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ARMOR HOLDINGS INC
Form 10-Q
July 26, 2004

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 10-Q

(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2004, or

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

FOR THE TRANSITION PERIOD FROM TO .

COMMISSION FILE NUMBER 0-18863

ARMOR HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of
incorporation or organization)

59-3392443
(IRS Employer
Identification No.)

1400 MARSH LANDING PARKWAY, SUITE 112
JACKSONVILLE, FLORIDA
(Address of principal executive offices)

32250
(Zip Code)

Registrant's telephone number, including area code: (904) 741-5400

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of shares outstanding of the registrant's Common Stock as of July 16, 2004 is 32,758,987.

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ARMOR HOLDINGS, INC.

FORM 10-Q

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

The accompanying unaudited condensed consolidated financial statements of Armor Holdings, Inc. and its wholly-owned subsidiaries include all adjustments (consisting only of normal recurring accruals and the elimination of all material intercompany accounts and transactions) which management considers necessary for a fair presentation of operating results and financial position as of June 30, 2004 and for the three-month and six-months periods ended June 30, 2004 and June 30, 2003.

These unaudited condensed consolidated financial statements should be read in conjunction with the financial statements included in our Annual Report on Form 10-K/A for the fiscal year ended December 31, 2003.

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED BALANCE SHEETS
 (IN THOUSANDS)

| | JUNE 30, 2004 (UNAUDITED) | DECEMBER 31, 2003 * |
|--|------------------------------|------------------------|
| | ----- | ----- |
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | \$229,083 | \$111,850 |
| Restricted cash | -- | 2,600 |
| Accounts receivable (net of allowance for doubtful accounts of \$2,358 and \$1,673) | 110,821 | 72,635 |
| Costs and earned gross profit in excess of billings | 834 | -- |
| Inventories | 112,523 | 80,527 |
| Prepaid expenses and other current assets | 27,198 | 22,032 |
| Current assets of discontinued operations (Note 2) | 1,096 | 753 |
| | ----- | ----- |
| Total current assets | 481,555 | 290,397 |
| PROPERTY AND EQUIPMENT (net of accumulated depreciation of \$22,562 and \$19,046) | 59,780 | 57,576 |
| GOODWILL (net of accumulated amortization of \$4,024 and \$4,024) | 176,169 | 175,707 |
| PATENTS, LICENSES AND TRADEMARKS (net of accumulated amortization of \$4,575 and \$2,627) | 45,127 | 44,174 |
| OTHER ASSETS | 12,811 | 16,169 |
| LONG-TERM ASSETS OF DISCONTINUED OPERATIONS (Note 2) | 458 | 1,603 |
| | ----- | ----- |
| TOTAL ASSETS | \$775,900 ===== | \$585,626 ===== |

* Condensed from audited financial statements.
 See notes to condensed consolidated financial statements.

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(IN THOUSANDS, EXCEPT FOR SHARE DATA)

| | JUNE 30, 2004 (UNAUDITED) | DECEMBER 31, 2003 * |
|---|------------------------------|------------------------|
| | ----- | ----- |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Current portion of long-term debt | \$ 717 | \$ 32,107 |
| Short-term debt | 1,274 | 498 |
| Accounts payable | 49,701 | 30,304 |
| Accrued expenses and other current liabilities | 62,537 | 58,218 |
| Income taxes payable | 12,741 | -- |
| Current liabilities of discontinued operations (Note 2) | 554 | 626 |
| | ----- | ----- |
| Total current liabilities | 127,524 | 121,753 |
| LONG-TERM LIABILITIES: | | |
| Long-term debt, less current portion | 151,542 | 158,300 |
| Other long-term liabilities | 4,619 | 10,208 |
| | ----- | ----- |
| Total liabilities | 283,685 | 290,261 |
| COMMITMENTS AND CONTINGENCIES | | |
| (NOTE 11) | | |
| STOCKHOLDERS' EQUITY: | | |
| Preferred stock, \$.01 par value, 5,000,000 shares authorized; no shares issued and outstanding | -- | -- |
| Common stock, \$.01 par value; 75,000,000 and 50,000,000 shares authorized; 38,815,098 and 34,337,034 issued and 32,754,876 and 28,267,812 outstanding at June 30, 2004 and December 31, 2003, respectively | 389 | 344 |
| Additional paid-in capital | 485,512 | 318,460 |
| Retained earnings | 75,253 | 44,942 |
| Accumulated other comprehensive income | 3,378 | 3,936 |
| Treasury stock | (72,317) | (72,317) |
| | ----- | ----- |
| Total stockholders' equity | 492,215 | 295,365 |
| | ----- | ----- |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ 775,900 | \$ 585,626 |
| | ===== | ===== |

* Condensed from audited financial statements.
See notes to condensed consolidated financial statements.

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
 (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

| | THREE MONTHS ENDED | | S JUNE 30, |
|--|--------------------|---------------|---------------|
| | JUNE 30, 2004 | JUNE 30, 2003 | |
| | ----- | ----- | ----- |
| REVENUES: | | | |
| Aerospace & Defense | \$ 129,773 | \$ 15,793 | \$ 210,7 |
| Products | 65,743 | 49,347 | 119,5 |
| Mobile Security | 28,188 | 16,519 | 54,9 |
| | ----- | ----- | ----- |
| Total Revenues | 223,704 | 81,659 | 385,3 |
| | ----- | ----- | ----- |
| COSTS AND EXPENSES: | | | |
| Cost of sales | 157,246 | 57,281 | 271,3 |
| Operating expenses | 23,386 | 14,524 | 46,6 |
| Amortization | 973 | 69 | 1,9 |
| Integration and other charges | 8,123 | 3,775 | 8,8 |
| | ----- | ----- | ----- |
| OPERATING INCOME | 33,976 | 6,010 | 56,6 |
| Interest expense, net | 2,057 | 437 | 3,7 |
| Other (income) expense, net | (390) | 16 | (2) |
| | ----- | ----- | ----- |
| INCOME FROM CONTINUING OPERATIONS BEFORE PROVISION FOR INCOME TAXES | 32,309 | 5,557 | 53,1 |
| PROVISION FOR INCOME TAXES | 14,588 | 2,079 | 22,7 |
| | ----- | ----- | ----- |
| INCOME FROM CONTINUING OPERATIONS | 17,721 | 3,478 | 30,3 |
| DISCONTINUED OPERATIONS (NOTE 2): | | | |
| INCOME (LOSS) FROM DISCONTINUED OPERATIONS, NET OF TAX | 100 | 1,135 | (|
| | ----- | ----- | ----- |
| NET INCOME | \$ 17,821 | \$ 4,613 | \$ 30,3 |
| | ===== | ===== | ===== |
| NET INCOME PER COMMON SHARE - BASIC | | | |
| INCOME FROM CONTINUING OPERATIONS | \$ 0.60 | \$ 0.13 | \$ 1. |
| INCOME FROM DISCONTINUED OPERATIONS | 0.00 | 0.04 | 0. |
| | ----- | ----- | ----- |
| BASIC EARNINGS PER SHARE | \$ 0.60 | \$ 0.17 | \$ 1. |
| | ===== | ===== | ===== |

See notes to condensed consolidated financial statements.

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS - CONTINUED (UNAUDITED)
 (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

| | THREE MONTHS ENDED | | SIX MONTHS |
|---------------------------------------|--------------------|---------------|---------------|
| | JUNE 30, 2004 | JUNE 30, 2003 | JUNE 30, 2004 |
| | ----- | ----- | ----- |
| NET INCOME PER COMMON SHARE - DILUTED | | | |
| INCOME FROM CONTINUING OPERATIONS | \$ 0.57 | \$ 0.13 | \$ 0.99 |
| INCOME FROM DISCONTINUED OPERATIONS | 0.00 | 0.04 | 0.00 |
| | ----- | ----- | ----- |
| DILUTED EARNINGS PER SHARE | \$ 0.57 | \$ 0.17 | \$ 0.99 |
| | ===== | ===== | ===== |
| | | | |
| WEIGHTED AVERAGE SHARES - BASIC | 29,670 | 27,555 | 29,236 |
| | ===== | ===== | ===== |
| | | | |
| WEIGHTED AVERAGE SHARES - DILUTED | 31,008 | 27,836 | 30,469 |
| | ===== | ===== | ===== |

See notes to condensed consolidated financial statements.

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
 (IN THOUSANDS)

| | SIX MONTHS |
|--|---------------|
| | ----- |
| | JUNE 30, 2004 |
| | ----- |
| CASH FLOWS FROM OPERATING ACTIVITIES: | |
| Income from continuing operations | \$ 30,349 |
| Adjustments to reconcile income from continuing operations to cash provided by operating activities: | |
| Depreciation and amortization | 6,603 |
| Loss on disposal of fixed assets | 115 |
| Deferred income taxes | (197) |
| Non-cash charge for acceleration of performance-based restricted stock awards | 5,913 |
| Non-cash impairment charge | 1,408 |
| Non-cash termination charge | -- |
| Changes in operating assets and liabilities, net of acquisitions: | |
| (Increase) in accounts receivable | (38,772) |
| (Increase) decrease in inventories | (31,997) |
| (Increase) in prepaid expenses and other assets | (8,881) |
| Increase in accounts payable, accrued expenses and other current liabilities | 27,649 |
| Increase (decrease) in income taxes payable | 17,475 |

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| | |
|--|------------|
| Net cash provided by operating activities | 9,665 |
| <hr/> | |
| CASH FLOWS FROM INVESTING ACTIVITIES: | |
| Purchase of property and equipment | (7,104) |
| Purchase of patents and trademarks | (77) |
| Purchase of equity investment | (5,275) |
| Proceeds from sale of equity investment | 5,823 |
| Collection of note receivable | 375 |
| Decrease in restricted cash | 2,600 |
| Additional consideration for purchased businesses | (1,855) |
| Purchase of business, net of cash acquired | (2,729) |
| <hr/> | |
| Net cash used in investing activities | (8,242) |
| <hr/> | |
| CASH FLOWS FROM FINANCING ACTIVITIES: | |
| Proceeds from the exercise of stock options | 8,310 |
| Proceeds from the issuance of common stock | 142,500 |
| Cash paid for common stock offering costs | (1,057) |
| Repurchases of treasury stock | -- |
| Repayments of long-term debt | (34,052) |
| Borrowings under lines of credit | 8,885 |
| Repayments under lines of credit | (8,122) |
| <hr/> | |
| Net cash provided by (used in) financing activities | 116,464 |
| <hr/> | |
| Effect of exchange rate changes on cash and cash equivalents | 63 |
| Net cash used in discontinued operations | (717) |
| <hr/> | |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 117,233 |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | 111,850 |
| <hr/> | |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | \$ 229,083 |
| <hr/> | |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | |
| CONTINUING OPERATIONS | \$ 229,083 |
| DISCONTINUED OPERATIONS | 157 |
| <hr/> | |
| | \$ 229,240 |
| <hr/> | |
| | ===== |

See notes to condensed consolidated financial statements.

ARMOR HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS - (UNAUDITED)

NOTE 1 - BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of Armor Holdings, Inc. and its wholly-owned subsidiaries (the "Company", "we", "our", "us") have been prepared in accordance with generally accepted accounting principles for interim information and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X, and do not include all the information and footnotes

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required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring accruals and the elimination of all material intercompany accounts and transactions) considered necessary by management to present a fair presentation have been included. The results of operations for the three month and six month period is not necessarily indicative of the results to be expected for the full year and should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K/A for the year ended December 31, 2003. The amounts disclosed in the footnotes are related to continuing operations unless otherwise indicated.

Effective in the first quarter 2004, we instituted a new segment reporting format to include three reportable business segments: Aerospace & Defense Group, the Products Division ("Armor Holdings Products"), and the Mobile Security Division ("Armor Mobile Security"). The Aerospace & Defense Group was formed upon the completion of our acquisition of Simula, Inc. on December 9, 2003, and results have been included since the acquisition date. The Aerospace & Defense Group also includes the military business, including armor and blast protection systems for M1114 Up-Armored High Mobility Multi-Purpose Wheeled Vehicles ("HMMWVs"), and other military vehicle armor programs, which previously were included in the Mobile Security Division. The Aerospace & Defense Group also includes the small arms protective insert ("SAPI") plate produced by our Protech subsidiary in Pittsfield, Massachusetts, which was previously reported as part of the Products Division. The historical results of these businesses have been reclassified as part of the Aerospace & Defense Group. This reporting change was made to better reflect management's approach to operating and directing the businesses, and, in certain instances, to align financial reporting with our market and customer segments. The reporting change had no impact on consolidated revenues, gross profit, operating income or net income.

As discussed in Note 2, in 2003 we sold the majority of our ArmorGroup Services Division (the "Services Division"). The assets and liabilities of the Services Division have been classified as assets and liabilities of discontinued operations on our condensed consolidated balance sheets and the results of their operations classified as income (loss) from discontinued operations in the accompanying unaudited condensed consolidated statements of operations.

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED (UNAUDITED)

NOTE 2 - DISCONTINUED OPERATIONS

On April 17, 2003, we announced that we had completed the sale of our ArmorGroup Integrated Systems business through the sale of 100% of the stock of ArmorGroup Integrated Systems, Inc. and Low Voltage Systems Technologies, Inc. to Aerwav Integration Systems, Inc. ("AIS"). AIS is a wholly owned subsidiary of Aerwav Holdings, LLC. As consideration for the integrated systems business, we received a \$4.1 million collateralized note due in two years and a warrant for approximately 2.5% of AIS. \$475,000 of the balance due was paid in advance through June 2004. In accordance with Statement of Financial Accounting Standards No. 144, we recorded a loss of \$366,000 on the sale in the second quarter of 2003.

On November 26, 2003, we announced that we completed the sale of

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ArmorGroup, our security service division, for \$33,660,000 in total consideration to a group of private investors led by Granville Baird Capital Partners of London, England and Management. We received \$31,360,000 in cash at closing and are scheduled to receive another \$2,300,000 by the end of 2004, of which we have received \$500,000 through July 23, 2004. We recorded a loss of \$8.8 million on the sale in the fourth quarter of 2003. In accordance with generally accepted accounting principles, unrealized foreign currency translation gains and losses, which are included in equity as accumulated other comprehensive income or loss, are not recognized until the period in which the related assets and liabilities are disposed of.

On June 30, 2004, our litigation support services subsidiary, New Technologies Armor, Inc. ("NTI"), was the last remaining business in discontinued operations. On July 2, 2004, we sold the security consulting division of NTI. The remaining division in NTI, consisting primarily of training services, will be included as part of the Products Division segment. In the second quarter of 2004, we recorded an impairment charge of \$1.4 million in integration and other charges in continuing operations to reduce the carrying value of remaining portion of NTI to its estimated fair value.

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED (UNAUDITED)

A summary of the operating results of the discontinued operations for the three months and six months ended June 30, 2004 and 2003 is as follows.

| | THREE MONTHS ENDED | | SIX MONTHS ENDED | |
|--|--------------------|---------------|------------------|---------------|
| | JUNE 30, 2004 | JUNE 30, 2003 | JUNE 30, 2004 | JUNE 30, 2003 |
| | (IN THOUSANDS) | | (IN THOUSANDS) | |
| Revenue | \$ 1,013 | \$23,911 | \$ 1,733 | \$49,000 |
| Cost of sales | 461 | 16,187 | 697 | 35,000 |
| Operating expenses | 385 | 5,005 | 821 | 11,000 |
| Integration and other charges | -- | 452 | -- | -- |
| | ----- | ----- | ----- | ----- |
| Operating income | 167 | 2,267 | 215 | 2,000 |
| Interest expense, net | -- | 15 | 2 | -- |
| Other expense, net | 10 | 392 | 273 | -- |
| | ----- | ----- | ----- | ----- |
| Income (loss) from discontinued operations before provision (benefit) for income taxes | 157 | 1,860 | (60) | 1,000 |
| Provision (benefit) for income taxes | 57 | 725 | (22) | -- |
| | ----- | ----- | ----- | ----- |
| Income (loss) from discontinued operations | \$ 100 | \$ 1,135 | \$ (38) | \$ 1,000 |
| | ===== | ===== | ===== | ===== |

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
 NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED (UNAUDITED)

The following is a summary of the assets and liabilities of our discontinued operations:

| | JUNE 30, 2004 | DECEMBER 31, 2003 |
|--|----------------|-------------------|
| | ----- | ----- |
| | (IN THOUSANDS) | |
| Assets | | |
| Cash and cash equivalents | \$ 157 | \$ 76 |
| Accounts receivable, net | 806 | 549 |
| Other current assets | 133 | 128 |
| | ----- | ----- |
| Total current assets | 1,096 | 753 |
| Property and equipment, net | 437 | 1,206 |
| Goodwill, net | -- | 356 |
| Other assets | 21 | 41 |
| | ----- | ----- |
| Total assets of discontinued operations | \$1,554 | \$2,356 |
| | ===== | ===== |
| Liabilities | | |
| Current portion of long-term debt | \$ -- | \$ 125 |
| Accounts payable | 142 | 5 |
| Accrued expenses and other current liabilities | 412 | 496 |
| | ----- | ----- |
| Total current liabilities | 554 | 626 |
| | ----- | ----- |
| Total liabilities of discontinued operations | \$ 554 | \$ 626 |
| | ===== | ===== |

Based upon our analysis and discussions with our advisors regarding the estimated realizable value, net of selling costs, of the Services Division, we reduced its carrying value and recorded net impairment charges of \$12.4 million in the third quarter of fiscal 2003. The 2003 impairment charges consisted of a non-cash goodwill reduction. The benefit for income taxes for discontinued operations was \$8.3 million for fiscal 2003. The reductions in the carrying value of the Services Division were management's best estimate based upon the information available at the time, including discussions with our investment bankers.

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
 NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED (UNAUDITED)

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NOTE 3 - COMPREHENSIVE INCOME

The components of comprehensive income, net of tax provision of zero and \$128,000 for the three months ended June 30, 2004 and 2003, respectively, and zero and \$224,000 for the six months ended June 30, 2004 and 2003, respectively, are listed below:

| | THREE MONTHS ENDED | | SIX MONTHS ENDED | |
|---|--------------------|---------------|------------------|---------------|
| | JUNE 30, 2004 | JUNE 30, 2003 | JUNE 30, 2004 | JUNE 30, 2003 |
| | (IN THOUSANDS) | | (IN THOUSANDS) | |
| Net income | \$ 17,821 | \$ 4,613 | \$ 30,311 | \$ 30,311 |
| Other comprehensive income (loss): | | | | |
| Foreign currency translations, net of tax | (230) | 1,861 | (558) | (558) |
| Comprehensive income: | \$ 17,591 | \$ 6,474 | \$ 29,753 | \$ 29,753 |

NOTE 4 - INVENTORIES

Inventories are stated at the lower of cost or market using the first-in, first-out (FIFO) method and are summarized as follows:

| | JUNE 30, 2004 | DECEMBER 31, 2003 |
|-------------------|----------------|-------------------|
| | (IN THOUSANDS) | |
| Raw material | \$ 67,500 | \$ 40,397 |
| Work-in-process | 28,367 | 25,422 |
| Finished goods | 16,656 | 14,708 |
| Total inventories | \$112,523 | \$ 80,527 |

NOTE 5 - ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

Accrued expenses and other current liabilities are summarized as follows:

| | JUNE 30, 2004 | DECEMBER 31, 2003 |
|--|----------------|-------------------|
| | (IN THOUSANDS) | |
| Accrued expenses and other current liabilities | \$43,539 | \$40,787 |
| Deferred consideration for acquisitions | 3,403 | 2,780 |
| Customer deposits | 15,595 | 14,651 |
| Total accrued expenses and other current liabilities | \$62,537 | \$58,218 |

ARMOR HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED (UNAUDITED)

NOTE 6 - DERIVATIVE FINANCIAL INSTRUMENTS

We account for derivative instruments in accordance with Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by Statement of Financial Accounting Standards No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities - an Amendment of SFAS 133", and Statement of Financial Accounting Standards No. 149 "Amendment of SFAS 133 on Derivative Instruments and Hedging Activities" (collectively "SFAS 133"). SFAS 133 requires all freestanding and embedded derivative instruments to be measured at fair value and recognized on the balance sheet as either assets or liabilities. In addition, all derivative instruments used in hedging relationships must be designated, reassessed and accounted for as either fair value hedges or cash flow hedges pursuant to the provisions of SFAS 133.

We hedge the fair value of our 8.25% \$150 million Senior Subordinated Notes due 2013 (the "Notes") using interest rate swaps. We enter into these derivative contracts to manage fair value changes which could be caused by our exposure to interest rate changes. On September 2, 2003, we entered into interest rate swap agreements, designated as fair value hedges as defined under SFAS 133 with an aggregate notional amount totaling \$150 million. The agreements were entered into to exchange the fixed interest rate on the Notes for a variable interest rate equal to six-month LIBOR (1.94% at June 30, 2004), set in arrears, plus a spread ranging from 2.735% to 2.75% fixed semi-annually on the fifteenth of February and August each year through maturity. The agreements are subject to other terms and conditions common to transactions of this type. These fair value hedges qualify for hedge accounting using the short-cut method since the swap terms match the critical terms of the Notes. Accordingly, changes in the fair value of the interest rate swap agreements offset changes in the fair value of the Notes due to changes in the market interest rate. As a result, no ineffectiveness is expected to be recognized in our earnings associated with the interest rate swap agreements on the Notes. The fair value of the interest rate swap agreements was approximately \$1.7 million and \$5.9 million at June 30, 2004 and December 31, 2003, respectively, and is included in other assets and long-term debt on the accompanying condensed consolidated balance sheet.

The fair values of our interest rate swap agreements are obtained from our counter-parties and represent the estimated amount we would receive or pay to terminate the agreement, taking into consideration the difference between the contract rate of interest and rates currently quoted for agreements of similar terms and maturities.

NOTE 7 - INFORMATION CONCERNING BUSINESS SEGMENTS AND
GEOGRAPHICAL SALES

We are a leading manufacturer and provider of specialized security products; training and support services related to these products; vehicle armor systems; military helicopter seating systems; aircraft and land vehicle safety

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systems; protective equipment for military personnel; and other technologies used to protect humans in a variety of life-threatening or catastrophic situations. Our products and systems are used domestically and internationally by military, law enforcement, security and corrections personnel, as well as governmental agencies, multinational corporations and individuals. We are organized and operated under three business segments: Aerospace & Defense Group, Armor

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED (UNAUDITED)

Holdings Products, also referred to as our Products Division, and Armor Mobile Security, also referred to as our Mobile Security Division. Our Services Division has been classified as discontinued operations and is no longer included in this presentation (See Note 2).

Aerospace & Defense Group. Our Aerospace & Defense Group supplies human safety and survival systems to the U.S. military, and major aerospace and defense prime contractors. Our core markets are military aviation safety, military personnel safety, and land and marine safety. Under the brand name O'Gara-Hess & Eisenhardt, we are the sole-source provider to the U.S. military of the armor and blast protection systems for M1114 Up-Armored HMMWVs. We are also under contract with the U.S. Army to provide spare parts, logistics and ongoing field support services for the currently installed base of approximately 5,862 Up-Armored HMMWVs. Additionally, we provide blast and ballistic protection kits for the standard HMMWVs, which are installed on existing equipment in the field. Our Aerospace & Defense Group is also subcontracted to develop a ballistic and blast protected armored and sealed truck cab for the High Mobility Artillery Rocket System ("HIMARS"), a program recently transitioned by the U.S. Army and U.S. Marine Corps from developmental to a low rate of initial production, deliveries of which commenced in 2003. We also supply armor sub-systems for other tactical wheeled vehicles. Through Simula, we provide military helicopter seating systems, helicopter cockpit airbag systems, aircraft and land vehicle armor kits, body armor and other protective equipment for military personnel, emergency bailout parachutes and survival ensembles worn by military aircrew. The primary customers for our products are the U.S. Army, U.S. Marine Corps, Boeing, and Sikorsky Aircraft. Most of Simula's aviation safety products are provided on a sole source basis. The U.S. armed forces have adopted ceramic body armor as a key element of the protective ensemble worn by our troops in Iraq and Afghanistan. Simula was the developer of this specialized product called SAPI, and is the largest supplier to U.S. forces.

Armor Holdings Products. Our Armor Holdings Products division manufactures and sells a broad range of high quality equipment marketed under brand names that are well known and respected in the military and law enforcement communities. Products manufactured by this division include concealable and tactical body armor, hard armor, duty gear, less-lethal munitions, anti-riot products, police batons, emergency lighting products, forensic products, firearms' accessories, weapon maintenance products, foldable ladders, and specialty gloves.

Armor Mobile Security. Our Armor Mobile Security division manufactures and installs ballistic and blast protection armoring systems for a variety of commercial vehicles including limousines, sedans, sport utility vehicles, commercial trucks, and cash-in-transit vehicles, to protect against varying degrees of ballistic and blast threats. Our customers in this business include the US and foreign governments, international corporations, non-government organizations and high net worth individuals. In addition, we supply ballistic and blast protected armoring systems to U.S. federal law enforcement and

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intelligence agencies and foreign heads of state.

We have invested substantial resources outside of the United States and plan to continue to do so in the future. The Armor Mobile Security Division has invested substantial resources in Europe and South America. These operations are subject to the risk of new and different legal and regulatory requirements in local jurisdictions, tariffs and trade barriers, potential difficulties in staffing and managing local operations, currency risks, potential imposition of restrictions on investments, potentially

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED (UNAUDITED)

adverse tax consequences, including imposition or increase of withholding and other taxes on remittances and other payments by subsidiaries, and local economic, political and social conditions. Governments of many developing countries have exercised and continue to exercise substantial influence over many aspects of the private sector. Government actions in the future could have a significant adverse effect on economic conditions in a developing country or may otherwise have a material adverse effect on us and our operating companies. We do not have political risk insurance in the countries in which we currently conduct business. Moreover, applicable agreements relating to our interests in our operating companies are frequently governed by foreign law. As a result, in the event of a dispute, it may be difficult for us to enforce our rights. Accordingly, we may have little or no recourse upon the occurrence of any of these developments.

Revenues, operating income and total assets for each of our continuing operating segments are as follows (net of intercompany eliminations):

| | THREE MONTHS ENDED | | SIX MONTHS ENDED | |
|---------------------------------|--------------------|---------------|------------------|---------------|
| | JUNE 30, 2004 | JUNE 30, 2003 | JUNE 30, 2004 | JUNE 30, 2003 |
| | (IN THOUSANDS) | | (IN THOUSANDS) | |
| Revenues: | | | | |
| Aerospace & Defense | \$ 129,773 | \$ 15,793 | \$ 210,781 | \$ 31,700 |
| Products | 65,743 | 49,347 | 119,583 | 93,300 |
| Mobile Security | 28,188 | 16,519 | 54,968 | 37,000 |
| Total revenues | \$ 223,704 | \$ 81,659 | \$ 385,332 | \$ 162,000 |
| Operating income (loss): | | | | |
| Aerospace & Defense | \$ 31,552 | \$ 4,051 | \$ 51,031 | \$ 7,600 |
| Products | 11,259 | 7,798 | 16,944 | 14,600 |
| Mobile Security | 3,847 | (58) | 4,920 | 4,000 |
| Corporate | (12,682) | (5,781) | (16,271) | (7,900) |
| Total operating income | \$ 33,976 | \$ 6,010 | \$ 56,624 | \$ 14,800 |

JUNE 30, 2004 DECEMBER 31, 2003

(IN THOUSANDS)

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| | | |
|---------------------|------------|----------|
| Total assets: | | |
| Aerospace & Defense | \$ 264,862 | \$ 209,8 |
| Products | 194,278 | 183,9 |
| Mobile Security | 80,014 | 63,1 |
| Corporate | 235,192 | 126,3 |
| | ----- | ----- |
| Total assets | \$ 774,346 | \$ 583,2 |
| | ===== | ===== |

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED (UNAUDITED)

The following unaudited information with respect to revenues, operating income from continuing operations (geographic operating income from continuing operations before amortization expense and integration and other charges) and total assets from continuing operations to principal geographic areas are as follows:

| | THREE MONTHS ENDED | | SIX MONTHS ENDED | |
|-----------------------------------|--------------------|---------------|------------------|-------------------|
| | JUNE 30, 2004 | JUNE 30, 2003 | JUNE 30, 2004 | JUNE 30, 2003 |
| | ----- | | ----- | |
| | (IN THOUSANDS) | | (IN THOUSANDS) | |
| Revenues: | | | | |
| North America | \$188,654 | \$ 61,206 | \$320,005 | \$117,830 |
| South America | 4,185 | 2,664 | 7,661 | 6,091 |
| Africa | 475 | 319 | 1,681 | 804 |
| Europe/Asia | 30,390 | 17,470 | 55,985 | 37,408 |
| | ----- | ----- | ----- | ----- |
| Total revenues | \$223,704 | \$ 81,659 | \$385,332 | \$162,133 |
| | ===== | ===== | ===== | ===== |
| Geographic operating income: | | | | |
| North America | \$ 37,745 | \$ 7,707 | \$ 59,383 | \$ 14,660 |
| South America | 387 | 51 | 618 | 105 |
| Africa | 107 | 96 | 206 | 194 |
| Europe/Asia | 4,833 | 2,000 | 7,174 | 4,203 |
| | ----- | ----- | ----- | ----- |
| Total geographic operating income | \$ 43,072 | \$ 9,854 | \$ 67,381 | \$ 19,162 |
| | ===== | ===== | ===== | ===== |
| | | | JUNE 30, 2004 | DECEMBER 31, 2003 |
| | | | ----- | ----- |
| | | | (IN THOUSANDS) | |
| Total assets: | | | | |
| North America | | | \$703,476 | \$523,954 |
| South America | | | 7,728 | 6,433 |
| Africa | | | -- | -- |
| Europe/Asia | | | 63,142 | 52,883 |

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| | | |
|--------------|-----------|-----------|
| Total assets | \$774,346 | \$583,270 |
| | ===== | ===== |

A reconciliation of consolidated geographic operating income from continuing operations to consolidated operating income from continuing operations follows:

| | THREE MONTHS ENDED | | SIX MONTHS ENDED | |
|--|--------------------|---------------|------------------|---------------|
| | JUNE 30, 2004 | JUNE 30, 2003 | JUNE 30, 2004 | JUNE 30, 2003 |
| | (IN THOUSANDS) | | (IN THOUSANDS) | |
| Consolidated geographic operating income | \$ 43,072 | \$ 9,854 | \$ 67,381 | \$ 19,160 |
| Amortization | (973) | (69) | (1,953) | (120) |
| Integration and other charges | (8,123) | (3,775) | (8,804) | (4,190) |
| Operating income | \$ 33,976 | \$ 6,010 | \$ 56,624 | \$ 14,830 |
| | ===== | ===== | ===== | ===== |

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED (UNAUDITED)

NOTE 8 - EARNINGS PER SHARE

The following details the numerators and denominators of the basic and diluted earnings per share computations for net income from continuing operations:

| | THREE MONTHS ENDED | | SIX M |
|--|----------------------------------|---------------|---------------|
| | JUNE 30, 2004 | JUNE 30, 2003 | JUNE 30, 2003 |
| | (IN THOUSANDS, EXCEPT PER SHARE) | | |
| Numerator for basic and diluted earnings per share: | | | |
| Income from continuing operations | \$17,721 | \$ 3,478 | \$30,349 |
| | ----- | ----- | ----- |
| Denominator for basic earnings per share - weighted average shares outstanding: | 29,670 | 27,555 | 29,236 |
| Effect of shares issuable under stock option and stock grant plans, based on the | | | |

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| | | | |
|---|---------|---------|---------|
| treasury stock method | 1,338 | 281 | 1,233 |
| | ----- | ----- | ----- |
| Denominator for diluted earnings per share- Adjusted weighted average shares outstanding | 31,008 | 27,836 | 30,469 |
| | ===== | ===== | ===== |
| Basic earnings per share from continuing operations | \$ 0.60 | \$ 0.13 | \$ 1.04 |
| | ===== | ===== | ===== |
| Diluted earnings per share from continuing operations | \$ 0.57 | \$ 0.13 | \$ 0.99 |
| | ===== | ===== | ===== |

NOTE 9 - NEW ACCOUNTING PRONOUNCEMENT

In April 2004, the FASB issued FASB Staff Position No. 129-1, Disclosure Requirements under FASB Statement No. 129, "Disclosure of Information about Capital Structure," relating to contingently convertible securities ("FSP 129-1"). The purpose of FSP 129-1 is to interpret how the disclosure provisions of FASB Statement No. 129 apply to contingently convertible securities and to their potentially dilutive effects on earnings per share. The guidance in FSP 129-1 is effective April 2004 and applies to all existing and newly created securities. This pronouncement has no effect on the Company.

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED (UNAUDITED)

NOTE 10 - STOCKHOLDERS' EQUITY

On June 15, 2004, we sold 4,000,000 shares of common stock at a price of \$37.50 per share, raising \$142.5 million of net proceeds after deducting the underwriter discounts and commissions. In addition, certain of our directors and officers granted the underwriters a 30-day option to purchase up to 600,000 shares. The 30-day option expired unexercised on July 15, 2004. We intend to use the net proceeds from the offering to fund future acquisitions, to take advantage of business development opportunities, and for general corporate and working capital purposes, including the funding of capital expenditures. Funds that are not immediately used are invested in money market funds, certificates of deposits, and other investment grade securities until needed.

On June 22, 2004, our stockholders approved an amendment to our Certificate of Incorporation that increased the number of shares of our authorized common stock to 75,000,000. The amendment was filed with the Secretary of State of the State of Delaware and became effective on July 22, 2004.

On July 15, 2004, our stockholders approved the increase in number of shares in our 2002 stock incentive plan by 4,000,000, however, we will not issue more than 2,000,000 of these shares without additional stockholder approval.

Statement of Financial Accounting Standard No. 123, "Accounting for

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Stock-Based Compensation" ("SFAS 123"), as amended by Statement of Financial Accounting Standard No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure," ("SFAS 148") establishes a fair value based method of accounting for stock-based employee compensation plans; however, it also allows an entity to continue to measure compensation cost for those plans using the intrinsic value based method of accounting prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"). Under the fair value based method, compensation cost is measured at the grant date based on the value of the award and is recognized over the service period, which is usually the vesting period. Under the intrinsic value based method, compensation cost is the excess, if any, of the quoted market price of the stock at the grant date or other measurement date over the amount an employee must pay to acquire the stock. We have elected to continue to account for our employee stock compensation plans under APB 25 with pro forma disclosures of net earnings and earnings per share, as if the fair value based method of accounting defined in SFAS 123 had been applied. If compensation cost for stock option grants had been determined based on the fair value on the grant dates for the three and six month periods ended June 30, 2004 and 2003 consistent with the method prescribed by SFAS 123, our net earnings and earnings per share would have been adjusted to the pro forma amounts indicated below:

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
 NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED (UNAUDITED)

| | THREE MONTHS ENDED | | SIX M |
|---|---------------------------------------|---------------|--------------|
| | JUNE 30, 2004 | JUNE 30, 2003 | JUNE 30, 200 |
| | (IN THOUSANDS, EXCEPT PER SHARE DATA) | | |
| Net income as reported: | \$ 17,821 | \$ 4,613 | \$ 30,311 |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | (1,290) | (1,156) | (2,533) |
| Add: Employee compensation expense for modification of stock option awards included in reported net income, net of income taxes | 57 | 506 | 57 |
| Pro-forma net income | \$ 16,588 | \$ 3,963 | \$ 27,835 |
| Earnings per share: | | | |
| Basic - as reported | \$ 0.60 | \$ 0.17 | \$ 1.04 |
| Basic - pro-forma | \$ 0.56 | \$ 0.14 | \$ 0.95 |
| Diluted - as reported | \$ 0.57 | \$ 0.17 | \$ 0.99 |
| Diluted - pro-forma | \$ 0.53 | \$ 0.14 | \$ 0.91 |

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NOTE 11 - LEGAL PROCEEDINGS

On January 16, 1998, our Services Division ceased operations in Angola and subsequently became involved in various disputes with SHRM S.A. ("SHRM"), its minority joint venture partner relating to the Angolan joint venture known as Defense System International Africa ("DSIA"). On March 6, 1998, SIA (a subsidiary of SHRM) filed a complaint against Defense Systems France, SA ("DSF") before the Commercial Court of Nanterre (Tribunal de Commerce de Nanterre) seeking to be paid an amount of \$577,286 corresponding to an alleged debt of DSIA to SIA. In October 2002, the Commercial Court of Nanterre stayed the proceedings before it, pending the decisions of the Court of Appeal and the Paris Commercial Court. In February 2003, the Court of Appeal ruled against SHRM and its parent entity, Compass Group, effectively ending all further proceedings on the merits of Compass' claims. Compass has appealed the decision before the French Court of Cassation, which reviews only matters of law.

In 1999 and prior to our acquisition of O'Gara-Hess & Eisenhardt Armoring Company (which has been converted to a limited liability company and is now known as O'Gara-Hess & Eisenhardt Armoring Company, L.L.C.) ("OHEAC") in 2001, O'Gara-Hess & Eisenhardt Armoring de Brasil Ltda.

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED (UNAUDITED)

("OHE Brazil") was audited by the Brazilian federal tax authorities and assessed over Ten Million Reals (US\$3.4 million based on the exchange rate as of December 31, 2003). OHE Brazil has appealed the tax assessment and the case is pending. To the extent that there may be any liability resulting from the 2001 audit, we believe that we are entitled to indemnification from Kroll, Inc. under the terms of our purchase agreement dated April 20, 2001, despite the denial by Kroll, Inc. of any such liability, because the events occurred prior to our purchase of the O'Gara Companies from Kroll, Inc. However, to the extent that the appeal relating to 2001 activity results in an unfavorable ruling, we could be liable for unpaid taxes incurred subsequent to the acquisition from Kroll.

In 1999 and prior to our acquisition of OHEAC in 2001, several of the former employees of Kroll O'Gara Company de Mexico, S.A. de C.V. ("O'Gara Mexico"), a subsidiary of OHEAC, commenced labor claims against O'Gara Mexico seeking damages for unjustified termination. These cases are still pending before the labor board in Mexico City. The terminated employees are seeking back pay and benefits since the date of termination amounting to approximately US \$2.9 million, and accruing at approximately US \$50,400 per month. To the extent that there may be any liability, we believe that we are entitled to indemnification from Kroll, Inc. under the terms of our purchase agreement dated April 20, 2001, despite the denial by Kroll, Inc. of any such liability, because the events occurred prior to our purchase of the O'Gara Companies from Kroll, Inc. Although we do not have any insurance coverage for this matter, at this time, we do not believe this matter will have a material impact on our financial position, operations or liquidity.

In December 2001, O'Gara-Hess & Eisenhardt France S.A. ("OHE France") sold its industrial bodywork business operated under the name Labbe/Division de O'Gara Hess & Eisenhardt France/ Carrosserie Industriells to SNC Labbe. Subsequent to the sale, the Labbe Family Trust ("LFT"), owner of the leasehold interest upon which the Carrosserie business is operated, sued OHE France and SNC Labbe claiming that the transfer of the leasehold was not valid because the

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LFT had not given its consent to the transfer as required under the terms of the lease. Further, LFT seeks to have OHE France, as the sole tenant, maintain and repair the leased building. The approximate cost of renovating the building is estimated to be between US \$3.2 and US \$6.4 million, based on the exchange rate as of December 31, 2003. The case is currently pending, and while we are contesting the allegations vigorously, we are unable to predict the outcome of this matter. Although we do not have any insurance coverage for this matter, at this time, we do not believe this matter will have a material impact on our financial position, operations or liquidity.

On October 18, 2002, we were notified by the Internal Revenue Service that our tax return for the tax year ended December 31, 2000 had been selected for examination. Further, on January 30, 2003 we were notified that our tax return for the tax year ended December 31, 2001 had been selected for examination. In April 2004, we reached an agreement with the Internal Revenue Service regarding our tax returns for the years ended December 31, 2000 and 2001 that did not have a material impact on our financial position, operations or liquidity.

In October 2002, we were sued in the United States District Court for the District of Wyoming with respect to one of our subsidiaries' Casper, Wyoming tear gas plant. The plaintiffs in the lawsuit asserted various state law tort claims and federal environmental law claims under the Resource Conservation and Recovery Act and the Clean Air Act stemming from the tear gas plant. In February

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED (UNAUDITED)

2004, we agreed with the plaintiffs to settle the lawsuit for an amount of money that is not material to us, and on April 19, 2004, the court dismissed the lawsuit with prejudice.

In September 2003, Second Chance Body Armor, Inc. ("Second Chance"), a body armor manufacturer and competitor to Armor Holdings, notified its customers of a potential safety issue with its Ultima(R) and Ultimax(R) models. Second Chance has claimed that Zylon(R) fiber, which is made by Toyobo, a Japanese corporation, and used in the ballistic fabric construction of those two models, degraded more rapidly than originally anticipated. Second Chance has also stated that the Zylon(R) degradation problem affects the entire body armor industry, not just its products. Both private claimants and State Attorneys General have already commenced legal action against Second Chance based upon its Ultima(R) and Ultimax(R) model vests.

We use Zylon(R) fiber in a number of concealable body armor models for law enforcement, but our vest design and construction are different from Second Chance. In addition, to our knowledge, no other body armor manufacturer has reported or experienced problems with Zylon(R)-based vests similar to those cited by Second Chance. The National Institute of Justice ("NIJ") tests and has certified each of our body armor designs before we begin to produce or sell any particular model.

In the Fall of 2003, following the assertions made by Second Chance, several law enforcement associations raised this issue to the U.S. Attorney General ("USAG"), who then asked the DOJ through the NIJ to investigate these concerns and attempt to clarify the issues. We have and continue to support the Attorney General's directive and investigation.

As a result of the USAG's and DOJ's initiative, the NIJ commenced an

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inquiry and investigation regarding the protocol for testing used vests, as well as the reliability of Zylon(R) and other ballistic fibers. We have consulted and continue to cooperate fully with the NIJ in this endeavor. To date, the NIJ has embarked only in its first phase of testing, which entails vests that have been heavily worn or exposed to adverse conditions, and which utilized the ballistic testing standard applicable to new vests. Although some of the vests tested, including ours, experienced a penetration, the NIJ specifically warned against the misuse and misinterpretation of these results, emphasizing that the data produced so far is preliminary in nature, applies to a very small sample size and therefore it is not possible to draw any definitive conclusions from these results. The NIJ will continue to conduct further testing and analyze these issues in order to determine if any conclusions can be reached as to the performance and reliability of aged vests. We have requested the NIJ to provide us with its testing data, and we intend to evaluate and review the NIJ's results upon our receipt of such data in our continuing effort to assist the NIJ in developing uniform standards for certification of new vests and the testing of used vests.

In April 2004, two class action complaints were filed in Florida state court by police organizations and individual police officers, alleging, among other things, that our vests do not have the qualities and performance characteristics as warranted, thereby breaching express warranty, implied warranty of merchantability, implied warranty of fitness for a particular purpose and duty to warn. The complaints allege no specific amount, although it has been publicly stated that they are seeking \$77 million in compensatory damages. We disagree with the allegations set forth in these complaints, are vigorously defending these lawsuits and have moved to dismiss the claims asserted against us. However, any adverse resolution of these matters could have a material adverse effect on our business,

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED (UNAUDITED)

financial condition, results of operations and liquidity. We have also received investigative demands from state agencies in Texas and Connecticut to which we have complied, as well as letters from two private attorneys threatening potential litigation.

It should be stressed that our vests are certified by the NIJ, have never suffered any penetration in the field and continue to save lives and protect officers from injury. In fact, neither of the two recently commenced lawsuits allege personal injuries of any kind, but instead speculate that our vests which contain Zylon(R) are defective without any reliable evidence of any defect.

Second Chance licenses from Simula a certain patented technology, which is used in some of the body armor it manufactures, but to our knowledge, no lawsuit has yet been brought against Second Chance based upon this licensed technology. Although Simula may be impacted by the pending suits filed against Second Chance, the licensed technology is not specifically related to the use of Zylon(R) fiber, however, any adverse resolution of these matters could have a material adverse effect on our business, financial condition, results of operations and liquidity.

In addition to the above, in the normal course of business, we are subjected to various types of claims and currently have on-going litigations in the areas of products liability and general liability. Our products are used in a wide variety of law enforcement situations and environments. Some of our products can cause serious personal or property injury or death if not carefully

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and properly used by adequately trained personnel. We believe that we have adequate insurance coverage for most claims that are incurred in the normal course of business. In such cases, the effect on our financial statements is generally limited to the amount of our insurance deductible or self-insured retention. Our annual insurance premiums and self insurance retention amounts have risen significantly over the past several years and may continue to do so to the extent we are unable to purchase insurance coverage. At this time, we do not believe any such claims or pending litigation will have a material impact on our financial position, operations and liquidity.

Except for the updates noted above, please see footnote 11 Commitments and Contingencies Legal/Litigation Matters in our Annual Report on Form 10-K/A for the fiscal year ended December 31, 2003, for a description of other legal proceedings.

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED (UNAUDITED)

NOTE 12 - GUARANTOR AND NONGUARANTOR FINANCIAL STATEMENTS

On August 12, 2003 we sold \$150 million of Senior Subordinated Notes in private placements pursuant to Rule 144A and Regulation S. The Senior Subordinated Notes are uncollateralized obligations and rank junior in right of payment to our existing and future senior debt. The Senior Subordinated Notes are guaranteed, jointly and severally on a senior subordinated and uncollateralized basis, by certain domestic subsidiaries.

The following condensed consolidating financial information presents the condensed consolidating balance sheets as of June 30, 2004 and December 31, 2003, the related condensed consolidating statements of operations for each of the three and six-month periods ended June 30, 2004 and June 30, 2003 and the related condensed consolidating statements of cash flows for the six month periods ended June 30, 2004 and June 30, 2003 for:

- a) Armor Holdings, Inc., the parent,
- b) the guarantor subsidiaries,
- c) the nonguarantor subsidiaries, and
- d) Armor Holdings, Inc. on a consolidated basis

The information includes elimination entries necessary to consolidate Armor Holdings, Inc., the parent, with the guarantor and nonguarantor subsidiaries.

Investments in subsidiaries are accounted for by the parent using the equity method of accounting. The guarantor and nonguarantor subsidiaries are presented on a combined basis. The principal elimination entries eliminate investments in subsidiaries and intercompany balances and transactions. Separate financial statements for the guarantor and nonguarantor subsidiaries are not presented because management believes such financial statements would not be meaningful to investors.

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
 NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED (UNAUDITED)

ARMOR HOLDINGS, INC. AND SUBSIDIARIES CONDENSED CONSOLIDATING BALANCE SHEETS

| | JUNE 30, 200 | | |
|---|----------------|---------------------------|----------------------------|
| | PARENT | GUARANTOR SUBSIDIARIES | NONGUARANTO SUBSIDIARIE |
| | (IN THOUSANDS) | | |
| ASSETS | | | |
| Current Assets: | | | |
| Cash and cash equivalents | \$ 213,065 | \$ 2,108 | \$ 13,910 |
| Accounts receivable, net | -- | 96,296 | 14,525 |
| Costs and earned gross profit in excess of billings | -- | 834 | -- |
| Intercompany receivables | 62,608 | 44,475 | 38,352 |
| Inventories | -- | 89,252 | 23,271 |
| Prepaid expenses and other current assets | 3,809 | 22,383 | 3,659 |
| Current assets of discontinued operations | -- | 41,455 | 6,235 |
| | ----- | ----- | ----- |
| Total Current Assets | 279,482 | 296,803 | 99,952 |
| Property and equipment, net | 2,741 | 37,857 | 19,182 |
| Goodwill, net | -- | 174,094 | 2,075 |
| Patents, licenses and trademarks, net | -- | 44,950 | 177 |
| Other assets | 10,546 | 2,107 | 158 |
| Long-term assets of discontinued operations | -- | 458 | -- |
| Investment in subsidiaries | 440,257 | 10,672 | -- |
| | ----- | ----- | ----- |
| Total Assets | \$ 733,026 | \$ 566,941 | \$ 121,544 |
| | ===== | ===== | ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | |
| Current Liabilities: | | | |
| Current portion of long-term debt | \$ -- | \$ 574 | \$ 143 |
| Short-term debt | -- | -- | 1,274 |
| Accounts payable | 1,245 | 41,624 | 6,832 |
| Accrued expenses and other current liabilities | 8,786 | 33,740 | 20,011 |
| Income taxes payable | (2,735) | 13,559 | 1,917 |
| Intercompany payables | 85,984 | 46,444 | 13,029 |
| Current liabilities of discontinued operations | -- | 3,883 | 43,243 |
| | ----- | ----- | ----- |
| Total Current Liabilities | 93,280 | 139,824 | 86,449 |
| Long-term debt, less current portion | 149,382 | 1,663 | 497 |
| Other long-term liabilities | (1,851) | 5,263 | 1,207 |
| Long-term liabilities of discontinued operations | -- | 2,653 | -- |
| | ----- | ----- | ----- |
| Total Liabilities | 240,811 | 149,403 | 88,153 |

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| | | | |
|--|------------|------------|------------|
| Stockholders' Equity: | | | |
| Preferred stock | -- | 1,450 | -- |
| Common stock | 389 | 4,392 | 7,854 |
| Additional paid in capital | 485,512 | 265,598 | 46,095 |
| Retained earnings (accumulated deficit) | 75,253 | 146,098 | (20,558) |
| Accumulated other comprehensive loss | 3,378 | -- | -- |
| Treasury stock | (72,317) | -- | -- |
| | ----- | ----- | ----- |
| Total Stockholders' Equity | 492,215 | 417,538 | 33,391 |
| | ----- | ----- | ----- |
| Total Liabilities and Stockholders' Equity | \$ 733,026 | \$ 566,941 | \$ 121,544 |
| | ===== | ===== | ===== |

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED (UNAUDITED)

ARMOR HOLDINGS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATING BALANCE SHEETS

| | DECEMBER 31, 2003 | | |
|---|-------------------|---------------------------|------------------------------|
| | PARENT | GUARANTOR SUBSIDIARIES | NONGUARANTOR SUBSIDIARIES |
| ASSETS | (IN THOUSANDS) | | |
| Current Assets: | | | |
| Cash and cash equivalents | \$ 90,764 | \$ 11,084 | \$ 10,002 |
| Restricted cash | 2,600 | - | - |
| Accounts receivable, net | 1,201 | 59,470 | 11,964 |
| Costs and earned gross profit in excess of billings | - | - | - |
| Intercompany receivables | 60,974 | 2,600 | 38,352 |
| Inventories | - | 61,494 | 19,033 |
| Prepaid expenses and other current assets | 20,241 | 1,844 | 2,600 |
| Current assets of discontinued operations | - | 753 | - |
| | ----- | ----- | ----- |
| Total Current Assets | 175,780 | 137,245 | 81,951 |
| Property and equipment, net | 2,122 | 34,853 | 20,601 |
| Goodwill, net | - | 173,640 | 2,067 |
| Patents, licenses and trademarks, net | - | 43,991 | 183 |
| Other assets | 14,092 | 1,924 | 153 |
| Long-term assets of discontinued operations | - | 1,603 | - |
| Investment in subsidiaries | 320,034 | 10,038 | - |
| | ----- | ----- | ----- |
| Total Assets | \$512,028 | \$403,294 | \$ 104,955 |
| | ===== | ===== | ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | |
| Current Liabilities: | | | |
| Current portion of long-term debt | \$ - | \$ 31,960 | \$ 147 |
| Short-term debt | - | - | 498 |
| Accounts payable | 1,584 | 20,941 | 7,779 |

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| | | | |
|---|------------------|------------------|-------------------|
| Accrued expenses and other current liabilities | 12,403 | 27,113 | 18,702 |
| Income taxes payable | - | - | - |
| Intercompany payables | 44,251 | 47,073 | 9,933 |
| Current liabilities of discontinued operations | - | (35,714) | 37,009 |
| Total Current Liabilities | 58,238 | 91,373 | 74,068 |
| Long-term debt, less current portion | 153,452 | 4,257 | 591 |
| Other long-term liabilities | 4,973 | 4,008 | 1,227 |
| Long-term liabilities of discontinued operations | - | 2,653 | - |
| Total Liabilities | 216,663 | 102,291 | 75,886 |
| Stockholders' Equity: | | | |
| Preferred stock | - | 1,450 | - |
| Common stock | 344 | 4,143 | 7,854 |
| Additional paid in capital | 318,460 | 191,781 | 46,095 |
| Retained earnings (accumulated deficit) | 44,942 | 103,629 | (24,880) |
| Accumulated other comprehensive loss | 3,936 | - | - |
| Treasury stock | (72,317) | - | - |
| Total Stockholders' Equity | 295,365 | 301,003 | 29,069 |
| Total Liabilities and Stockholders' Equity | \$512,028 | \$403,294 | \$ 104,955 |

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED (UNAUDITED)

ARMOR HOLDINGS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS

| | THREE MONTHS ENDED JUNE 30, 20 | | |
|-------------------------------|--------------------------------|---------------------------|------------------------------|
| | PARENT | GUARANTOR SUBSIDIARIES | NONGUARANTOR SUBSIDIARIES |
| | | | (IN THOUSANDS) |
| REVENUES: | | | |
| Aerospace & Defense | \$ -- | \$ 129,773 | \$ -- |
| Products | -- | 53,367 | 12,376 |
| Mobile Security | -- | 6,216 | 22,604 |
| Total revenues | -- | 189,356 | 34,980 |
| COSTS AND EXPENSES: | | | |
| Cost of sales | -- | 130,793 | 27,085 |
| Operating expenses | 5,246 | 15,252 | 2,888 |
| Amortization | -- | 970 | 3 |
| Integration and other charges | 7,431 | 692 | -- |

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| | | | |
|---|-----------|-----------|----------|
| Related party management (income) fees | -- | (1) | 1 |
| | ----- | ----- | ----- |
| OPERATING (LOSS) INCOME: | (12,677) | 41,650 | 5,003 |
| Interest expense, net | 1,890 | 144 | 23 |
| Other expense, net | (23) | (338) | (29) |
| Equity in (earnings) losses of subsidiaries | (29,840) | (812) | -- |
| | ----- | ----- | ----- |
| INCOME FROM CONTINUING OPERATIONS BEFORE (BENEFIT) PROVISION FOR INCOME TAXES | 15,296 | 42,656 | 5,009 |
| (BENEFIT) PROVISION FOR INCOME TAXES | (2,525) | 15,246 | 1,867 |
| | ----- | ----- | ----- |
| INCOME FROM CONTINUING OPERATIONS | 17,821 | 27,410 | 3,142 |
| DISCONTINUED OPERATIONS: | | | |
| Income from discontinued operations, net of tax | -- | 100 | -- |
| | ----- | ----- | ----- |
| NET INCOME | \$ 17,821 | \$ 27,510 | \$ 3,142 |
| | ===== | ===== | ===== |

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED (UNAUDITED)

ARMOR HOLDINGS INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS

| | THREE MONTHS ENDED JUNE 30, 20 | | | |
|-------------------------------|--------------------------------|---------------------------|------------------------------|-------|
| | PARENT | GUARANTOR SUBSIDIARIES | NONGUARANTOR SUBSIDIARIES | ELI |
| | ----- | ----- | ----- | ----- |
| | (IN THOUSANDS) | | | |
| REVENUES: | | | | |
| Aerospace & Defense Products | \$ -- | \$ 15,793 | \$ -- | \$ -- |
| Mobile Security | -- | 39,069 | 10,278 | -- |
| | -- | 2,980 | 13,539 | -- |
| | ----- | ----- | ----- | ----- |
| Total revenues | -- | 57,842 | 23,817 | -- |
| | ----- | ----- | ----- | ----- |
| COSTS AND EXPENSES: | | | | |
| Cost of sales | -- | 37,938 | 19,343 | -- |
| Operating expenses | 2,470 | 9,485 | 2,569 | -- |
| Amortization | -- | 67 | 2 | -- |
| Integration and other charges | 3,273 | 502 | -- | -- |
| | ----- | ----- | ----- | ----- |

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| | | | |
|---|----------|----------|----------|
| OPERATING (LOSS) INCOME: | (5,743) | 9,850 | 1,903 |
| Interest expense, net | 267 | 121 | 49 |
| Other expense, net | -- | 2 | 14 |
| Equity in earnings of subsidiaries | (8,421) | (119) | -- |
| Related parting interest expense (income), net | 16 | (16) | -- |
| | ----- | ----- | ----- |
| INCOME FROM CONTINUING OPERATIONS BEFORE (BENEFIT) PROVISION FOR INCOME TAXES | 2,395 | 9,862 | 1,840 |
| (BENEFIT) PROVISION FOR INCOME TAXES | (2,218) | 3,703 | 594 |
| | ----- | ----- | ----- |
| INCOME FROM CONTINUING OPERATIONS | 4,613 | 6,159 | 1,246 |
| DISCONTINUED OPERATIONS: | | | |
| (Loss) income from discontinued operations, net of tax | -- | (6) | 1,141 |
| | ----- | ----- | ----- |
| NET INCOME | \$ 4,613 | \$ 6,153 | \$ 2,387 |
| | ===== | ===== | ===== |

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED (UNAUDITED)

ARMOR HOLDINGS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS

| | SIX MONTHS ENDED JUNE 30, 200 | | |
|--|-------------------------------|---------------------------|------------------------------|
| | PARENT | GUARANTOR SUBSIDIARIES | NONGUARANTOR SUBSIDIARIES |
| | ----- | ----- | ----- |
| | (IN THOUSANDS) | | |
| REVENUES: | | | |
| Aerospace & Defense Products | \$ -- | \$ 210,781 | \$ -- |
| Mobile Security | -- | 97,616 | 21,967 |
| | -- | 11,583 | 44,536 |
| | ----- | ----- | ----- |
| Total revenues | -- | 319,980 | 66,503 |
| | ----- | ----- | ----- |
| COSTS AND EXPENSES: | | | |
| Cost of sales | -- | 219,143 | 53,322 |
| Operating expenses | 8,748 | 31,639 | 6,250 |
| Amortization | -- | 1,947 | 6 |
| Integration and other charges | 7,521 | 1,283 | -- |
| Related party management (income) fees | 16 | (18) | 2 |
| | ----- | ----- | ----- |
| OPERATING (LOSS) INCOME | (16,285) | 65,986 | 6,923 |
| Interest expense, net | 3,546 | 176 | 63 |

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| | | | |
|---|-----------|-----------|----------|
| Other expense (income), net | 27 | (322) | 20 |
| Equity in (earnings) losses of subsidiaries | (46,161) | (630) | -- |
| | ----- | ----- | ----- |
| INCOME FROM CONTINUING OPERATIONS BEFORE PROVISION (BENEFIT) FOR INCOME TAXES | 26,303 | 66,762 | 6,840 |
| PROVISION (BENEFIT) FOR INCOME TAXES | (4,008) | 24,255 | 2,518 |
| | ----- | ----- | ----- |
| INCOME FROM CONTINUING OPERATIONS | 30,311 | 42,507 | 4,322 |
| DISCONTINUED OPERATIONS: | | | |
| (Loss) from discontinued operations, net of tax | -- | (38) | -- |
| | ----- | ----- | ----- |
| NET INCOME | \$ 30,311 | \$ 42,469 | \$ 4,322 |
| | ===== | ===== | ===== |

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED (UNAUDITED)

ARMOR HOLDINGS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS

| | SIX MONTHS ENDED JUNE 30, | | |
|------------------------------------|---------------------------|---------------------------|------------------------------|
| | PARENT | GUARANTOR SUBSIDIARIES | NONGUARANTOR SUBSIDIARIES |
| | ----- | ----- | ----- |
| | (IN THOUSANDS) | | |
| REVENUES: | | | |
| Aerospace & Defense | \$ -- | \$ 31,703 | \$ -- |
| Products | -- | 75,753 | 17,601 |
| Mobile Security | -- | 7,069 | 30,007 |
| | ----- | ----- | ----- |
| Total revenues | -- | 114,525 | 47,608 |
| | ----- | ----- | ----- |
| COSTS AND EXPENSES: | | | |
| Cost of sales | -- | 75,158 | 39,285 |
| Operating expenses | 4,542 | 18,787 | 5,199 |
| Amortization | -- | 124 | 5 |
| Integration and other charges | 3,349 | 848 | -- |
| | ----- | ----- | ----- |
| OPERATING (LOSS) INCOME: | (7,891) | 19,608 | 3,119 |
| Interest expense, net | 495 | 191 | 130 |
| Other expense, net | -- | 2 | 83 |
| Equity in earnings of subsidiaries | (15,085) | 163 | -- |
| Related parting interest expense | | | |

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| | | | |
|--|----------|-----------|----------|
| (income), net | 16 | (16) | -- |
| | ----- | ----- | ----- |
| INCOME FROM CONTINUING OPERATIONS BEFORE (BENEFIT) PROVISION FOR INCOME TAXES | 6,683 | 19,268 | 2,906 |
| (BENEFIT) PROVISION FOR INCOME TAXES | (3,017) | 7,263 | 966 |
| | ----- | ----- | ----- |
| INCOME FROM CONTINUING OPERATIONS | 9,700 | 12,005 | 1,940 |
| DISCONTINUED OPERATIONS: | | | |
| (Loss) income from discontinued operations, net of tax | -- | (453) | 1,430 |
| | ----- | ----- | ----- |
| NET INCOME | \$ 9,700 | \$ 11,552 | \$ 3,370 |
| | ===== | ===== | ===== |

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED (UNAUDITED)

ARMOR HOLDINGS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS

| | SIX MONTHS ENDED JUNE 30, 2012 | | |
|---|--------------------------------|---------------------------|------------------------------|
| | PARENT | GUARANTOR SUBSIDIARIES | NONGUARANTOR SUBSIDIARIES |
| | ----- | ----- | ----- |
| | | | (IN THOUSAND) |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Income from continuing operations | \$ 30,311 | \$ 42,507 | \$ 4,322 |
| Adjustments to reconcile income from continuing operations to cash provided by (used in) operating activities: | | | |
| Depreciation and amortization | 556 | 4,735 | 1,312 |
| Loss on disposal of fixed assets | -- | 106 | 9 |
| Deferred income taxes | 492 | (665) | (24) |
| Non-cash charge for acceleration of performance-based restricted stock awards | 5,913 | -- | -- |
| Non-cash impairment charge | 1,408 | -- | -- |
| Changes in operating assets & liabilities, net of acquisitions: | | | |
| Decrease (increase) in accounts receivable | 1,201 | (37,412) | (2,561) |
| Decrease (increase) in intercompany receivables & payables | 38,134 | (41,229) | 3,095 |
| Increase in inventory | -- | (27,759) | (4,238) |
| (Increase) decrease in prepaid expenses | | | |

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| | | | |
|---|------------|----------|-----------|
| & other assets | (3,678) | (4,491) | (712) |
| (Decrease) increase in accounts payable, accrued expenses and other current liabilities | (1,153) | 28,440 | 362 |
| Increase (decrease) in income taxes payable | 17,515 | (1,609) | 1,569 |
| | ----- | ----- | ----- |
| Net cash provided by (used in) operating activities | 90,699 | (37,377) | 3,134 |
| | ----- | ----- | ----- |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Purchase of property and equipment | (902) | (5,570) | (632) |
| Purchase of patents and trademarks | -- | (77) | -- |
| Purchase of equity investment | -- | (5,275) | -- |
| Proceeds from sale of equity investment | -- | 5,823 | -- |
| Collection of note receivable | 375 | -- | -- |
| Decrease in restricted cash | 2,600 | -- | -- |
| Additional consideration for purchased businesses | -- | (1,855) | -- |
| Investment in subsidiaries | (120,224) | 73,433 | -- |
| Purchase of businesses net of cash acquired | -- | (2,729) | -- |
| | ----- | ----- | ----- |
| Net cash (used in) provided by investing activities | (118,151) | 63,750 | (632) |
| | ----- | ----- | ----- |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | |
| Proceeds from exercise of stock options | 8,310 | -- | -- |
| Proceeds from the issuance of common stock | 142,500 | -- | -- |
| Cash paid for common stock offering costs | (1,057) | -- | -- |
| Repayments of long-term debt | -- | (33,981) | (71) |
| Borrowings under lines of credit | 8,083 | -- | 802 |
| Repayments under lines of credit | (8,083) | -- | (39) |
| | ----- | ----- | ----- |
| Net cash provided by (used in) financing activities | 149,753 | (33,981) | 692 |
| | ----- | ----- | ----- |
| Effect of exchange rate on cash and cash equivalents | -- | (651) | 714 |
| Net cash used in discontinued operations | -- | (717) | -- |
| | ----- | ----- | ----- |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 122,301 | (8,976) | 3,908 |
| | ----- | ----- | ----- |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | 90,764 | 11,084 | 10,002 |
| | ----- | ----- | ----- |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | \$ 213,065 | \$ 2,108 | \$ 13,910 |
| | ===== | ===== | ===== |

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES CONDENSED CONSOLIDATING STATEMENTS OF CASH FLOWS

| | SIX MONTHS ENDED JUNE 30, 2017 | | |
|---|--------------------------------|---------------------------|------------------------------|
| | PARENT | GUARANTOR SUBSIDIARIES | NONGUARANTOR SUBSIDIARIES |
| | | | (IN THOUSANDS) |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Income from continuing operations | \$ 9,700 | \$ 12,005 | \$ 1,940 |
| Adjustments to reconcile income from continuing operations to cash used in operating activities | | | |
| Depreciation and amortization | 514 | 2,005 | 949 |
| Deferred income taxes | (5,330) | 5,912 | 1,131 |
| (Gain) loss on disposal of fixed assets | -- | (3) | 42 |
| Non-cash termination charge | 2,093 | -- | -- |
| Changes in operating assets & liabilities, net of acquisitions | | | |
| Decrease (increase) in accounts receivable | -- | 350 | (1,103) |
| Decrease (increase) in intercompany receivables & payables | 11,697 | (12,294) | 597 |
| Decrease in inventory | -- | 679 | 653 |
| Increase in prepaid expenses & other assets | (2,107) | (933) | (1,130) |
| Increase (decrease) in accounts payable, accrued expenses and other current liabilities | 3,252 | (1,505) | 2,224 |
| (Decrease) increase in income taxes payable | (3,998) | 148 | 202 |
| Net cash provided by operating activities | 15,821 | 6,364 | 5,505 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Purchase of property and equipment | (81) | (2,176) | (1,661) |
| Purchase of patents and trademarks | -- | (38) | -- |
| Additional consideration for purchased businesses | -- | (243) | -- |
| Investment in subsidiaries | (14,735) | (52) | (135) |
| Net cash used in investing activities | (14,816) | (2,509) | (1,796) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | |
| Proceeds from exercise of options | 136 | -- | -- |
| Repurchase of treasury stock | (22,684) | -- | -- |
| Repayments of long-term debt | -- | (362) | -- |
| Borrowings under lines of credit | 29,809 | -- | 396 |
| Repayments under lines of credit | (14,809) | -- | (200) |
| Net cash (used in) provided by financing activities | (7,548) | (362) | 196 |
| Effect of exchange rate on cash and cash equivalents | 2,230 | (323) | (1,440) |
| Net cash used in discontinued operations | -- | (3,777) | 383 |

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| | | | |
|--|----------|----------|----------|
| NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS | (4,313) | (607) | 2,848 |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | 7,152 | 3,556 | 2,205 |
| | ----- | ----- | ----- |
| CASH AND CASH EQUIVALENTS, END OF PERIOD | \$ 2,839 | \$ 2,949 | \$ 5,053 |
| | ===== | ===== | ===== |

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
 NOTES TO CONDENSED AND CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED (UNAUDITED)

NOTE 13 - CREDIT AGREEMENT AMENDMENT

On March 29, 2004, we amended our credit agreement to allow us to pay dividends subject to certain limitations.

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

The following is a discussion of the results of operations and analysis of financial condition for the three months and six months ended June 30, 2004. The results of operations for purchase business combinations are included since their effective acquisition dates. The following discussion may be understood more fully by reference to the consolidated financial statements, notes to the consolidated financial statements, and management's discussion and analysis contained in our Annual Report on Form 10-K/A for the year ended December 31, 2003, as filed with the Securities and Exchange Commission.

CRITICAL ACCOUNTING POLICIES (INCLUDING NEW ACCOUNTING PRONOUNCEMENTS):

Revenue Recognition. We record products revenue at the time of shipment. Returns are minimal and do not materially affect the financial statements.

We record revenue from our Aerospace & Defense Group and Mobile Security Division when the vehicle is shipped, except for larger commercial contracts typically longer than four months in length and the contract for the delivery of HMMWVs to the U.S. Government, which continues through 2005. Revenue from such contracts is recognized on the percentage of completion, units-of-work performed method. HMMWV units sold to the U.S. Government are considered complete when the onsite Department of Defense officer finishes the inspection of the HMMWV and approves it for delivery. Should such contracts be in a loss position, the entire estimated loss would be recognized for the balance of the

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contract at such time. Current contracts are profitable.

We record service revenue as services are provided on a contract-by-contract basis. Revenues from service contracts are recognized over the term of the contract.

Comprehensive income and foreign currency translation. In accordance with Statement of Financial Accounting Standard No. 130, "Reporting Comprehensive Income" ("SFAS 130"), assets and liabilities denominated in a foreign currency are translated into U.S. dollars at the current rate of exchange existing at period-end and revenues and expenses are translated at the average monthly exchange rates. In accordance with Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS 115"), we record changes in the market value of available-for-sale securities in the accumulated other comprehensive income caption of stockholders' equity in the condensed consolidated balance sheet, until we dispose of the securities. Once these securities are disposed of, either by sale or maturity, the gain or loss is recognized in other income or expense. The cumulative translation adjustment, which represents the effect of translating assets and liabilities of our foreign operations is recorded as an increase of equity of \$3,378,000 and \$3,936,000 as of June 30, 2004 and December 31, 2003, respectively, and is classified as accumulated other comprehensive income. The current year change in the accumulated amount is included as a component of comprehensive income.

Stock options and Grants. SFAS 123, as amended by SFAS 148, establishes a fair value based method of accounting for stock-based employee compensation plans; however, it also allows an entity to continue to measure

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS - CONTINUED

compensation cost for those plans using the intrinsic value based method of accounting prescribed by APB 25. Under the fair value based method, compensation cost is measured at the grant date based on the value of the award and is recognized over the service period, which is usually the vesting period.

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS - CONTINUED

Under the intrinsic value based method, compensation cost is the excess, if any, of the quoted market price of the stock at the grant date or other measurement date over the amount an employee must pay to acquire the stock. We have elected to continue to account for our employee stock compensation plans under APB 25 with pro forma disclosures of net earnings and earnings per share, as if the fair value based method of accounting defined in SFAS 123 had been applied. If compensation cost for stock option grants had been determined based on the fair value on the grant dates for June 30, 2004 and 2003 consistent with the method prescribed by SFAS 123, our net earnings and earnings per share would have been adjusted to the pro forma amounts indicated below:

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| | THREE MONTHS ENDED | | SIX MONTHS EN |
|---|--------------------|---------------|---------------|
| | JUNE 30, 2004 | JUNE 30, 2003 | JUNE 30, 2004 |
| (IN THOUSANDS, EXCEPT PER SHARE DATA) | | | |
| Net income as reported: | \$ 17,821 | \$ 4,613 | \$ 30,311 |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | (1,290) | (1,156) | (2,533) |
| Add: Employee compensation expense for modification of stock option awards included in reported net income, net of income taxes | 57 | 506 | 57 |
| Pro-forma net income | \$ 16,588 | \$ 3,963 | \$ 27,835 |
| Earnings per share: | | | |
| Basic - as reported | \$ 0.60 | \$ 0.17 | \$ 1.04 |
| Basic - pro-forma | \$ 0.56 | \$ 0.14 | \$ 0.95 |
| Diluted - as reported | \$ 0.57 | \$ 0.17 | \$ 0.99 |
| Diluted - pro-forma | \$ 0.53 | \$ 0.14 | \$ 0.91 |

Discontinued Operations. In accordance with Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"), a component classified as held for sale is reported in discontinued operations when the following conditions are met: (a) the operations and cash flows of the component have been (or will be) eliminated from the ongoing operations of the entity as a result of the disposal transaction and (b) the entity will not have any significant continuing involvement in the operations of the component after the disposal transaction. In a period in which a component of an entity either has been disposed of or is classified as held for sale, the income statement for current and prior periods reports the results of operations of the component,

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS - CONTINUED

including any gain or loss recognized in accordance with SFAS 144, in discontinued operations. The results of discontinued operations, less applicable income taxes (benefit), is reported as a separate component of income before

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extraordinary items and the cumulative effect of accounting changes (if applicable). The assets and liabilities of a disposal group classified as held for sale is presented separately in the asset and liability sections, respectively, of the statement of financial position. See Note 2 to the Condensed and Consolidated Financial Statements included in this report.

Derivative Instruments and Hedging Activities. We account for derivative instruments in accordance with SFAS 133. All derivative instruments are recorded on the balance sheet at fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction and, if it is, depending on the type of hedge transaction. For fair-value hedge transactions in which we hedge changes in an asset's, liability's, or firm commitment's fair value, changes in the fair value of the derivative instrument will generally be offset in the income statement by changes in the hedged item's fair value. We do not hold or issue interest rate swap agreements or other derivative instruments for trading purposes.

Changes in the fair value of the interest rate swap agreements offset changes in the fair value of the fixed rate debt due to changes in the market interest rate. Accordingly, other assets on the Condensed Consolidated Balance Sheet as of June 30, 2004 decreased by \$4.2 million from December 31, 2003, which reflected a decrease in the fair value of the interest rate swap agreements. The corresponding increase in the hedge liability was recorded in long-term debt. The agreements are deemed to be a perfectly effective fair value hedge and therefore qualify for the short-cut method of accounting under SFAS 133. As a result, no ineffectiveness is expected to be recognized in our earnings associated with the interest rate swap agreements.

Goodwill. Goodwill represents the excess of the purchase price over the fair value of the net assets acquired in a purchase business combination. Goodwill and other intangible assets are stated on the basis of cost. The \$124.8 million in goodwill resulting from acquisitions made subsequent to June 30, 2001 was immediately subjected to the non-amortization provisions of SFAS 142.

Estimates. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts in the financial statements and accompanying notes. Significant estimates inherent in the preparation of the accompanying condensed consolidated financial statements include periodic testing of the carrying value of long-lived assets for impairment, valuation allowances for receivables, inventories and deferred income tax assets, liabilities for potential litigation claims and settlements, and contract contingencies and obligations. Actual results could differ from those estimates.

Impairment. Long-lived assets including certain identifiable intangibles, and the goodwill related to those assets, are reviewed annually for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset in question may not be recoverable including, but not limited to, a deterioration of profits for a business segment that has long-lived assets, and when other changes occur which might impair recovery of long-lived assets. Management reviewed our long-lived assets and has taken an impairment charge of \$12.4 million in fiscal 2003 to reduce the carrying value of the Services Division to estimated realizable value. The method used to determine the existence of an

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impairment would generally be discounted operating cash flows estimated over the remaining useful lives of the related long-lived assets for continuing operations in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets." Impairment is measured as the difference between fair value and unamortized cost at the date impairment is determined.

On June 30, 2004, our litigation support services subsidiary, New Technologies Armor, Inc. ("NTI"), was the last remaining business in discontinued operations. On July 2, 2004, we sold the security consulting division of NTI. The remaining division in NTI, consisting primarily of training services, will be included as part of the Products Division segment. In the second quarter of 2004, we recorded an impairment charge of \$1.4 million in integration and other charges in continuing operations to reduce the carrying value of remaining portion of NTI to its estimated fair value.

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS - CONTINUED

NEW ACCOUNTING PRONOUNCEMENT:

In April 2004, the FASB issued FASB Staff Position No. 129-1, Disclosure Requirements under FASB Statement No. 129, "Disclosure of Information about Capital Structure," relating to contingently convertible securities ("FSP 129-1"). The purpose of FSP 129-1 is to interpret how the disclosure provisions of FASB Statement No. 129 apply to contingently convertible securities and to their potentially dilutive effects on earnings per share. The guidance in FSP 129-1 is effective April 2004 and applies to all existing and newly created securities. This pronouncement has no effect on the Company.

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND
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RESULTS OF OPERATIONS

THREE MONTHS ENDED JUNE 30, 2004 COMPARED TO THREE MONTHS ENDED JUNE 30, 2003.

Net income. Net income increased \$13.2 million, or 286.3%, to \$17.8 million for the three months ended June 30, 2004, compared to \$4.6 million for the three months ended June 30, 2003. Net income for the three months ended June 30, 2004, includes income from continuing operations of \$17.7 million and income from discontinued operations of \$100,000, compared to income from continuing operations of \$3.5 million and income from discontinued operations of \$1.1 million for the three months ended June 30, 2003.

CONTINUING OPERATIONS

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Total revenues. Total revenues increased \$142.0 million, or 173.9%, to \$223.7 million in the three months ended June 30, 2004, compared to \$81.7 million in the three months ended June 30, 2003. For the three months ended June 30, 2004, total revenue increased 116.4% internally, including year over year changes in acquired businesses, and 57.5% due to acquisitions.

Aerospace & Defense Group revenues. Aerospace & Defense Group revenues increased \$114.0 million, or 721.7%, to \$129.8 million in the three months ended June 30, 2004, compared to \$15.8 million in the three months ended June 30, 2003. For the three months ended June 30, 2004, Aerospace & Defense Group revenue increased 277.1% internally, including year over year changes in acquired businesses, and 444.6% from acquisitions. Internal growth was due to strong demand for the M1114 Up-Armored HMMV and SAPI plates, while acquired growth was a function of the Simula, Inc. acquisition on December 9, 2003.

Products Division revenues. Products Division revenues increased \$16.4 million, or 33.2%, to \$65.7 million in the three months ended June 30, 2004, compared to \$49.3 million in the three months ended June 30, 2003. For the three months ended June 30, 2004, Products Division revenue increased 25.4% internally, including year over year changes in acquired businesses, and 7.8% due to the acquisitions of Vector Associations, Inc. (dba ODV, Inc.), which was completed during the first quarter of 2004, and Hatch Imports, Inc., which was completed during the fourth quarter of 2003. Internal growth was due to strong sales of International body armor, and other soft armor and hard armor sectors, providing protection to troops and private sector employees within Iraq as well as strong military and international sales within duty gear.

Mobile Security revenues. Mobile Security Division revenues increased \$11.7 million, or 70.6%, to \$28.2 million in the three months ended June 30, 2004, compared to \$16.5 million in the three months ended June 30, 2003, primarily due to increased demand in the Middle East. All of Mobile Security Division's 70.6% revenue growth was internal.

Cost of sales. Cost of sales increased \$100.0 million, or 174.5%, to \$157.2 million for the three months ended June 30, 2004, compared to \$57.3 million for the three months ended June 30, 2003. As a percentage of total revenues, cost of sales increased to 70.3% of total revenues for the three months ended June 30, 2004, from 70.1% for the three months ended June 30, 2003.

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
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Gross margins in the Aerospace & Defense Group were 29.0% for the three months ended June 30, 2004, compared to 30.2% for the three months ended June 30, 2003, primarily due to a lower margin product mix, which included a large number of crew protection kits.

Gross margins in the Products Division were 33.5% for the three months ended June 30, 2004, compared to 33.1% for the three months ended June 30, 2003. The increase in Products Division gross margins resulted primarily from product mix.

Gross margins in the Mobile Security Division were 24.2% in the three months ended June 30, 2004, compared to 19.9% for the three months ended June 30, 2003. The margin improvement was primarily due to improved fixed cost absorption associated with increased manufacturing volumes, and a richer sales mix of high-end, higher margin vehicles.

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Operating expenses. Operating expenses increased \$8.9 million, or 61.0%, to \$23.4 million (10.5% of total revenues) for the three months ended June 30, 2004, compared to \$14.5 million (17.8% of total revenues) for the three months ended June 30, 2003. The decrease as a percentage of revenues was largely a function of increased revenues, and the acquisition of Simula, which operates with lower operating expenses as a percentage of revenues than the Products Division and the Mobile Security Division.

Aerospace & Defense Group operating expenses increased \$4.0 million, or 563.8%, to \$4.7 million (3.6% of Aerospace & Defense Group revenues) for the three months ended June 30, 2004, compared to \$710,000 (4.5% of Aerospace & Defense Group revenues) for the three months ended June 30, 2003. The increase in operating expenses is due primarily to the acquisition of Simula on December 9, 2003, as well as additional operating expenses in the M1114 Up-Armored HMMWV program as we increase production.

Products Division operating expenses increased \$2.4 million, or 29.0%, to \$10.5 million (15.9% of Products Division revenues) for the three months ended June 30, 2004, compared to \$8.1 million (16.4% of Products Division revenues) for the three months ended June 30, 2003. This increase is due primarily to acquisitions, higher sales expenses as related to increased sales volumes, wage increases, higher insurance cost, and bonus expenses that previously were allocated to corporate operating expenses.

Mobile Security Division operating expenses decreased \$0.2 million, or 7.4%, to \$3.0 million (10.5% of Mobile Security Division revenues) for the three months ended June 30, 2004, compared to \$3.2 million (19.4% of Mobile Security Division revenues) for the three months ended June 30, 2003. This decrease in operating expenses as a percentage of revenue is due primarily to increased sales volumes and management's ability to scale its business.

Corporate operating expenses increased \$2.7 million, or 109.4%, to \$5.2 million (2.3% of total revenues) for the three months ended June 30, 2004, compared to \$2.5 million (3.1% of total revenues) for the three months ended June 30, 2003. This increase in administrative expenses is associated with the overall growth of the Company, increased legal expenses for Zylon litigation, and Sarbanes-Oxley requirements.

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND
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Amortization. Amortization expense increased \$904,000, or 1,310.1% to \$973,000 for the three months ended June 30, 2004, compared to \$69,000 for the three months ended June 30, 2003, primarily due to the acquisitions of Simula and Hatch Imports in December 2003. SFAS 142, which we adopted on January 1, 2002, eliminated amortization of intangible assets with indefinite lives and goodwill for all acquisitions completed after July 1, 2001, as well as for all fiscal years ending after January 1, 2002. Remaining amortization expense is related to patents and trademarks with finite lives, and acquired amortizable intangible assets that meet the criteria for recognition as an asset apart from goodwill under SFAS 141.

Integration and other charges. Integration and other charges increased \$4.3 million, or 115.2%, to \$8.1 million for the three months ended June 30,

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2004, compared to \$3.8 million for the three months ended June 30, 2003 primarily due to a non-cash charge of \$5.9 million for the acceleration of performance based, long-term restricted stock awards granted to certain executives in 2002. In the second quarter of 2004, we recorded an impairment charge of \$1.4 million in integration and other charges in continuing operations to reduce the carrying value of remaining portion of NTI to its estimated fair value. The remaining integration and other charges in the second quarter of 2004 were primarily for the integration of Simula, Inc., Hatch Imports, Inc., and ODV, Inc., which were all acquired subsequent to the second quarter of fiscal year 2003.

Operating income. Operating income from continuing operations increased \$28.0 million, or 465.3%, to \$34.0 million for the three months ended June 30, 2004, compared to \$6.0 million in the three months ended June 30, 2003, due to the factors discussed above.

Interest expense, net. Interest expense, net increased \$1.6 million, or 370.7%, to \$2.1 million for the three months ended June 30, 2004, compared to \$437,000 for the three months ended June 30, 2003. This increase was due primarily to interest expense associated with the \$150 million aggregate principal amount of 8.25% senior subordinated notes due 2013 issued in August 2003. On September 2, 2003, we entered into interest rate swap agreements that effectively exchanged the 8.25% fixed rate for a variable rate of six-month LIBOR (1.94% at June 30, 2004), set in arrears, plus a spread of 2.735% to 2.75%.

Other (income) expense, net. Other (income), net, was \$(390,000) for the three months ended June 30, 2004, compared to other expense, net, of \$16,000 for the three months ended June 30, 2003. The increase in other (income) expense, net, was a result of the realization of a gain on the sale of a certain equity investment.

Income from continuing operations before provision for income taxes. Income from continuing operations before provision for income taxes increased \$26.8 million, or 481.4%, to \$32.3 million for the three months ended June 30, 2004, compared to \$5.6 million for the three months ended June 30, 2003, due to the reasons discussed above.

Provision for income taxes. Provision for income taxes was \$14.6 million for the three months ended June 30, 2004, compared to \$2.1 million for the three months ended June 30, 2003. The effective tax rate was 45.2% for the three months ended June 30, 2004, compared to 37.4% for the three months ended June 30, 2003. The increased tax rate relates primarily to an increased mix of profitability generated by our Ohio, Arizona and Massachusetts locations, which operate in higher-taxed jurisdictions,

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
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and the non-tax deductible charge due to the accelerated vesting of performance based, long-term restricted stock awards.

Income from continuing operations. Income from continuing operations increased \$14.2 million, or 409.5%, to \$17.7 million for the three months ended June 30, 2004, compared to \$3.5 million for the three months ended June 30, 2003, due to the factors discussed above.

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DISCONTINUED OPERATIONS

On April 17, 2003, we announced that we had completed the sale of our ArmorGroup Integrated Systems business through the sale of 100% of the stock of ArmorGroup Integrated Systems, Inc. and Low Voltage Systems Technologies, Inc. to AIS. AIS is a wholly owned subsidiary of Aerway Holdings, LLC. As consideration for the integrated systems business, we received a \$4.1 million collateralized note due in two years and a warrant for approximately 2.5% of AIS. Through June 30, 2004, we have received \$475,000 in prepayments on the note receivable. We have previously recorded a loss of \$366,000 on the sale during the second quarter of 2003.

On November 26, 2003, we announced that we completed the sale of ArmorGroup, our security service division, for \$33.7 million in consideration to a group of private investors led by Granville Baird Capital Partners of London, England and Management. We received \$31.4 million in cash at closing and are scheduled to receive another \$2.3 million by the end of 2004, of which we have received \$500,000 through July 23, 2004. We have previously recorded a loss of \$8.8 million on the sale in the fourth quarter of 2003. In accordance with generally accepted accounting principles, foreign currency translation unrealized gains and losses, which are included in equity as accumulated other comprehensive income or loss, are not recognized until the period of disposition of the related assets and liabilities (which was a large component of the loss).

On June 30, 2004, our litigation support services subsidiary, New Technologies Armor, Inc. ("NTI"), was the last remaining business in discontinued operations. On July 2, 2004, we sold the security consulting division of NTI. The remaining division in NTI, consisting primarily of training services, will be included as part of the Products Division segment. In the second quarter of 2004, we recorded an impairment charge of \$1.4 million in integration and other charges in continuing operations to reduce the carrying value of remaining portion of NTI to its estimated fair value.

Services revenues. Services Division revenue decreased \$22.9 million to \$1.0 million for the three months ended June 30, 2004, compared to \$23.9 million for the three months ended June 30, 2003. Exclusive of ArmorGroup Integrated Systems, which we sold on April 17, 2003, and ArmorGroup, which we sold on November 26, 2003, revenue increased \$438,000, or 76.2%, to \$1.0 million for the three months ended June 30, 2004, compared to \$575,000 for the three months ended June 30, 2003. This increase was due to a significant consulting engagement that began in June 2004.

Cost of sales. Cost of sales decreased \$15.7 million to \$461,000 for the three months ended June 30, 2004, compared to \$16.2 million for the three months ended June 30, 2003. Exclusive of ArmorGroup Integrated Systems and ArmorGroup, cost of sales increased \$211,000, or 84.4%, to \$461,000 for the three months ended June 30, 2004, compared to \$250,000 for the three months ended

June 30, 2003. This increase was due to a significant consulting engagement that began in June 2004. As a percentage of total revenue exclusive of ArmorGroup Integrated Systems and ArmorGroup, cost of sales increased to 45.5% of total revenues for the three months ended June 30, 2004, from 43.5% for the three

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months ended June 30, 2003.

Operating expenses. Operating expenses decreased \$4.6 million to \$385,000 (38.0% of Services revenues) for the three months ended June 30, 2004, compared to \$5.0 million (20.9% of Services revenues) for the three months ended June 30, 2003. Exclusive of ArmorGroup Integrated Systems and ArmorGroup, operating expenses decreased \$4,000, or 1.0%, to \$385,000 for the three months ended June 30, 2004, compared to \$389,000 for the three months ended June 30, 2003.

Integration and other charges. Integration and other charges decreased to zero for the three months ended June 30, 2004, compared to \$452,000 for the three months ended June 30, 2003. Excluding ArmorGroup Integrated Systems and ArmorGroup, there were no integration and other charges for the three months ended June 30, 2003.

Operating income. Operating income was \$167,000 for the three months ended June 30, 2004, compared to operating income of \$2.3 million for the three months ended June 30, 2003, due to the factors discussed above. Excluding the ArmorGroup Integrated Systems and ArmorGroup, the balance of the assets held for sale generated an operating income of \$167,000 for the three months ended June 30, 2004, compared to an operating loss of (\$67,000) for the three months ended June 30, 2003, due to the reasons discussed above.

Interest expense, net. Interest expense, net, decreased \$15,000, or 100%, to zero for the three months ended June 30, 2004, compared to \$15,000 for the three months ended June 30, 2003, primarily due to the sale of ArmorGroup Integrated Systems and ArmorGroup. All interest bearing liabilities in discontinued operations have been repaid.

Other expense, net. Other expense, net, decreased \$382,000, or 97.4%, to \$10,000 for the three months ended June 30, 2004, compared to other expense, net, of \$392,000 for the three months ended June 30, 2003 primarily due to the sale of ArmorGroup Integrated Systems and ArmorGroup. Excluding ArmorGroup Integrated Systems and ArmorGroup, there was no significant change in other expense, net.

Income from discontinued operations before provision for income taxes. Income from discontinued operations before provision for income taxes was \$157,000 for the three months ended June 30, 2004, compared to income of \$1.9 million for the three months ended June 30, 2003, due to the reasons discussed above. Excluding ArmorGroup Integrated Systems and ArmorGroup, the balance of the assets held for sale generated income (loss) from discontinued operations before provision for income taxes of \$157,000 for the three months ended June 30, 2004, compared to (\$62,000) for the three months ended June 30, 2003, due to reasons discussed above.

Provision for income taxes. Provision for income taxes was \$57,000 for the three months ended June 30, 2004 compared to a provision for income taxes of \$725,000 for the three months ended June 30, 2003. The effective tax rate for the three months ended June 30, 2004 was 36.3% compared to 39.0% for the three months ended June 30, 2003. Excluding the ArmorGroup Integrated Systems and

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the three months ended June 30, 2004, compared to a benefit of (\$18,000) for the three months ended June 30, 2003.

Income from discontinued operations. Income from discontinued operations was \$100,000 for the three months ended June 30, 2004, compared to income from discontinued operations of \$1.1 million for the three months ended June 30, 2003, due to the factors discussed above. Excluding ArmorGroup Integrated Systems and ArmorGroup, the balance of the assets held for sale generated income (loss) from discontinued operations of \$100,000 for the three months ended June 30, 2004, compared to (\$44,000) for the three months ended June 30, 2003, due to the reasons discussed above.

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - CONTINUED

SIX MONTHS ENDED JUNE 30, 2004 COMPARED TO SIX MONTHS ENDED JUNE 30, 2003.

Net income. Net income increased \$20.6 million, or 212.5%, to net income of \$30.3 million for the six months ended June 30, 2004, compared to net income of \$9.7 million for the six months ended June 30, 2003. Net income for the six months ended June 30, 2004, includes income from continuing operations of \$30.3 million and loss from discontinued operations of (\$38,000), compared to income from continuing operations of \$8.7 million and net income from discontinued operations of \$977,000 for the six months ended June 30, 2003.

CONTINUING OPERATIONS

Total revenues. Total revenues increased \$223.2 million, or 137.7%, to \$385.3 million in the six months ended June 30, 2004, compared to \$162.1 million in the six months ended June 30, 2003. For the six months ended June 30, 2004, total revenue increased 92.2% internally, including year over year changes in acquired businesses, and 45.5% due to the acquisitions.

Aerospace & Defense Group revenues. Aerospace & Defense Group revenues increased \$179.1 million, or 564.9%, to \$210.8 million in the six months ended June 30, 2004, compared to \$31.7 million in the six months ended June 30, 2003. For the six months ended June 30, 2004, Aerospace & Defense Group revenue increased 228.7% internally, including year-over-year changes in acquired businesses, and 336.2% from acquisitions. Internal growth was due to strong demand for the M1114 Up-Armored HMMWV, SAPI plates, and armored kits; while acquired growth was a function of the Simula, Inc. acquisition on December 9, 2003.

Products Division revenues. Products Division revenues increased \$26.2 million, or 28.1%, to \$119.6 million in the six months ended June 30, 2004, compared to \$93.4 million in the six months ended June 30, 2003. For the six months ended June 30, 2004, Products Division revenue increased 20.4% internally, including year-over-year changes in acquired businesses, and 7.7% due to the acquisitions of Vector Associations, Inc. (dba ODV, Inc.), which was completed during the first quarter of 2004, and Hatch Imports, Inc., which was completed during the fourth quarter of 2003. Internal growth was due to strong sales of International body armor, and other soft armor and hard armor sectors, providing protection to troops and private sector employees within Iraq as well as strong military and international sales within duty gear.

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Mobile Security revenues. Mobile Security Division revenues increased \$17.9 million, or 48.3%, to \$55.0 million in the six months ended June 30, 2004, compared to \$37.1 million in the six months ended June 30, 2003. All of the revenue growth was generated internally, primarily as a result of increased demand in the Middle East.

Cost of sales. Cost of sales increased \$156.9 million, or 137.1%, to \$271.3 million for the six months ended June 30, 2004, compared to \$114.4 million for the six months ended June 30, 2003. As a percentage of total revenues, cost of sales decreased to 70.4% of total revenues for the six months ended June 30, 2004, from 70.6% for the six months ended June 30, 2003.

Gross margins in the Aerospace & Defense Group were 30.2% for the six months ended June 30, 2004, compared to 30.0% for the six months ended June 30, 2003.

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - CONTINUED

Gross margins in the Products Division were 32.6% for the six months ended June 30, 2004, compared to 33.6% for the six months ended June 30, 2003. The decrease in Products Division gross margins resulted primarily from product mix, certain large lower margin international and governmental orders and certain additional inventory reserves provided for during the first quarter.

Gross margins in the Mobile Security Division were 20.8% in the six months ended June 30, 2004, compared to 18.4% for the six months ended June 30, 2003. The increase in the Mobile Security Divisions gross margins resulted primarily from improved fixed-cost absorption benefits associated with increased manufacturing volumes, and a richer sales mix of high-end, higher margin vehicles.

Operating expenses. Operating expenses increased \$18.1 million, or 63.5%, to \$46.6 million (12.1% of total revenues) for the six months ended June 30, 2004, compared to \$28.5 million (17.6% of total revenues) for the six months ended June 30, 2003. The decrease as a percentage of revenues was largely a function of increased revenues, and the acquisition of Simula, which operates with lower operating expenses as a percent of revenues than the Products Division and the Mobile Security Division.

Aerospace & Defense Group operating expenses increased \$8.2 million, or 450.9%, to \$10.0 million (4.7% of Aerospace & Defense Group revenues) for the six months ended June 30, 2004, compared to \$1.8 million (5.7% of Aerospace & Defense Group revenues) for the six months ended June 30, 2003. The increase in operating expenses is due primarily to the acquisition of Simula on December 9, 2003, as well as additional operating expenses in the M1114 Up-Armored HMMWV program as we increased production. The decrease in operating expense as a percentage of revenue was due to leveraging of the operating expenses over a much larger revenue base.

Products Division operating expenses increased \$5.4 million, or 33.5%, to \$21.4 million (17.9% of Products Division revenues) for the six months ended June 30, 2004, compared to \$16.0 million (17.2% of Products Division revenues) for the six months ended June 30, 2003. This increase is due primarily to acquisitions, increased research and development spending, higher sales expenses as related to increased sales volumes, wage increases, higher insurance cost,

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increased bad debt provisions, and bonus expenses that previously were allocated to corporate operating expenses.

Mobile Security Division operating expenses increased \$0.4 million, or 7.2%, to \$6.5 million (11.9% of Mobile Security Division revenues) for the six months ended June 30, 2004, compared to \$6.1 million (16.4% of Mobile Security Division revenues) for the six months ended June 30, 2003. This increase is due primarily to increased operating expenses related to significant revenue growth and increased warranty provisions. The decrease in operating expense as a percentage of revenue was due to leveraging the operating expenses over larger revenue base and management's ability to scale its business.

Corporate operating expenses increased \$4.1 million, or 89.8%, to \$8.8 million (2.3% of total revenues) for the six months ended June 30, 2004, compared to \$4.6 million (2.8% of total revenues) for the six months ended June 30, 2003. This increase in administrative expenses is associated with the overall growth of the Company, increased legal expenses for Zylon litigation, and Sarbanes-Oxley requirements.

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - CONTINUED

Amortization. Amortization expense increased \$1.8 million, or 1,414.0% to \$2.0 million for the six months ended June 30, 2004, compared to \$129,000 for the six months ended June 30, 2003, primarily due to the acquisitions of Simula and Hatch Imports in December 2003. SFAS 142, which we adopted on January 1, 2002, eliminated amortization of intangible assets with indefinite lives and goodwill for all acquisitions completed after July 1, 2001, as well as for all fiscal years ending after January 1, 2002. Remaining amortization expense is related to patents and trademarks with finite lives, and acquired amortizable intangible assets that meet the criteria for recognition as an asset apart from goodwill under SFAS 141.

Integration and other charges. Integration and other charges increased \$4.6 million, or 109.8%, to \$8.8 million for the six months ended June 30, 2004, compared to \$4.2 million for the six months ended June 30, 2003 primarily due to a non-cash charge of \$5.9 million for the acceleration of performance based, long-term restricted stock awards granted to certain executives in 2002. In the second quarter of 2004, we recorded an impairment charge of \$1.4 million in integration and other charges in continuing operations to reduce the carrying value of remaining portion of NTI to its estimated fair value. \$1.5 million of the integration and other charges in the six months ended June 30, 2004, were primarily for the integration of Simula, Inc., Hatch Imports, Inc., and ODV, Inc., which were all acquired subsequent to the second quarter of fiscal year 2003.

Operating income. Operating income from continuing operations increased \$41.8 million, or 281.7%, to \$56.6 million for the six months ended June 30, 2004, compared to \$14.8 million in the six months ended June 30, 2003, due to the factors discussed above.

Interest expense, net. Interest expense, net increased \$3.0 million, or 363.8%, to \$3.8 million for the six months ended June 30, 2004, compared to \$816,000 for the six months ended June 30, 2003. This increase was due primarily to interest expense associated with the \$150 million aggregate principal amount of 8.25% senior subordinated notes due 2013 issued in August 2003. On September 2, 2003, we entered into interest rate swap agreements that effectively

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exchanged the 8.25% fixed rate for a variable rate of six-month LIBOR (1.94% at June 30, 2004), set in arrears, plus a spread of 2.735% to 2.75%.

Other (income) expense, net. Other (income) expense, net, was (\$275,000) for the six months ended June 30, 2004, compared to other expense, net, of \$85,000 for the six months ended June 30, 2003. The income for the six months ended June 30, 2004, was a result of the realization of a gain on the sale of a certain equity investment.

Income from continuing operations before provision for income taxes. Income from continuing operations before provision for income taxes increased \$39.2 million, or 281.2%, to \$53.1 million for the six months ended June 30, 2004, compared to \$13.9 million for the six months ended June 30, 2003, due to the reasons discussed above.

Provision for income taxes. Provision for income taxes was \$22.8 million for the six months ended June 30, 2004, compared to \$5.2 million for the six months ended June 30, 2003. The effective tax rate was 42.9% for the six months ended June 30, 2004, compared to 37.4% for the six months ended June 30, 2003. The increased tax rate relates to an increased mix of profitability generated by our Ohio, Arizona and Massachusetts locations, which operate in higher-taxed jurisdictions,

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and the non-tax deductible charge due to the accelerated vesting of performance based, long-term restricted stock awards.

Income from continuing operations. Income from continuing operations increased \$21.6 million, or 247.9%, to \$30.3 million for the six months ended June 30, 2004, compared to \$8.7 million for the six months ended June 30, 2003 due to the factors discussed above.

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS - CONTINUED

DISCONTINUED OPERATIONS

Services revenues. Services Division revenue decreased \$48.0 million to \$1.7 million for the six months ended June 30, 2004, compared to \$49.7 million for the six months ended June 30, 2003. Exclusive of ArmorGroup Integrated Systems, which we sold on April 17, 2003, and ArmorGroup, which we sold on November 26, 2003, revenue increased \$218,000, or 14.4%, to \$1.7 million for the six months ended June 30, 2004, compared to \$1.5 million for the six months ended June 30, 2003. This increase was due to a significant consulting engagement that began in June 2004.

Cost of sales. Cost of sales decreased \$34.7 million to \$697,000 for the six months ended June 30, 2004, compared to \$35.4 million for the six months ended June 30, 2003. Exclusive of ArmorGroup Integrated Systems and ArmorGroup, cost of sales increased \$106,000, or 17.9%, to \$697,000 for the six months ended

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June 30, 2004, compared to \$591,000 for the six months ended June 30, 2003. This increase was due to a significant consulting engagement that began in June 2004. As a percentage of total revenue exclusive of ArmorGroup Integrated Systems and ArmorGroup, cost of sales increased to 40.2% of total revenues for the six months ended June 30, 2004, from 39.0% for the six months ended June 30, 2003.

Operating expenses. Operating expenses decreased \$10.6 million to \$821,000 (47.4% of Services revenues) for the six months ended June 30, 2004, compared to \$11.4 million (23.0% of Services revenues) for the six months ended June 30, 2003. Exclusive of ArmorGroup Integrated Systems and ArmorGroup, operating expenses decreased \$55,000, or 6.3%, to \$821,000 for the six months ended June 30, 2004, compared to \$876,000 for the six months ended June 30, 2003. This decrease was due to a decline in revenues.

Integration and other charges. Integration and other charges decreased to zero for the six months ended June 30, 2004, compared to \$494,000 for the six months ended June 30, 2003. Excluding ArmorGroup Integrated Systems and ArmorGroup, there were no integration and other charges for the six months ended June 30, 2003.

Operating income. Operating income was \$215,000 for the six months ended June 30, 2004, compared to operating income of \$2.4 million for the six months ended June 30, 2003, due to the factors discussed above. Excluding the ArmorGroup Integrated Systems and ArmorGroup, the balance of the assets held for sale generated operating income of \$215,000 for the six months ended June 30, 2004, compared to operating income of \$46,000 for the six months ended June 30, 2003, due to the reasons discussed above.

Interest expense, net. Interest expense, net, decreased \$51,000, or 96.2%, to \$2,000 for the six months ended June 30, 2004, compared to \$53,000 for the six months ended June 30, 2003, primarily due to the sale of ArmorGroup Integrated Systems and ArmorGroup. All interest bearing liabilities in discontinued operations have been repaid.

Other expense, net. Other expense, net, decreased \$179,000, or 39.6%, to \$273,000 for the six months ended June 30, 2004, compared to other expense, net, of \$452,000 for the six months ended June 30, 2003. Excluding the ArmorGroup Integrated Systems and ArmorGroup, the balance of the assets held for sale generated other expense, net, from discontinued operations of \$273,000 for the six months ended

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS - CONTINUED

June 30, 2004, compared to other income, net, of (\$7,000) for the three months ended June 30, 2003, due to additional accounting fees incurred in connection with the sale of ArmorGroup.

(Loss) income from discontinued operations before (benefit) provision for income taxes. Loss from discontinued operations before provision for income taxes was (\$60,000) for the six months ended June 30, 2004, compared to income of \$1.9 million for the six months ended June 30, 2003, due to the reasons discussed above. Excluding the ArmorGroup Integrated Systems and ArmorGroup, the balance of the assets held for sale generated a loss from discontinued operations before provision for income taxes of (\$60,000) for the six months ended June 30, 2004, compared to income of \$48,000 for the three months ended June 30, 2003, due to the reasons discussed above.

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(Benefit) Provision for income taxes. Benefit for income taxes was (\$22,000) for the six months ended June 30, 2004 compared to a provision for income taxes of \$937,000 for the six months ended June 30, 2003. The effective tax rate for the three months ended June 30, 2004 was a benefit of 36.7% compared to a provision of 49.0% for the six months ended June 30, 2003. Excluding the ArmorGroup Integrated Systems and ArmorGroup, the balance of the assets held for sale benefit was (\$22,000) for the six months ended June 30, 2004, compared to a provision of \$28,000 for the six months ended June 30, 2003.

(Loss) income from discontinued operations. Loss from discontinued operations was (\$38,000) for the six months ended June 30, 2004, compared to income from discontinued operations of \$977,000 for the six months ended June 30, 2003, due to the factors discussed above. Excluding the ArmorGroup Integrated Systems and ArmorGroup, the balance of the assets held for sale generated a loss from discontinued operations (\$38,000) for the six months ended June 30, 2004, compared to income of \$20,000 for the six months ended June 30, 2003, due to the reasons discussed above.

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS - CONTINUED

LIQUIDITY AND CAPITAL RESOURCES

On June 22, 2004, our stockholders approved an amendment to our Certificate of Incorporation, as amended that increased the number of shares of our authorized capital stock to 80,000,000, 75,000,000 shares of which are common stock and 5,000,000 of which are preferred stock.

On June 12, 2004, we sold 4,000,000 primary shares of common stock at a price of \$37.50 per share, raising \$142.5 million of net proceeds after deducting the underwriter discounts and commissions. In addition, certain of our directors and officers granted the underwriters a 30-day option to purchase up to 600,000 shares. The 30-day option expired unexercised on July 15, 2004. We intend to use the net proceeds from the offering to fund future acquisitions, to take advantage of business development opportunities, and for general corporate and working capital purposes, including the funding of capital expenditures. Funds that are not immediately used are invested in money market funds, certificates of deposits, and other investment grade securities until needed.

On September 2, 2003, we entered into interest rate swap agreements, which have been designated as fair value hedges as defined under SFAS 133 with a notional amount totaling \$150 million. The agreements were entered into to exchange the fixed interest rate on the Notes for a variable interest rate equal to six-month LIBOR, set in arrears, plus a spread ranging from 2.735% to 2.75% fixed semi-annually on the fifteenth day of February and August. The agreements are subject to other terms and conditions common to transactions of this type. In accordance with SFAS 133, changes in the fair value of the interest rate swap agreements offset changes in the fair value of the fixed rate debt due to changes in the market interest rate. Accordingly, other assets on the Consolidated Balance Sheet as of June 30, 2004 decreased by \$4.2 million from December 31, 2003, which reflected a decrease in the fair value of the interest rate swap agreements. The corresponding increase in the hedge liability was recorded in long-term debt. The agreements are deemed to be a perfectly effective fair value hedge, and, therefore, qualify for the short-cut method of accounting under SFAS 133. As a result, no ineffectiveness is expected to be

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recognized in our earnings associated with the interest rate swap agreements.

On August 12, 2003, we completed a private placement of \$150 million aggregate principal amount of 8.25% Senior Subordinated Notes due 2013 (the "Notes"). The Notes are guaranteed by all of our domestic subsidiaries, excluding Cyconics International Training Services, Inc. (formally known as Advanced Training Solutions, Inc. which was formally known as USDS, Inc.), on a senior subordinated basis. The Notes have been sold to qualified institutional investors in reliance on Rule 144A of the Securities Act of 1933, as amended, and to non-U.S. persons in reliance on Regulation S under the Securities Act of 1933, as amended. The Notes were initially rated B1/B+ by Moody's Investors' Service and Standard & Poor's Rating Services, respectively. We used a portion the funds to repay debt, acquire Simula, Inc., Hatch Imports, Inc., and ODV, Inc. and we intend to use the remaining proceeds of the offering to fund acquisitions, for general corporate and working capital purposes, including the funding of capital expenditures. On March 29, 2004, we completed a registered exchange offer for the Notes and exchanged the Notes for new Notes that were registered under the Securities Act of 1933, as amended.

On August 12, 2003, in concert with our high yield note offering, we entered into a new secured revolving credit facility (the "Credit Facility") with Bank of America, N.A., Wachovia Bank, National

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - CONTINUED

Association and a syndicate of other financial institutions arranged by Bank of America Securities, LLC. The Credit Facility consists of a five-year revolving credit facility, and, among other things, provides for (i) total maximum borrowings of \$60 million, (ii) a \$25 million sub-limit for the issuances of standby and commercial letters of credit, (iii) a \$5 million sub-limit for swing-line loans, and (iv) a \$5 million sub-limit for multi-currency borrowings. All borrowings under the Credit Facility will bear interest at either (i) a rate equal to LIBOR, plus an applicable margin ranging from 1.125% to 1.625%, (ii) an alternate base rate which will be the higher of (a) the Bank of America prime rate and (b) the Federal Funds rate plus 0.50%, or (iii) with respect to foreign currency loans, a fronted offshore currency rate, plus an applicable margin ranging from 1.125% to 1.625%, depending on certain conditions. The Credit Facility is guaranteed by certain of our direct and indirect domestic subsidiaries and is collateralized by, among other things, (i) a pledge of all of the issued and outstanding shares of stock or other equity interests of certain of our domestic subsidiaries, (ii) a pledge of 65% of the issued and outstanding voting shares of stock or other voting equity interests of certain of our direct and indirect foreign subsidiaries, (iii) a pledge of 100% of the issued and outstanding nonvoting shares of stock or other nonvoting equity interests of certain of our direct and indirect foreign subsidiaries, and (iv) a first priority perfected security interest on certain of our domestic assets and certain domestic assets of certain of our direct and indirect subsidiaries that will become guarantors of our obligations under the Credit Facility, including, among other things, accounts receivable, inventory, machinery, equipment, certain contract rights, intellectual property rights and general intangibles. On March 29, 2004, we amended our credit agreement to allow us to pay dividends subject to certain limitations.

As of June 30, 2004, we were in compliance with all of our negative and affirmative covenants contained in the Credit Facility and the indenture governing the Notes.

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In March 2002, our Board of Directors approved a stock repurchase program authorizing the repurchase of up to a maximum 3.2 million shares of our common stock. In February 2003, the Board of Directors increased this stock repurchase program to authorize the repurchase, from time to time depending upon market conditions and other factors, of up to an additional 4.4 million shares. Through July 23, 2004, we repurchased 3.8 million shares of our common stock under the stock repurchase program at an average price of \$12.49 per share, leaving us with the ability to repurchase up to an additional 3.8 million shares of our common stock. Repurchases may be made in the open market, in privately negotiated transactions or otherwise. At June 30, 2004, we had 32.8 million shares of common stock outstanding.

We expect to continue our policy of repurchasing our common stock from time to time, subject to the restrictions contained in our Credit Facility and the indenture governing the Notes. Our Credit Facility permits us to repurchase shares of our common stock with no limitation if our ratio of Consolidated Total Indebtedness to Consolidated EBITDA (as such terms are defined in the Credit Facility) for any rolling twelve-month period is less than 1.00 to 1. At ratios greater than 1.00 to 1, our credit agreement limits our ability to repurchase shares at \$15.0 million. This basket resets to \$0 each time the ratio is less than 1.00 to 1. Our indenture governing the Notes also permits us to repurchase shares of our common stock, subject to certain limitations, as long as we satisfy the conditions to such repurchase contained therein.

Working capital for continuing operations was \$353.5 million and \$168.5 million as of June 30, 2004, and December 31, 2003, respectively.

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - CONTINUED

Our fiscal 2004 capital expenditures for continuing operations are expected to be approximately \$13.9 million, of which we have spent approximately \$7.1 million through the six months ended June 30, 2004. Such expenditures include leasehold improvements, information technology and communications infrastructure equipment and software, and manufacturing machinery and equipment.

We anticipate that the cash generated from operations, cash on hand and available borrowings under the Credit Facility will enable us to meet liquidity, working capital and capital expenditure requirements during the next 12 months. We may, however, require additional financing to pursue our strategy of growth through acquisitions. If such financing is required, there are no assurances that it will be available, or if available, that it can be obtained on terms favorable to us or on a basis that is not dilutive to our stockholders.

See Part II Item 1 Legal Proceedings regarding outstanding legal matters.

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - CONTINUED

FORWARD LOOKING AND CAUTIONARY STATEMENTS

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Except for the historical information and discussions contained herein, statements contained in this Form 10-Q may constitute "forward looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These statements involve a number of risks, uncertainties and other factors that could cause actual results to differ materially, including, but not limited to, our failure to continue to develop and market new and innovative products and services and to keep pace with technological change; competitive pressures; failure to obtain or protect intellectual property rights; the ultimate effect of various domestic and foreign political and economic issues on our business, financial condition or results of operations; quarterly fluctuations in revenues and volatility of stock prices; contract delays; cost overruns; our ability to attract and retain key personnel; currency and customer financing risks; dependence on certain suppliers, customers and availability of raw materials; changes in the financial or business condition of our distributors or resellers; our ability to successfully manage acquisitions, alliances and integrate past and future business combinations; regulatory, legal, political and economic changes; an adverse determination in connection with the Zylon(R) investigation being conducted by the U.S. Department of Justice and certain state agencies and/or other Zylon(R)-related litigation; and other risks, uncertainties and factors inherent in our business and otherwise discussed elsewhere in this Form 10-Q and in our other filings with the Securities and Exchange Commission or in materials incorporated therein by reference.

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As a result of our global operating and financial activities, we are exposed to changes in raw material prices, interest rates and foreign currency exchange rates, which may adversely affect our results of operations and financial position. In seeking to minimize the risks and/or costs associated with such activities, we manage exposure to changes in raw material prices, interest rates, and foreign currency exchange rates through our regular operating and financing activities. We have entered into interest rate swap agreements to reduce our overall interest expense. We do not utilize financial instruments for trading purposes.

MARKET RATE RISK

The following discussion about our market rate risk involves forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements. We are exposed to market risk related to changes in interest rates, foreign currency exchange rates, and equity security price risk.

Interest Rate Risk. Our exposure to market rate risk for changes in interest rates relates primarily to borrowings under our \$150 million senior subordinated notes, our credit facilities and our short-term monetary investments. To the extent that, from time to time, we hold short-term money market instruments, there is a market rate risk for changes in interest rates on such instruments. To that extent, there is inherent rollover risk in the short-term money market instruments as they mature and are renewed at current market rates. The extent of this risk is not quantifiable or predictable, because of the variability of future interest rates and business financing

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requirements. However, there is only a remote risk of loss of principal in the short-term money market instruments. The main risk is related to a potential reduction in future interest income.

On September 2, 2003, we entered into interest rate swap agreements in which we effectively exchanged the \$150 million fixed rate 8.25% interest on the senior notes for variable rates in the notional amount of \$80 million, \$50 million, and \$20 million at six-month LIBOR, set in arrears, plus 2.75%, 2.75%, and 2.735%, respectively. The agreements involve receipt of fixed rate amounts in exchange for floating rate interest payments over the life of the agreement without an exchange of the underlying principal amount. The variable interest rates are fixed semi-annually on the fifteenth day of February and August each year through maturity. The six-month LIBOR rate was 1.89% on July 16, 2004. The maturity dates of the interest rate swap agreements match those of the underlying debt. Our objective for entering into these interest rate swaps was to reduce our exposure to changes in the fair value of senior notes and to obtain variable rate financing at an attractive cost. Changes in the six-month LIBOR would affect our earnings either positively or negatively. An assumed 100 basis point increase in the six-month LIBOR would increase our interest obligations under the interest rate swaps by approximately \$750,000 for a six-month period.

In accordance with SFAS 133, we designated the interest rate swap agreements as perfectly effective fair value hedges and, accordingly, use the short-cut method of evaluating effectiveness. As permitted by the short-cut method, the change in fair value of the interest rate swaps will be reflected in earnings and an equivalent amount will be reflected as a change in the carrying value of the swaps, with an offset to earnings. There is no ineffectiveness to be recorded. On June 30, 2004, we recorded the fair value of the interest rate swap agreements of \$1.7 million and recorded the corresponding fair value

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK - CONTINUED

adjustment to the 8.25% senior subordinated notes in other assets and long-term debt sections of the Condensed Consolidated Balance Sheets, respectively.

We are exposed to credit-related losses in the event of nonperformance by counterparties to these financial instruments. However, counterparties to these agreements are major financial institutions and the risk of loss due to nonperformance is considered by management to be minimal. We do not hold or issue interest rate swap agreements or other derivative instruments for trading purposes.

Foreign Currency Exchange Rate Risk. The majority of our business is denominated in U.S. dollars. There are costs associated with our operations in foreign countries that require payments in the local currency. Where appropriate and to partially manage our foreign currency risk related to those payments we receive payment from customers in local currencies in amounts sufficient to meet our local currency obligations. We do not use derivatives or other financial instruments to hedge foreign currency risk.

RISKS ASSOCIATED WITH INTERNATIONAL OPERATIONS

We do business in numerous countries, including emerging markets in South America. We have invested substantial resources outside of the United States and plan to continue to do so in the future. Our international operations

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are subject to the risk of new and different legal and regulatory requirements in local jurisdictions, tariffs and trade barriers, potential difficulties in staffing and managing local operations, potential imposition of restrictions on investments, potentially adverse tax consequences, including imposition or increase of withholding and other taxes on remittances and other payments by subsidiaries, and local economic, political and social conditions. Governments of many developing countries have exercised and continue to exercise substantial influence over many aspects of the private sector. Government actions in the future could have a significant adverse effect on economic conditions in a developing country or may otherwise have a material adverse effect on us and our operating companies. We do not have political risk insurance in the countries in which we currently conduct business, but periodically analyze the need for and cost associated with this type of policy. Moreover, applicable agreements relating to our interests in our operating companies are frequently governed by foreign law. As a result, in the event of a dispute, it may be difficult for us to enforce our rights. Accordingly, we may have little or no recourse upon the occurrence of any of these developments.

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES

ITEM 4. CONTROLS AND PROCEDURES

As of the end of the period covered by this report, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures. Our disclosure controls and procedures are designed to provide reasonable assurance that the information that we must disclose in our reports filed under the Securities Exchange Act of 1934, as amended, is communicated and processed in a timely manner. Warren B. Kanders, Chairman and Chief Executive Officer, and Glenn J. Heiar, Chief Financial Officer, participated in this evaluation.

Based on such evaluation, Mr. Kanders and Mr. Heiar concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective. During the period covered by this report, there have not been any significant changes in our internal controls over financial reporting or in other factors that could significantly affect those controls.

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES

PART II

ITEM 1. LEGAL PROCEEDINGS

On January 16, 1998, our Services Division ceased operations in Angola and subsequently became involved in various disputes with SHRM S.A. ("SHRM"), its minority joint venture partner relating to the Angolan joint venture known as Defense System International Africa ("DSIA"). On March 6, 1998, SIA (a subsidiary of SHRM) filed a complaint against Defense Systems France, SA ("DSF") before the Commercial Court of Nanterre (Tribunal de Commerce de Nanterre) seeking to be paid an amount of \$577,286 corresponding to an alleged debt of DSIA to SIA. In October 2002, the Commercial Court of Nanterre stayed the

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proceedings before it, pending the decisions of the Court of Appeal and the Paris Commercial Court. In February 2003, the Court of Appeal ruled against SHRM and its parent entity, Compass Group, effectively ending all further proceedings on the merits of Compass' claims. Compass has appealed the decision before the French Court of Cassation, which reviews only matters of law.

In 1999 and prior to our acquisition of O'Gara-Hess & Eisenhardt Armoring Company (which has been converted to a limited liability company and is now known as O'Gara-Hess & Eisenhardt Armoring Company, L.L.C.) ("OHEAC") in 2001, O'Gara-Hess & Eisenhardt Armoring de Brasil Ltda. ("OHE Brazil") was audited by the Brazilian federal tax authorities and assessed over Ten Million Reals (US\$3.4 million based on the exchange rate as of December 31, 2003). OHE Brazil has appealed the tax assessment and the case is pending. To the extent that there may be any liability resulting from the 2001 audit, we believe that we are entitled to indemnification from Kroll, Inc. under the terms of our purchase agreement dated April 20, 2001, despite the denial by Kroll, Inc. of any such liability, because the events occurred prior to our purchase of the O'Gara Companies from Kroll, Inc. However, to the extent that the appeal relating to 2001 activity results in an unfavorable ruling, we could be liable for unpaid taxes incurred subsequent to the acquisition from Kroll.

In 1999 and prior to our acquisition of OHEAC in 2001, several of the former employees of Kroll O'Gara Company de Mexico, S.A. de C.V. ("O'Gara Mexico"), a subsidiary of OHEAC, commenced labor claims against O'Gara Mexico seeking damages for unjustified termination. These cases are still pending before the labor board in Mexico City. The terminated employees are seeking back pay and benefits since the date of termination amounting to approximately US \$2.9 million, and accruing at approximately US \$50,400 per month. To the extent that there may be any liability, we believe that we are entitled to indemnification from Kroll, Inc. under the terms of our purchase agreement dated April 20, 2001, despite the denial by Kroll, Inc. of any such liability, because the events occurred prior to our purchase of the O'Gara Companies from Kroll, Inc. Although we do not have any insurance coverage for this matter, at this time, we do not believe this matter will have a material impact on our financial position, operations or liquidity.

In December 2001, O'Gara-Hess & Eisenhardt France S.A. ("OHE France") sold its industrial bodywork business operated under the name Labbe/Division de O'Gara Hess & Eisenhardt France/ Carrosserie Industriells to SNC Labbe. Subsequent to the sale, the Labbe Family Trust ("LFT"), owner of the leasehold interest upon which the Carrosserie business is operated, sued OHE France and SNC Labbe claiming that the transfer of the leasehold was not valid because the LFT had not given its consent to the transfer as required under the terms of the lease. Further, LFT seeks to have OHE France, as the sole tenant, maintain and repair the leased building. The approximate cost of renovating the

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES

building is estimated to be between US \$3.2 and US \$6.4 million, based on the exchange rate as of December 31, 2003. The case is currently pending, and while we are contesting the allegations vigorously, we are unable to predict the outcome of this matter. Although we do not have any insurance coverage for this matter, at this time, we do not believe this matter will have a material impact on our financial position, operations or liquidity.

On October 18, 2002, we were notified by the Internal Revenue Service that our tax return for the tax year ended December 31, 2000 had been selected for examination. Further, on January 30, 2003 we were notified that our tax return for the tax year ended December 31, 2001 had been selected for

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examination. In April 2004, we reached an agreement with the Internal Revenue Service regarding our tax returns for the years ended December 31, 2000 and 2001 that did not have a material impact on our financial position, operations or liquidity.

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES

In October 2002, we were sued in the United States District Court for the District of Wyoming with respect to one of our subsidiaries' Casper, Wyoming tear gas plant. The plaintiffs in the lawsuit asserted various state law tort claims and federal environmental law claims under the Resource Conservation and Recovery Act and the Clean Air Act stemming from the tear gas plant. In February 2004, we agreed with the plaintiffs to settle the lawsuit for an amount of money that is not material to us, and on April 19, 2004, the court dismissed the lawsuit with prejudice.

In September 2003, Second Chance Body Armor, Inc. ("Second Chance"), a body armor manufacturer and competitor to Armor Holdings, notified its customers of a potential safety issue with its Ultima(R) and Ultimax(R) models. Second Chance has claimed that Zylon(R) fiber, which is made by Toyobo, a Japanese corporation, and used in the ballistic fabric construction of those two models, degraded more rapidly than originally anticipated. Second Chance has also stated that the Zylon(R) degradation problem affects the entire body armor industry, not just its products. Both private claimants and State Attorneys General have already commenced legal action against Second Chance based upon its Ultima(R) and Ultimax(R) model vests.

We use Zylon(R) fiber in a number of concealable body armor models for law enforcement, but our vest design and construction are different from Second Chance. In addition, to our knowledge, no other body armor manufacturer has reported or experienced problems with Zylon(R)-based vests similar to those cited by Second Chance. The National Institute of Justice ("NIJ") tests and has certified each of our body armor designs before we begin to produce or sell any particular model.

In the Fall of 2003, following the assertions made by Second Chance, several law enforcement associations raised this issue to the U.S. Attorney General ("USAG"), who then asked the DOJ through the NIJ to investigate these concerns and attempt to clarify the issues. We have and continue to support the Attorney General's directive and investigation.

As a result of the USAG's and DOJ's initiative, the NIJ commenced an inquiry and investigation regarding the protocol for testing used vests, as well as the reliability of Zylon(R) and other ballistic fibers. We have consulted and continue to cooperate fully with the NIJ in this endeavor. To date, the NIJ has embarked only in its first phase of testing, which entails vests that have been heavily worn or

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES

exposed to adverse conditions, and which utilized the ballistic testing standard applicable to new vests. Although some of the vests tested, including ours, experienced a penetration, the NIJ specifically warned against the misuse and misinterpretation of these results, emphasizing that the data produced so far is

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preliminary in nature, applies to a very small sample size and therefore it is not possible to draw any definitive conclusions from these results. The NIJ will continue to conduct further testing and analyze these issues in order to determine if any conclusions can be reached as to the performance and reliability of aged vests. We have requested the NIJ to provide us with its testing data, and we intend to evaluate and review the NIJ's results upon our receipt of such data in our continuing effort to assist the NIJ in developing uniform standards for certification of new vests and the testing of used vests.

In April 2004, two class action complaints were filed in Florida state court by police organizations and individual police officers, alleging, among other things, that our vests do not have the qualities and performance characteristics as warranted, thereby breaching express warranty, implied warranty of merchantability, implied warranty of fitness for a particular purpose and duty to warn. The complaints allege no specific amount, although it has been publicly stated that they are seeking \$77 million in compensatory damages. We disagree with the allegations set forth in these complaints, are vigorously defending these lawsuits and have moved to dismiss the claims asserted against us. However, any adverse resolution of these matters could have a material adverse effect on our business, financial condition, results of operations and liquidity. We have also received investigative demands from state agencies in Texas and Connecticut to which we have complied, as well as letters from two private attorneys threatening potential litigation.

It should be stressed that our vests are certified by the NIJ, have never suffered any penetration in the field and continue to save lives and protect officers from injury. In fact, neither of the two recently commenced lawsuits allege personal injuries of any kind, but instead speculate that our vests which contain Zylon(R) are defective without any reliable evidence of any defect.

Second Chance licenses from Simula a certain patented technology, which is used in some of the body armor it manufactures, but to our knowledge, no lawsuit has yet been brought against Second Chance based upon this licensed technology. Although Simula may be impacted by the pending suits filed against Second Chance, the licensed technology is not specifically related to the use of Zylon(R) fiber, however, any adverse resolution of these matters could have a material adverse effect on our business, financial condition, results of operations and liquidity.

In addition to the above, in the normal course of business, we are subjected to various types of claims and currently have on-going litigations in the areas of products liability and general liability. Our products are used in a wide variety of law enforcement situations and environments. Some of our products can cause serious personal or property injury or death if not carefully and properly used by adequately trained personnel. We believe that we have adequate insurance coverage for most claims that are incurred in the normal course of business. In such cases, the effect on our financial statements is generally limited to the amount of our insurance deductible or self-insured retention. Our annual insurance premiums and self insurance retention amounts have risen significantly over the past several years and may continue to do so to the extent we are unable to purchase insurance coverage. At this time, we do not believe any such claims or pending litigation will have a material impact on our financial position, operations and liquidity.

ARMOR HOLDINGS, INC. AND SUBSIDIARIES

Reference is made to Part I, Item 3, Legal Proceedings, in our Annual Report on Form 10-K/A for the fiscal year ended December 31, 2003, for a

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description of other legal proceedings.

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES

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

We held our annual meeting of stockholders on June 22, 2004 for the purpose of (i) electing directors, (ii) approving an increase in the number of shares of authorized capital stock to 80,000,000 shares, 75,000,000 shares of which will be common stock and 5,000,000 shares of which will be preferred stock, and (iii) approving an increase, by 4,000,000 shares, of the total number of shares of common stock that may be awarded under the Armor Holdings, Inc. 2002 Stock Incentive Plan, as amended (the "2002 Stock Incentive Plan").

The increase in the number of shares of our authorized capital stock as set forth above was approved with the number of votes set forth below:

| For | Against | Abstentions | Broker Non-Votes |
|------------|-----------|-------------|------------------|
| --- | ----- | ----- | ----- |
| 25,808,352 | 1,355,209 | 10,929 | -- |

We adjourned our annual meeting until 10:00 A.M. on July 15, 2004. The adjournment of the annual meeting was approved with the number of votes set forth below:

| For | Against | Abstentions | Broker Non-Votes |
|------------|-----------|-------------|------------------|
| --- | ----- | ----- | ----- |
| 25,808,352 | 1,355,209 | 10,929 | -- |

The annual meeting of stockholders was reconvened on July 15, 2004 for the purpose of electing directors and approving an increase, by 4,000,000 shares, of the total number of shares of common stock that may be awarded under the 2002 Stock Incentive Plan. In connection with the stockholder vote relating to the increase of the total number of shares of common stock that may be awarded under the 2002 Stock Incentive Plan, we will not issue more than 2,000,000 of the 4,000,000 additional shares of common stock that may be awarded under our 2002 Stock Incentive Plan, as proposed to be amended, without further stockholder approval.

Each of our nominees for directors, as listed in the proxy statement, was elected with the number of votes set forth below.

| | FOR | WITHHELD |
|--------------------|------------|-----------|
| | --- | ----- |
| Warren B. Kandera | 27,082,802 | 858,938 |
| Burt R. Ehrlich | 29,955,486 | 986,254 |
| David R. Haas | 26,671,296 | 1,270,444 |
| Nicholas Sokolow | 24,940,014 | 3,001,726 |
| Thomas W. Strauss | 26,940,748 | 1,000,992 |
| Deborah A. Zoullas | 26,940,742 | 1,000,998 |

The increase in the total number of shares of common stock that may be awarded under the 2002 Stock Incentive Plan as described above was approved with the number of votes set forth below:

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| For | Against | Abstentions | Broker Non-Votes |
|------------|-----------|-------------|------------------|
| --- | ----- | ----- | ----- |
| 15,252,317 | 6,792,387 | 35,889 | 5,861,147 |

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ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

The following exhibits are filed as part of this quarterly report on Form 10-Q.

- 3.1 Certificate of Amendment of the Certificate of Incorporation of Armor Holdings, Inc., as amended.
- 31.1 Certification of Principal Executive Officer Pursuant to Rule 13a-14(a) (17 CFR 240.13a-14(a)).
- 31.2 Certification of Principal Financial Officer Pursuant to Rule 13a-14(a) (17 CFR 240.13a-14(a)).
- 32.1 Certification of Principal Executive Officer Pursuant to Rule 13a-14(b) (17 CFR 240.13a-14(b)) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350).
- 32.2 Certification of Principal Financial Officer Pursuant to Rule 13a-14(b) (17 CFR 240.13a-14(b)) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350).

(b) Reports on Form 8-K.

Form 8-K filed on May 10, 2004, relating to a press release issued on May 10, 2004, announcing our earnings for the fiscal quarter ended March 31, 2004.

Form 8-K filed on June 2, 2004 pursuant to which we filed a preliminary prospectus supplement to the shelf registration statement, as amended, filed with the Securities and Exchange Commission on May 26, 2004.

Form 8-K filed on June 2, 2004, relating to a press release, issued on June 1, 2004, announcing revised earnings per share guidance for the quarter ending June 30, 2004.

Form 8-K filed on June 25, 2004, relating to, among other things, our proposed increase in the number of shares available under our 2002 Stock Incentive Plan.

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ARMOR HOLDINGS, INC.

/S/ Warren B. Kandars

Warren B. Kandars
Chairman and Chief Executive Officer
Dated: July 26, 2004

/S/ Glenn J. Heiar

Glenn J. Heiar
Chief Financial Officer
Dated: July 26, 2004