

FORCE PROTECTION INC  
Form 10-K/A  
October 15, 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.  X

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  X

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  X No  O

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.  O

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  O Accelerated filer  O Non-accelerated filer  X

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

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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**EXPLANATORY NOTE**

Management has reevaluated the effectiveness of our disclosure controls and procedures as of December 31, 2005. As a result, management has concluded that our disclosure controls were not effective as of December 31, 2005, because of certain material weaknesses. Management's revised evaluation is contained, and the material weaknesses are described, in Item 9A of this Form 10-K/A.

We have also added a legend to the report of Michael Johnson & Co., LLC, with respect to our financial statements for the year ended December 31, 2003, included in Item 8 of this Form 10-K/A, describing our inability to obtain and file a reissued report. There are no changes to that report or to the financial statements and other information included in Item 8.

**PART II**

**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

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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

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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

**The consolidated statements of income, cash flows and changes in stockholders' equity of Force Protection, Inc. for the year ended December 31, 2003 have been audited by Michael Johnson & Co., LLC, independent public accountants. We have not been able to obtain a reissued report of Michael Johnson & Co., LLC of their audit report regarding such financial statements because Michael Johnson & Co., LLC is no longer registered with the PCAOB as required by Section 102 of the Sarbanes-Oxley Act of 2002. The absence of such reissued report from Michael Johnson & Co., LLC may limit a stockholder's ability to assert claims against Michael Johnson & Co., LLC under Section 11(a) of the 1933 Act for any untrue statement of a material fact contained in the financial statements audited by Michael Johnson & Co., LLC or any omissions to state a material fact required to be stated in the financial statements.**



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

|   | 2005<br>Restated     | 2004<br>Restated     | 2003<br>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

|  | 2005<br>Restated | 2004<br>Restated | 2003<br>Restated |
|--|------------------|------------------|------------------|
| <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.

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

|  | Series B            |                | Series C            |                | Common Stock     |                | Warrants     | BCF        | Additional<br>Paid-in Capital | Accumulated<br>Deficit | Total        |
|--|---------------------|----------------|---------------------|----------------|------------------|----------------|--------------|------------|-------------------------------|------------------------|--------------|
|  | Preferred<br>Shares | Par<br>\$ .001 | Preferred<br>Shares | Par<br>\$ .001 | Common<br>Shares | Par<br>\$ .001 |              |            |                               |                        |              |
| <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 ) |
| <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) |



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|   | Series B<br>Preferred Stock |               | Series C<br>Preferred Stock |               | Common Stock |               | Warrants     | BCF           | Additional<br>Paid-in Capital | Accumulated<br>Deficit | Total         |
|---|-----------------------------|---------------|-----------------------------|---------------|--------------|---------------|--------------|---------------|-------------------------------|------------------------|---------------|
|   | Shares                      | Par<br>\$.001 | Shares                      | Par<br>\$.001 | Shares       | Par<br>\$.001 |              |               |                               |                        |               |
| <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 )     |
| Net loss  |                             |               |                             |               |              |               |              |               |                               | (11,953,803 )          | (11,953,803 ) |
| <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  |

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|  | Series B<br>Preferred Stock | Series C<br>Preferred Stock | Common Stock        |               | Warrants    | BCF          | Additional<br>Paid-in Capital | Accumulated<br>Capital Deficit | Total           |                |
|--|-----------------------------|-----------------------------|---------------------|---------------|-------------|--------------|-------------------------------|--------------------------------|-----------------|----------------|
|  | Shares                      | Par<br>\$.001Shares         | Par<br>\$.001Shares | Par<br>\$.001 |             |              |                               |                                |                 |                |
| <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) |

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**FORCE PROTECTION, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003**

|  | 2005<br>Restated    | 2004<br>Restated     | 2003<br>Restated    |
|--|---------------------|----------------------|---------------------|
| <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>   |
| Supplemental cashflow information  |                     |                      |                     |
| 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         |

| Quarter   | (Increase)/decrease in net loss |                 |               |                 |
|---|---------------------------------|-----------------|---------------|-----------------|
|   | 2005<br>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         |

| Quarter   | (Increase)/decrease in net loss |                 |                 |                 |
|---|---------------------------------|-----------------|-----------------|-----------------|
|   | 2004<br>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          |



| 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%          |

#### 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

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 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 definitization 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

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

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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:

|                                    | 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:

|                                   | 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          | \$                | \$               | \$        |                      |
| <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.

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<br>December 31, 2005 | Year Ended<br>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 is 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.

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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 Office, 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.

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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

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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.

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.



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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

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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 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

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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.

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 |

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|                                 |         |
|---------------------------------|---------|
| 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%      |

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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% |
| 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:

- 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.

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 Office 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.

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% |
|-------------------------|----|

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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       |
|  | 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:

**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 measured 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

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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

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<br>Shares subject<br>to options | Exercise<br>price | Market<br>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<br>Restated | 2004<br>Restated | 2003<br>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.

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 )      |
| <b>Net Deferred Tax asset</b>    | <b>\$</b>         | <b>\$</b>         | <b>\$</b>         |

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.



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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,<br>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             |
| <b>Allowance for Inventory Losses</b> | 2005 | \$                             | \$ 498,281                              | \$         | \$    | \$ 498,281               |
| <b>Warranty Reserve (B)</b>           | 2005 | \$ 729,461                     | \$ 1,764,264                            | \$ 807,663 | \$    | \$ 1,686,062             |

|      |         |         |         |         |
|------|---------|---------|---------|---------|
| 2004 | 180,384 | 728,595 | 179,518 | 729,461 |
| 2003 |         | 180,384 |         | 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              |
| Net Sales                     | \$ 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 )    |
| Net Loss                      | \$ (936,306 ) | \$ (647,344 ) | \$ (5,666,483 ) | \$ (7,154,489 ) |
| Basic loss per common share   | \$ (0.05 )    | \$ (0.04 )    | \$ (0.19 )      | \$ (0.23 )      |
| Diluted loss per common share | \$ (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**

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 9A. CONTROLS & PROCEDURES**



## DISCLOSURE CONTROLS AND PROCEDURES

Our management evaluated, with the participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act )) as of the end of the period covered by this Annual Report on Form 10-K/A. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures were not effective as of December 31, 2005 to ensure that information we are required to disclose in reports that we file or submit under the Exchange Act (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 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 management concluded so because of the material weaknesses discussed below.

Our financial and accounting organization was not adequate to support our financial accounting and reporting needs. Specifically, we did not maintain a sufficient complement of personnel with an appropriate level of accounting knowledge, experience with the Company and training in the application of GAAP commensurate with our financial reporting requirements. The lack of a sufficient complement of personnel with an appropriate level of accounting knowledge, experience with our Company and training contributed to the control deficiencies noted below.

(1) We did not maintain effective policies and procedures related to the accounting for specific equity issuances, including accounting for stock-based compensation in accordance with Statement of Financial Accounting Standard ( SFAS ) No. 123, *Share-Based Payment*, and accounting for convertible and redeemable preferred stock and warrants. This deficiency resulted in errors in the Company s accounting and disclosures for these equity issuances and related earnings per share calculations.

(2) We did not maintain effective controls to ensure the accuracy of disclosures in our financial statements and classification of certain financial transactions in the financial statements. Specifically, we failed to classify the allowance for contractual adjustments as a reduction in receivables and had incorrect or inadequate disclosures in financial statement disclosures related to the non-recurring warranty, statement of shareholders equity, deferred tax assets, liabilities and related income tax expense, contingency losses, discontinued operations, receivables and factoring accounts, debt and the statement of cash flows in our financial statements.

The control deficiency described above in (1) resulted in the restatement of our annual consolidated financial statements for 2005, 2004, and 2003. The control deficiency described in (2) required amendment of our annual financial statements for the years 2005, 2004 and 2003 which are included in our amended 2005 Form 10-K filing dated June 27, 2007.

## 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.

**PART IV**

ITEM 15. **EXHIBITS**

## Edgar Filing: FORCE PROTECTION INC - Form 10-K/A

| NUMBER | DESCRIPTION   |
|--------|---|
| 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). |

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- 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).
- 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).

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- 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).
- 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).



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- 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. (included as Exhibit 23.1 to the Form 10-K/A for the fiscal year ended 2005 filed on June 27, 2007)
- 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.

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**SIGNATURES**

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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.

Date: October 12, 2007

**Force Protection, Inc.**

By: /s/ Gordon McGilton  
Gordon McGilton  
*Chief Executive Officer*

Date: October 12, 2007

By: /s/ Michael S. Durski  
Michael S. Durski  
*Chief Financial Officer*  
*Principal Accounting Officer*

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