The Company's net deferred tax asset as of December 31, 2005, 2004, and 2003 consisted of the following:

	December 31, 2005	December 31, 2004	December 31, 2003
Deferred tax assets:			
Provisions and allowances	\$ 2,381,178	\$ 859,085	\$ 111,350
Depreciation difference	(204,486 )	(168,722 )	(29,595 )
Net operating loss carryforwards	12,009,446	7,562,010	5,498,351
	14,186,138	8,252,373	5,580,106
Valuation allowance	(14,186,138 )	(8,252,373 )	(5,580,106 )
Net Deferred Tax asset	\$	\$	\$

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The Company has provided a full valuation allowance for deferred tax assets since these future benefits may not be realized. If the Company achieves future profitability, these deferred tax assets could be available to offset future income taxes. The Company's valuation allowance was increased \$5,933,765 and \$2,672,267 for the years ended December 31, 2005, and 2004 respectively.

As of December 31, 2005, 2004 and 2003, the Company has available Federal operating loss carry-forwards of \$32,868,929, \$21,257,284 and \$13,096,137, expiring through 2025 and state operating loss carry-forwards of \$21,610,537, \$9,879,269 and \$2,057,029, expiring through 2025, respectively.

The following is a reconciliation of the provision for income taxes at the U.S. federal income tax rate to the income taxes reflected in the Statement of Operations:

	December 31, 2005	December 31, 2004	December 31, 2003
Tax expense (credit) at statutory rate-federal	(35.00)	)% (35.00)	)% (35.00)
State tax expense net of federal tax	(3.25)	)% (3.25)	)% (3.25)
Changes in valuation allowance	38.25	% 38.25	)% 38.25
Tax expense at actual rate	0	% 0	% 0

### NOTE 19 EARNINGS (LOSS) PER SHARE

The Company utilizes SFAS No. 128, Earnings per Share to calculate gain/loss per share. Basic gain/loss per share is computed by dividing the gain/loss available to common stockholders (as the numerator) by the weighted-average number of common shares outstanding (as the denominator). Diluted gain/loss per share is computed similar to basic gain/loss per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if all potential common stock (including common stock equivalents) had all been issued, and if such additional common shares were dilutive. Under SFAS No. 128, where there is a loss, the inclusion of additional common shares is anti-dilutive (since the increased number of shares reduces the per share loss available to common stock holders), and if the additional common shares are anti-dilutive, they are not added to the denominator in the calculation. For periods, where the additional common shares are anti-dilutive, the following common stock equivalents have been excluded from the calculation of diluted loss per share:

	2005 Restated	2004 Restated	2003 Restated
<b><u>Common stock equivalents excluded from calculation</u></b>			
Convertible Preferred Stock Series B		10,493,939	3,553,270
Convertible Preferred Stock Series C			4,619,251
Convertible Preferred Stock Series D	6,288,428		
Warrants	2,104,863	1,725,942	1,141,667
Options	323,420		
<b>Total</b>	<b>8,716,711</b>	<b>12,219,881</b>	<b>9,314,188</b>

### **Basic & diluted loss per share computations (Restated):**

Net loss	\$ (14,404,622 )	\$ (11,953,803 )	\$ (8,087,869 )
Accretion of Series D 6% convertible preferred stock	(2,041,697 )		
Preferred stock dividends	(778,530 )		
<b>Loss available to common shareholders</b>	<b>\$ (17,224,849 )</b>	<b>\$ (11,953,803 )</b>	<b>\$ (8,087,869 )</b>
<b>Weighted average shares used to compute:</b>			
Basic and diluted loss per common share	33,926,573	19,357,939	8,185,153
Basic loss per common share before discontinued operations	\$ (0.51 )	\$ (0.62 )	\$ (0.63 )
Basic loss per common share from discontinued operations			(0.36 )
<b>Basic loss per common share</b>	<b>\$ (0.51 )</b>	<b>\$ (0.62 )</b>	<b>\$ (0.99 )</b>

### NOTE 20 VALUATION AND QUALIFYING ACCOUNTS AND RESERVES

The following table summarizes information about valuation and qualifying accounts and reserves recorded for 2005, 2004 and 2003.

Description	Year	Balance at Beginning of Period	Additions Charged to Costs and Expenses	Writeoffs	Other	Balance at End of Period
<b>Revenue Based Provisions (A)</b>	2005	\$	\$ 1,018,051	\$	\$	\$ 1,018,051



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Allowance for Inventory Losses	2005	\$	\$	498,281	\$	\$	\$	498,281	
Warranty Reserve (B)	2005	\$	729,461	\$	1,764,264	\$	807,663	\$	1,686,062
	2004	180,384	728,595	179,518	729,461				
	2003		180,384						

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(A) Consists of the Allowance for Contractual Adjustments, as presented on the Company's balance sheet and explained in Footnote 1 to the financial statements.

(B) Inclusive of the general warranty reserve as well as the Twin Disc Warranty Reserve of \$1,306,018 recorded in 2005.

**NOTE 21 DISCONTINUED OPERATIONS**

Discontinued operations follow SFAS No. 144. The loss from discontinued operations consist of impairment loss, the loss or gain from actual operations, and the gain/loss on the disposal of assets. All these accounts are included in discontinued operations in the period in which they occur.

On October 1, 2003, the Company sold all of the assets associated with its fire and rescue boat business, and discontinued all fire boat related operations. The Company recognized a loss as a result of such discontinued operations as follows:

**Discontinued operations:**

Loss from operations including	
Impairment loss	\$ 2,932,179
Income tax benefit	
Loss from Discontinued Operations, net of tax	\$ 2,932,179

**NOTE 22 RESTRUCTURING EXPENSES NET**

The Company implemented restructuring actions to streamline operations and exit the boat business. These actions include workforce reductions, rationalization and the exit of the boat business. Charges and credits related to discontinued operations are included in income (loss) from operations of discontinued operations. As of December 31, 2003, there is no longer a restructuring reserve on the balance sheet. Restructuring expense for 2003 was \$224,947.

SFAS 146 requires that a liability for a cost associated with an exit or disposal activity be recognized and measured initially at fair value only when the liability is incurred. The adoption of SFAS 146 did not have a material impact on the Company's financial condition.

**NOTE 23 GOODWILL**

There is no goodwill on the balance sheet as of December 31, 2005.

In 2002, the Company incurred impairment expense of \$1,400,000, of which \$482,874 was reclassified from Investment in TSG to Goodwill during the period ending December 31, 2002. In 2003, the Company incurred a goodwill impairment expense of \$1,917,747 and as of December 31, 2003, the Company had no goodwill on our balance sheet.

**NOTE 24 SUMMARIZED QUARTERLY UNAUDITED FINANCIAL DATA (RESTATED)**

	2005			
	Q1	Q2	Q3	Q4
<b>Net Sales</b>	\$ 5,853,423	\$ 18,295,357	\$ 9,303,526	\$ 16,260,523
Gross Profit/(Loss)	(541,896 )	4,036,672	(1,314,823 )	1,104,261
Operating Loss	(3,528,382 )	(473,325 )	(5,321,045 )	(6,307,311 )
<b>Net Loss</b>	\$ (936,306 )	\$ (647,344 )	\$ (5,666,483 )	\$ (7,154,489 )
<b>Basic loss per common share</b>	\$ (0.05 )	\$ (0.04 )	\$ (0.19 )	\$ (0.23 )
<b>Diluted loss per common share</b>	\$ (0.05 )	\$ (0.04 )	\$ (0.19 )	\$ (0.23 )

	2004			
	Q1	Q2	Q3	Q4
<b>Net Sales</b>	\$ 1,642,853	\$ 15,578	\$ 93,727	\$ 8,520,599
Gross Profit/ (Loss)	410,816	(280,949 )	(663,732 )	(460,376 )
Operating Loss	(1,910,483 )	(1,920,175 )	(3,719,662 )	(4,288,263 )
<b>Net Loss</b>	\$ (1,913,786 )	\$ (1,923,831 )	\$ (3,885,820 )	\$ (4,230,366 )
<b>Basic loss per common share</b>	\$ (0.16 )	\$ (0.14 )	\$ (0.28 )	\$ (0.04 )
<b>Diluted loss per common share</b>	\$ (0.16 )	\$ (0.14 )	\$ (0.28 )	\$ (0.04 )

**NOTE 25 SUBSEQUENT EVENTS**

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On January 10, 2006, the Company issued a stock option to the Company's Chief Executive Officer to purchase 1,000,000 shares of its unregistered common stock at a fixed exercise price of \$0.72 per share. These options vest in full on January 1, 2007 and were valued on the grant date at \$246,580.

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING & FINANCIAL DISCLOSURE**

None.

**ITEM     CONTROLS & PROCEDURES**  
**9A.**

*DISCLOSURE CONTROLS AND PROCEDURES*

Our management evaluated, with the participation of our Chief Executive Officer and our Interim Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Annual Report on Form 10-K. Based on this evaluation, our Chief Executive Officer and our Interim Chief Financial Officer have concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 (i) is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and (ii) is accumulated and communicated to our management, including our Chief Executive Officer and our Interim Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Our disclosure controls and procedures are designed to provide reasonable assurance that such information is accumulated and communicated to our management. Our disclosure controls and procedures include components of our internal control over financial reporting. Management's assessment of the effectiveness of our internal control over financial reporting is expressed at the level of reasonable assurance that the control system, no matter how well designed and operated, can provide only reasonable, but not absolute, assurance that the control system's objectives will be met.

*CHANGE IN INTERNAL CONTROL OVER FINANCIAL REPORTING*

There were no changes in our internal control over financial reporting that occurred during our last fiscal year that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. However, as discussed above we are committed to a process of change and improvement throughout the enterprise intended to optimize our operations, and this process will necessarily entail improvements to our financial controls over the coming year.

**ITEM     OTHER INFORMATION**  
**9B:**

- On January 13, 2006, we announced the appointment of Mr. Jack Davis as a member of our Board of Directors.
- On January 26, 2006, we announced the appointment of the firm of C.E. Unterberg Towbin as investment bankers.
- On February 3, 2006, we announced the award of a Letter Contract from the United States Army for the delivery of 19 Buffalo Vehicles with an option for an additional 27 vehicles.
- On February 13, 2006, we announced the extension of \$6,250,000 of the principal amount due under the Notes executed by the Company in favor of Longview Fund and Longview Equity Fund on November 18, 2005.
- On March 1, 2006, we announced the payment of the semi-annual dividend in the amount of \$377,554 due under our Convertible Preferred Series D stock.
- On March 2, 2006, we announced the award of a contract from the United States Army for Authorized Stock Lists for spare parts for our vehicles.

- On March 31, 2006 we announced the resignation of the President of our operating subsidiary.

**PART III**

**ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT**

*DIRECTORS, EXECUTIVE OFFICERS*

The following table sets forth certain information about our directors and executive officers as of April 1.

Name	Age	Position
Gordon McGilton	62	Chief Executive Officer, Director
R. Scott Ervin	51	Interim Chief Financial Officer, Director, General Counsel
Frank Kavanaugh	45	Chairman of the Board
Gale Aguilar	73	Director
Raymond W. Pollard	63	Director
Jack Davis	59	Director

*BIOGRAPHIES OF EXECUTIVE OFFICERS AND DIRECTORS*

Gordon McGilton: Director, Chief Executive Officer. Mr. McGilton has served as a Senior Executive for a multitude of organizations in manufacturing, medical devices, and Education. He has extensive experience in manufacturing, and business

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management. He is a partner in a technology company, APT Leadership and teaches business process seminars worldwide specializing in the creation of model companies. As a consultant, over the prior 5 years Mr. McGilton advised several companies throughout the U.S. including JD Edwards, the United States Navy, United Healthcare and Cigna Insurance Companies.

R. Scott Ervin: Director, General Counsel, Interim Chief Financial Officer. Mr. Ervin acted initially as a director from June through October 2001, and has served on the board continuously since February 2002. He is an attorney, having graduated from Boston College Law School (JD 1984) and is licensed to practice in New York and Texas. From 1984 through 1991 Mr. Ervin was associated with the New York law firm of Burlingham, Underwood and from 1991 through 1999, he practiced law with the law offices of Dr. Abdelrahman Abbar, in Jeddah Saudi Arabia. Since 1999 Mr. Ervin has been in private practice in Austin, Texas. He is a director of Interlex, Inc. a Texas corporation and a director of The Behavioural Sciences Foundation, a non-profit scientific research foundation. He also acts as trustee for several private trusts.

Frank Kavanaugh: Chairman of the Board. Mr. Kavanaugh was appointed to the board of directors, in December of 2003 and became Chairman in January of 2005. He currently is the managing director of Fort Ashford Funds, LLC, a provider of secured bridge loans, and a principal of Ashford Capital, LLC an equity investment firm. He was employed by the Company from July of 2002 until he resigned on May 14, 2005 as a VP with responsibility for strategic investment. Over the last 10 years he has acted as a principal at Ashford Capital, LLC and its predecessor. In that capacity he has served in several interim executive positions including operational or executive roles at several portfolio companies. He co-founded and served as President of QuickStart Technologies and held positions at Microsoft and Hewlett Packard. His education includes: an MBA from Pepperdine University, and a BS degree in Information & Computer Science, from University of California, Irvine. He serves on several community boards including the Child Guidance Center of Orange County, and the board of advisors at Chapman University's Leatherby Center.

Gale Aguilar: Director. Mr. Aguilar has served as our director since October of 2003, and served as interim CEO in 2004 and 2005. Currently he is the President and a member of the Board of Directors at MITEM Corporation which he joined in 1995. His experience includes SF2 Corp, Stardent Corporation, and Prime Computer as Senior VP of Marketing, VP of Corp. Strategy and Corp. Development he was a member of the operating committee. In addition, he worked at IBM for 27 years in several positions including \ Director of Marketing and Service General Products Division, IBM Director of Product Marketing, and Director of Systems Strategy. His experience includes active duty in the Army 1951-53. He participates on several corporate and charitable boards.

Raymond W. Pollard: Director. Mr. Pollard has worked for more than 30 years in the automotive and forging industries and has held positions of engineering management, manufacturing operations management, supplier development, contract negotiations, strategic alliance development, quality and logistics management and purchasing. Mr. Pollard is currently the Executive Director of Supplier development and Strategic Alliances for General Motors Corporation's Fuel Cell Activity. Mr. Pollard has a B.S. degree in Manufacturing Engineering and Business from Utah State University and is a veteran of the Vietnam War.

Jack Davis: Director. Mr. Davis has held various senior level positions over the past 35 years in the military, law enforcement and business fields. He served in the United States Marine Corps from 1968 until his retirement in 2005 where he held the rank of Major General. In 1999, Mr. Davis retired from the North Carolina State Bureau of Investigation after 20 years of distinguished service. He is also the founder of J.A. Davis & Associates, a security training company. Mr. Davis holds undergraduate and masters degrees from Indiana State University and a Masters of Urban Administration from the University of North Carolina at Charlotte.

### *COMPLIANCE WITH SECTION 16(A) OF THE EXCHANGE ACT.*

Section 16(a) of the Exchange Act, as amended, requires our executive officers, directors and persons who beneficially own more than 10% of our common stock to file reports of their beneficial ownership and changes in ownership (Forms 3, 4 and 5, and any amendment thereto) with the SEC. Executive officers, directors, and greater-than-ten percent holders are required to furnish us with copies of all Section 16(a) forms they file. Based on our review of the activity of our officers and directors for the fiscal year ended December 31, 2005, we believe Forms 3, 4 or 5 were timely filed, except for the following: Mr. McGilton filed a Form 3 304 days late, Mr. Pollard filed a form 3 113 days late, Mr. Ervin filed a Form 3 1460 days late, Mr. Davis filed a Form 3 67 days late and Mr. Aguilar filed a Form 3 880 days late.

### *CODE OF ETHICS*

We have adopted a Code of Ethics that applies to our principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions. Our Code of Ethics is available for review on our website ([www.forceprotection.net](http://www.forceprotection.net)).

### *NUMBER AND ELECTION OF DIRECTORS*

We currently have six directors. Directors are elected according to a staggered election cycle according to Class. There are three classes: Class A to be elected in 2006, for a period of three years, Class B to be elected in 2007 for a period of three years and Class C to be elected in 2008 for a period of three years.

## AUDIT COMMITTEE

We do not have a separate Audit Committee. Our Board of Directors performs the functions usually designated to an Audit Committee. We do not currently have a director that qualifies as an Audit Committee expert as defined by the rules of the SEC. We are currently searching for a director that meets this requirement. We employ an outside firm to advise and consult management and the board on matters relating to our financial statements.

## ITEM 11. EXECUTIVE COMPENSATION

## SUMMARY COMPENSATION TABLE

The following table presents a summary of the compensation paid to our Chief Executive Officer and other highly compensated employees during the last three fiscal years. Except as listed below, there are no bonuses, other annual compensation, restricted stock awards or options/SARs or any other compensation paid to executive officers.

Name and Principal Position	Year	Annual Compensation		Other Annual Comp.(\$)	Long Term Compensation		All Other Comp.
		Salary(\$)	Bonus(\$)		Restricted Stock Awards (\$)	Awards Securities Underlying Options	
Gordon McGilton(1)	2004	n/a					
Chief Executive Officer	2005	\$ 289,327	\$ 60,000				\$ 20,000
Mike Aldrich	2003	\$ 96,000					
Vice President Sales	2004	\$ 113,758					
	2005	\$ 118,560	\$ 234,761				
Ted McQuinn(2)	2004	n/a					
President FPII	2005	\$ 159,919			\$ 20,000		\$ 30,000
R. Scott Ervin(3)	2003	n/a					
General Counsel& Acting CFO	2004	\$ 56,800			\$ 108,000		\$ 15,000
	2005	\$ 139,842					
Mark Edwards(4)	2004	\$ 67,308					\$ 10,000
Sr. VP Vehicle Systems	2005	\$ 144,070				82,666	
Michael Watts(5)	2003	\$ 180,500			\$ 240,000		
Former Chief Executive Officer	2004	\$ 207,962			\$ 360,000		\$ 30,000
	2005			\$ 150,000			\$ 4,621
Gale Aguilar(6)	2003	n/a					
Former Interim Chief Executive Officer	2004	n/a			\$ 40,000		
	2005	\$ 45,000			\$ 122,000		

The value shown for issuances of restricted (unregistered) common shares is 100% of the market price as of the effective date of the grant by the Board of Directors (or the vesting date if different). LTIP Payout column has been omitted as no transactions were reportable thereunder.

- (1) Mr. McGilton received \$20,000 as additional in kind compensation during 2005 in the form of a jet boat.
- (2) Mr. McQuinn was granted 9,950 shares of our unregistered common stock as compensation during 2005. During 2005 Mr. McQuinn received \$30,000 cash as a relocation benefit
- (3) Mr. Ervin was granted 41,667 shares of our unregistered common stock and 4 shares of our Series C stock as compensation during 2004 During 2004 Mr. Ervin received \$15,000 cash as a relocation benefit
- (4) Mr. Edwards was granted an option to purchase 83,334 shares of our unregistered common stock as compensation during 2005 During 2004 Mr. Edwards received a \$10,000 cash as a relocation benefit
- (5) Mr. Watts served as a consultant to the Company for 12 months following his resignation as CEO in October 2004. During 2003 Mr. Watts was granted 166,667 shares of our unregistered common stock as



compensation. During 2004 Mr. Watts was granted 83,333 shares of our unregistered common stock and 20 shares of our Series C stock as compensation. During 2005 Mr. Wat received consulting fees of \$150,000 and \$4,621 in health insurance benefits.

(6) Mr. Aguilar resigned as our Interim Chief Executive Officer on January 27, 2005. During 2004 Mr. Aguilar was granted 20,833 shares of our unregistered common stock as compensation. During 2005 Mr. Aguilar was granted 20,833 shares of our unregistered common stock and 1 share of our Series C stock as compensation

#### *AGREEMENTS WITH KEY PERSONS*

On January 27, 2005, the Company entered into an agreement with Mr. Gordon McGilton to act as its Chief Quality Officer. Under the terms of such agreement, Mr. McGilton is to receive a base salary of \$180,000 plus an annual bonus of \$180,000 and reimbursement for travel, lodging and other out of pocket expenses incurred during employment. The Company also agreed to provide Mr. McGilton stock options once it adopts a stock option plan. Effective April 18, 2005, the Company appointed Mr. McGilton as its Chief Executive Officer. During 2005 Mr. McGilton received in kind compensation in the amount of \$20,000 in the form of a Vortex jet boat which the Company gave Mr. McGilton title to. Mr. McGilton joined the board of directors on April 18, 2005. Mr. McGilton received no compensation for his services as a director during 2005.

On February 4, 2005, the Company entered into an agreement with Mr. Ted McQuinn to act as President of its subsidiary Force Protection Industries, Inc. Under the terms of such agreement, Mr. McQuinn is to receive compensation of \$180,000 per year, plus an annual grant (for a period of three years) of unregistered common stock valued at \$100,000 and a one time grant of unregistered common stock valued at \$12,910.

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On November 15, 2004, the Company entered into an employment agreement with Mr. R. Scott Ervin to act as its General Counsel. Under the terms of such agreement, Mr. Ervin is to receive compensation of \$118,000 per year, plus relocation expenses of \$15,000, plus a grant of unregistered common stock valued at \$75,001. Effective January 1, 2005, the annual compensation under such agreement was increased to \$140,000. On January 27, 2005, Mr. Ervin was appointed by the Board to act as Interim Chief Executive Officer during the Company's search for a Chief Executive Officer. Upon the appointment of the new Company Chief Executive Officer on April 18, 2005, Mr. Ervin ceased to serve as the Interim Chief Executive Officer but continues to serve as General Counsel and a member of the board of directors. Mr. Ervin received no compensation for his services as a director during 2005. On November 14, 2005, the Board appointed Mr. Ervin to serve as the Acting Chief Financial Officer following the resignation of the former CFO.

On November 8, 2004, the Company entered into an employment agreement with Mr. Gale Aguilar to act as the Interim Chief Executive Officer. Under the terms of such agreement, Mr. Aguilar is to receive compensation of \$180,000 per year, plus a grant of 15,099 shares of unregistered common stock vesting on November 18, 2004 valued at \$72,650. Mr. Aguilar's employment agreement was terminated effective January 27, 2005. Mr. Aguilar received no compensation for his services as a director during 2005.

On March 31, 2003, the Company entered into an employment agreement with Mr. Frank Kavanaugh to act as its Vice President of Business Development. Under the terms of such agreement, Mr. Kavanaugh is to receive compensation of \$180,000 per year. In addition, on December 31, 2004, Mr. Kavanaugh received a one time grant of 10 Series C shares and 41,667 common shares valued at \$460,890. On May 14, 2005, Mr. Kavanaugh resigned from his employment with the Company, but continues to serve on the board of directors as Chairman. In connection with Mr. Kavanaugh's resignation, the Company agreed to pay for 24 months of health coverage valued at \$24,178. Mr. Kavanaugh received no compensation for his services as a director during 2005.

### *DIRECTOR COMPENSATION*

During 2004 and 2005 we reimbursed Directors for travel expenses associated with their work for the company, but did not pay Directors any compensation. During 2003, we compensated directors in the form of grants of unregistered common stock. Scott Ervin was awarded 20,833 shares of common stock valued at \$20,000 during 2003 for services as an independent director.

## **ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

### *PRINCIPAL SHAREHOLDERS*

The following table sets forth, to our knowledge, certain information concerning the beneficial ownership of our common stock as of March 31, 2006 by each stockholder known by us to be (i) the beneficial owner of more than 5% of the outstanding shares of common stock, (ii) each current director, (iii) each of the executive officers named in the Summary Compensation Table who were serving as executive officers at the end of the 2005 fiscal year and (iv) all of our directors and current executive officers as a group.

Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and includes voting or investment power with respect to shares beneficially owned. Shares of Common Stock subject to options or warrants currently exercisable are deemed outstanding for computing the percentage ownership of the person holding such options or warrants, but are not deemed outstanding for computing percentage ownership of any other person.

<b>Name of Beneficial Owner</b>	<b>Number of Shares Beneficially Owned</b>	<b>Percentage Ownership(1)</b>	
Gordon McGilton(2)	1,383,333	2.9	%
R. Scott Ervin	505,835	1.1	%
Frank Kavanaugh(3)	6,448,727	13.7	%
Gale Aguilar(4)	117,583	0.2	%
Raymond Pollard	500		*
All Officer and Directors as a Group	8,455,978	17.9	%

\* less than 1%

(1) The number of shares of fully diluted common stock outstanding as of March 31, 2006 is 47,117,377.

(2) Includes an option for 1,000,000 shares at \$0.72 per share. The option vests on January 1, 2007.

(3) Mr. Kavanaugh is a principal in Ashford Capital, LLC and his total beneficial share holdings include shares owned by Ashford Capital.

(4) As compensation for Mr. Aguilar's employment as our Interim Chief Executive Office during the period of October 2004 through January 2005, we granted to him a total of 117,583 shares of our unregistered common stock valued at \$122,000. 20,833 of these shares vested on November 18, 2004 and 96,750 of these shares vested on January 1, 2005. The share certificates representing all these shares were issued on February 28, 2006.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

Our Chief Executive Officer, Mr. McGilton, is a principle of APT Leadership, a consulting firm we hired to provide various business consulting services, training seminars and certain business software. For the years 2005 and 2004, APT Leadership billed us \$225,400 and \$21,017, respectively, for such services, training and software, of which \$21,017 remains unpaid as of December 31, 2005.

**ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

*AUDIT FEES*

We paid our principal accountant \$20,000 for audit fees in 2004. In 2005, we paid \$40,000 in audit fees.

*AUDIT-RELATED FEES*

None.

*TAX FEES*

None.

*OTHER FEES*

None.

*NOTE*

The independent Auditor's Report dated April 18, 2005 inadvertently referred to Jaspers + Hall PC (formerly Michael Johnson & Company LLC). This was an incorrect identification of the audit firm, which is Jaspers + Hall.

*THE BOARD OF DIRECTORS PRE-APPROVAL POLICY AND PROCEDURES*

We do not have a separate Audit Committee. Our full Board of Directors performs the functions of an Audit Committee. During fiscal year 2004, the Board of Directors adopted policies and procedures for the pre-approval of audit and non-audit services for the purpose of maintaining the independence of our independent auditors. We may not engage our independent auditors to render any audit or non-audit service unless either the service is approved in advance by the Board of Directors or the engagement to render the service is entered into pursuant to the Board of Directors' pre-approval policies and procedures. On an annual basis, the Board of Directors may pre-approve services that are expected to be provided to us by the independent auditors during the following 12 months. At the time such pre-approval is granted, the Board of Directors must (1) identify the particular pre-approved services in a sufficient level of detail so that management will not be called upon to make judgment as to whether a proposed service fits within the pre-approved services and (2) establish a monetary limit with respect to each particular pre-approved service, which limit may not be exceeded without obtaining further pre-approval under the policy.

The Board has considered whether the provision of the services described above under the caption "All Other Fees" is compatible with maintaining the auditor's independence.

**PART IV**

**ITEM 15. EXHIBITS**

<b>NUMBER</b>	<b>DESCRIPTION</b>
2.1	Agreement and Plan of Merger (included as Attachment A to Exhibit 99.2 to the Form DEF 14A filed November 19, 2004, and incorporated herein by reference).
3.1	Articles of Incorporation (included as Attachment B to Exhibit 99.2 to the Form DEF 14A filed November 19, 2004, and incorporated herein by reference).
3.2	By-Laws (included as Attachment C to Exhibit 99.2 to the Form DEF 14A filed November 19, 2004, and incorporated herein by reference).
3.3	Amended Articles of Incorporation (included as Attachment D to Exhibit 99.2 to the Form DEF 14A filed November 19, 2004, and incorporated herein by reference).
4.1	Certificate of Designation for Series D Convertible Preferred Stock, dated January 19, 2005 (included as Exhibit 4.1 to the Form 8-K filed January 27, 2005, and incorporated herein by reference).
4.2	Form of Common Stock Purchase Warrant, dated January 19, 2005, (included as Exhibit 4.2 to the Form 8-K filed January 27, 2005, and incorporated herein by reference).
4.3	Securities Purchase Agreement, dated January 19, 2005 (included as Exhibit 4.3 to the Form 8-K filed January 27, 2005, and incorporated herein by reference).
4.4	Registration Rights Agreement, dated January 19, 2005 (included as Exhibit 4.4 to the Form 8-K filed January 27, 2005, and incorporated herein by reference).
4.5	Amended and Restated Certificate of Designation for Series B Convertible Preferred Stock (included as Exhibit 4.1 of the Form 8-K filed February 15, 2005, and incorporated herein by reference).
4.6	Amended and Restated Certificate of Designation for Series C Convertible Preferred Stock (included as Exhibit 4.2 of the Form 8-K filed February 15, 2005, and incorporated herein by reference).
4.7	Bridge Facility between the Company and GC Financial Services, Inc., dated September 29, 2005 (included as Exhibit 4.1 to the Form 8-K filed July 8, 2005, and incorporated herein by reference).
4.8	Demand Note between the Company and GC Financial Services, Inc., dated September 29, 2005 (included as Exhibit 4.2 to the Form 8-K filed July 8, 2005, and incorporated herein by reference).
4.9	Secured Note between the Company and Longview Equity Fund, LP, dated November 18, 2005 (included as Exhibit 4.1 to the Form 8-K filed November 23, 2005, and incorporated herein by reference).
4.10	Secured Note between the Company and Longview Fund, LP, dated November 18, 2005 (included as Exhibit 4.2 to the Form 8-K filed November 23, 2005, and incorporated herein by reference).
10.1	Sonic Jet Corporation 2000 Stock Option Plan & Advisory and Consulting Agreement, dated May 1, 2000 (included as Appendix A to the Form 14C filed September 30, 2000, and incorporated herein by reference).
10.2	Series B Convertible Preferred Stock Purchase Agreement between the Company and Ashford Capital, LLC, dated December 27, 2001 (included as Exhibit 10.1 to the Form 8-K filed January 7, 2002, and incorporated herein by reference).
10.3	Series C Convertible Preferred Stock Purchase Agreement between the Company and eFund Capital Partners, LLC, dated December 27, 2001 (included as Exhibit 10.2 to the Form 8-K filed on January 7, 2002, and incorporated herein by reference).
10.4	Letter Agreement between the Company and Ashford Capital, LLC, dated April 15, 2003 (included as Exhibit 4.9 to the Form 10-QSB filed November 18, 2003, and incorporated herein by reference).



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- 10.5 Industrial Lease between the Company and Aerospace/Defense, Inc., dated September 2, 2003 (included as Exhibit 10.12 to the Form 10-QSB filed August 13, 2004, and incorporated herein by reference).
- 10.6 Modification of Business Asset Sale, License Agreement & Assignment of Rights between the Company and Rockwell Power Systems, Inc., dated September 15, 2003 (included as Exhibit 2.3 to the Form 10-QSB filed November 18, 2003, and incorporated herein by reference).
- 10.7 Non-Employee Directors and Consultants Retainer Stock Plan, dated September 30, 2003 (included as Exhibit 4 to the Form S-8 filed November 7, 2003, and incorporated herein by reference).
- 10.8 Investment Agreement between the Company and Dutchess Private Equities Fund, L.P., dated January 26, 2004 (included as Exhibit 10.8 to the SB-2 filed January 27, 2004, and incorporated herein by reference).
- 10.9 Registration Rights Agreement between the Company and Dutchess Private Equities Fund, L.P., dated January 26, 2004 (included as Exhibit 10.9 to the SB-2 filed January 27, 2004, and incorporated herein by reference).
- 10.10 Placement Agent Agreement between the Company, Charleston Capital, LLC, and Dutchess Private Equities Fund, L.P., dated January 27, 2004 (included as Exhibit 10.10 to the SB-2 filed on January 27, 2004, and incorporated herein by reference).
- 10.11 Form of Subscription Agreement between the Company and Gamma Opportunity Capital Partners, LP, Longview Fund, LP, Alpha Capital Aktiengesellschaft, Domino International Ltd, Magellan International Ltd, and Mountain Ridge Capital LLC, dated March 23, 2004 (included as Exhibit 4 to the Form 8-K filed on March 26, 2004, and incorporated herein by reference).
- 10.12 Royalty Agreement between the Company and J.J. van Eck, dated April 1, 2004 (included as Exhibit 10.13 to the Form 10-QSB filed August 13, 2004, and incorporated herein by reference).
- 10.13 Contract between the Company and the U.S. Marines, dated April 21, 2004 (included as Exhibit 10.14 to the 10-QSB filed August 13, 2004, and incorporated herein by reference).
- 10.14 Term Sheet between the Company and GC Financial Services, Inc., dated September 16, 2004 (included as Exhibit 10.14 to the 10-QSB filed November 15, 2004, and incorporated herein by reference).
- 10.15 Employment Agreement between the Company and Thomas Thebes (included as Exhibit 10.10 to the Form 10-QSB filed August 13, 2004, and incorporated herein by reference).
- 10.16 Letter re: Industrial Lease Agreement between the Company and Aerospace/Defense, Inc., dated July 13, 2004 (included as Exhibit 10.11 to the Form 10-QSB filed August 13, 2004, and incorporated herein by reference).
- 10.17 Employment Agreement between the Company and Garth Barrett, dated August 12, 2004 (included as Exhibit 10.16 to the 10-QSB filed November 15, 2004, and incorporated herein by reference).
- 10.18 Employment Agreement between the Company and Gale Aguilar, dated November 8, 2004 (included as Exhibit 10.1 to the Form 8-K/A filed November 10, 2004, and incorporated herein by reference).
- 10.19 Employment Agreement between the Company and Frank Kavanaugh, dated November 15, 2004 (included as Exhibit 10.15 to the 10-QSB filed November 15, 2004, and incorporated herein by reference).
- 10.20 Letter Contract awarded to the Company by the Department of the Army dated November 18, 2004 (as described in the 8-K filed November 24, 2004, and incorporated herein by reference).
- 10.21 Promissory Note between the Company and Dutchess Private Equity Fund, II, LP dated December 3, 2004 (included as Exhibit 10.1 to the Form 8-K filed December 8, 2004, and incorporated herein by reference).
- 10.22 Employment Agreement between the Company and Gordon McGilton, dated January 27, 2005 (included as Exhibit 10.22 to the Form 10-KSB/A filed April 22, 2005, and incorporated herein by reference).





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- 10.23 Employment Agreement between the Company and Ted McQuinn, dated February 4, 2005 (included as Exhibit 10.23 to the Form 10-KSB/A filed April 22, 2005, and incorporated herein by reference).
- 10.24 Order for Supplies or Services between the Company and U.S. Department of Defense, dated May 13, 2005 (included as Exhibit 10.1 to the Form 8-K filed May 18, 2005, and incorporated herein by reference).
- 10.25 Order for Supplies or Services between the Company and U.S. Department of Defense, dated May 18, 2005 (included as Exhibit 10.1 to the Form 8-K filed May 23, 2005, and incorporated herein by reference).
- 10.26 Order for Supplies or Services and Delivery Order between the Company and U.S. Department of Defense, dated September 23, 2005 (included as Exhibit 10.1 to the Form 8-K filed September 27, 2005, and incorporated herein by reference).
- 10.27 Purchase and Sale Agreement the Company and GC Financial Services, Inc., dated September 29, 2005 (included as Exhibit 10.1 to the Form 8-K filed July 8, 2005, and incorporated herein by reference).
- 10.28 Security Agreement the Company and GC Financial Services, Inc., dated September 29, 2005 (included as Exhibit 10.2 to the Form 8-K filed July 8, 2005, and incorporated herein by reference).
- 10.29 Purchase Order between the Company and Ricardo Engineering, dated September 29, 2005 (included as Exhibit 10.1 to the Form 8-K filed July 19, 2005, and incorporated herein by reference).
- 10.30 Solicitation/Contract/Order for Commercial Items and Delivery Order between the Company and the United States Marine Corps, dated September 7, 2005 (included as Exhibit 10.1 to the Form 8-K filed September 9, 2005, and incorporated herein by reference).
- 10.31 Engineering Services Agreement between the Company and TecStar, dated August 22, 2005 (included as Exhibit 10.31 to the Form 10-QSB filed November 15, 2005, and incorporated herein by reference).
- 10.32 Security Agreement between the Company and Barbara R. Mittman, dated November 18, 2005 (included as Exhibit 10.1 to the Form 8-K filed November 23, 2005, and incorporated herein by reference).
- 10.33 Form of Guaranty between the Company, Longview Equity Fund, LP, and Longview Fund, LP, dated November 18, 2005 (included as Exhibit 10.2 to the Form 8-K filed November 23, 2005, and incorporated herein by reference).
- 10.34 Subscription Agreement between the Company, Longview Equity Fund, LP, and Longview Fund, LP, dated November 18, 2005 (included as Exhibit 10.3 to the Form 8-K filed November 23, 2005, and incorporated herein by reference).
- 10.35 Letter Contract between the Company and the United States Army dated February 3, 2006 (included as Exhibit 10.1 to the Form 8-K filed February 9, 2006, and incorporated herein by reference).
- 10.36 Contract between the Company and the United States Army (included as Exhibit 10.36 to the Form 10-K filed on April 20, 2006).
- 23.1 Consent of Jaspers + Hall, PC.
- 31.1 Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Officers pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.



## SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

### Force Protection, Inc.

Date: June 27, 2007

By: GORDON MCGILTON  
Gordon McGilton  
*Chief Executive Officer*

Date: June 27, 2007

By: MICHAEL S. DURSKI  
Michael S. Durski  
*Chief Financial Officer*  
*Principal Accounting Officer*

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

### Signatures

Name	Title	Date
/s/ GORDON MCGILTON Gordon McGilton	Director and Chief Executive Officer	June 27, 2007
/s/ MICHAEL MOODY Michael Moody	Director	June 27, 2007
/s/ JACK DAVIS Jack Davis	Director	June 27, 2007
/s/ ROGER THOMPSON, JR. Roger Thompson, Jr.	Director	June 27, 2007