

FORCE PROTECTION INC  
Form 10-Q  
May 15, 2006

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

**FORM 10-Q**

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

**FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2006**

**OR**

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

**FOR THE TRANSITION PERIOD FROM TO**

**COMMISSION FILE NUMBER: 000-22273**

**FORCE PROTECTION, INC.**

**Nevada**  
(State of Incorporation)

**84-1383888**  
(I.R.S. EIN)

**9801 Highway 78, Bldg #2  
Ladson, South Carolina  
29456**

Issuer's telephone number: **(843) 740-7015**

Securities registered pursuant to Section 12(b) of the Act: **None**

Securities registered pursuant to Section 12(g) of the Act: **Common Stock par value \$0.001 per share**

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 x** **No o**

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

**No x**

As of March 31, 2006, the Issuer had 38,734,639 shares of common stock issued and outstanding.

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Transitional Small Business Disclosure Format (check one): Yes

No

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**PART I FINANCIAL INFORMATION**

**ITEM 1 - FINANCIAL STATEMENTS**

**REPORT ON REVIEW BY INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

*JASPERS + HALL, PC*  
*CERTIFIED PUBLIC ACCOUNTANTS*  
*9175 E Kenyon Avenue*  
*Denver, CO 80237*  
*303-796-0099*

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors

Force Protection, Inc. and Subsidiary

We have reviewed the accompanying consolidated balance sheet of Force Protection, Inc., and Subsidiary as of March 31, 2006 and the related consolidated statement of operations and consolidated statement of cash flows for the three month period ended March 31, 2006. These financial statements are the responsibility of the company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying interim financial statements referred to above for them to be in conformity with accounting principles generally accepted in the United States of America.

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

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the balance sheet as of December 31, 2005, and the related statements of operations, stockholders' equity and cash flows for the year then ended (not presented herein). In our report dated March 17, 2006, we expressed an unqualified opinion on those financial statements. In our opinion, the information set forth in the accompanying balance sheet as of March 31, 2006 is fairly stated in all material respects in relation to the balance sheet from which it has been derived.

/s/ Jaspers + Hall,  
PC  
May 8, 2006

**FORCE PROTECTION, INC.**  
**CONSOLIDATED BALANCE SHEET**  
**MARCH 31, 2006**

|   | March 31,<br>2006<br>(unaudited) | December 31,<br>2005 |
|---|----------------------------------|----------------------|
| <b>ASSETS</b>   |                                  |                      |
| Current Assets:   |                                  |                      |
| Cash  | \$ 6,146,738                     | \$ 1,217,509         |
| Accounts receivable   | 1,416,729                        | 4,033,582            |
| Inventories   | 33,587,108                       | 32,486,776           |
| Other current assets  | 371,137                          | 267,189              |
| Total current assets  | 41,521,712                       | 38,005,056           |
| Property and equipment, net   | 2,597,105                        | 2,138,703            |
| <b>Total Assets</b>   | <b>\$ 44,118,817</b>             | <b>\$ 40,143,759</b> |
| <b>LIABILITIES &amp; SHAREHOLDERS EQUITY</b>  |                                  |                      |
| <b>LIABILITIES</b>  |                                  |                      |
| Current Liabilities:  |                                  |                      |
| Accounts payable  | \$ 19,551,390                    | \$ 14,688,855        |
| Other accrued liabilities   | 1,757,368                        | 1,618,451            |
| Contract liabilities  | 1,652,646                        | 2,053,285            |
| Notes payable   | 3,750,000                        | 7,500,000            |
| Note payable - Related Party  | 2,500,000                        |                      |
| Deferred revenue  | 13,734,314                       | 12,598,921           |
| Total Current Liabilities   | 42,945,718                       | 38,459,512           |
|   | <b>Total Liabilities</b>         | <b>\$ 42,945,718</b> |
| <b>SHAREHOLDERS EQUITY</b>  |                                  |                      |
| Preferred stock: no par value, 10,000,000 shares authorized:  |                                  |                      |
| Series D convertible preferred stock, \$1,000 par value; 20,000 shares authorized 8,478 shares at 3.31.2006 and 13,004 shares at 12.31.2005 issued and outstanding, | 8,212,918                        | 12,597,390           |
| Common stock, Par Value \$0.001, 300,000,000 shares authorized; in 2005 38,734,639 shares at 3.31.2006 and 36,114,217 shares at 12.31.2005 issued and outstanding   | 38,735                           | 36,114               |
| Warrants - 3,057,050 outstanding  | 1,500                            | 1,500                |
| Shares committed to be issued ***   |                                  | 122,000              |
| Additional Paid-in Capital  | 43,052,845                       | 38,232,994           |
| Accumulated deficit   | (50,132,899)                     | (49,305,752)         |
|   | <b>Total Shareholders Equity</b> | <b>1,173,099</b>     |
| <b>Total Liabilities and Shareholders Equity</b>  | <b>\$ 44,118,817</b>             | <b>\$ 40,143,759</b> |

\*\*\* Represents shares accrued in 2005 and issued in 2006

The accompanying Notes are an integral part of these Financial Statements.

See Accountant's Review Report

**FORCE PROTECTION, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**For the Three Month Period ended March 31**  
**(Unaudited)**

|   | <b>2006</b>   | <b>2005</b>     |
|---|---------------|-----------------|
| <b>Net Sales</b>                                | \$ 34,802,585 | \$ 5,853,423    |
| Cost of sales                                   | 28,164,816    | 6,395,319       |
| Gross Profit                                    | 6,637,769     | (541,896 )      |
| General and administrative expense              | 5,859,537     | 2,991,444       |
| Research and Development                        | 663,590       | 210,855         |
| <b>Operating Profit (Loss)</b>                  | 114,642       | (3,744,195 )    |
| Other income                                    | 27,049        | 38,541          |
| Interest expense                                | (807,324 )    | (277,256 )      |
| <b>Net Loss</b>                                 | \$ (665,633 ) | \$ (3,982,910 ) |
| <b>Basic loss per common share</b>              | \$ (0.02 )    | \$ (0.13 )      |
| <b>Diluted loss per common share</b>            | \$ (0.02 )    | \$ (0.13 )      |
| <b>Weighted-average shares used to compute:</b> |               |                 |
| Basic loss per share                            | 37,451,698    | 30,728,806      |
| Diluted loss per share                          | 37,451,698    | 30,728,806      |

The accompanying Notes are an integral part of these Financial Statements.

See Accountants Review Report

**FORCE PROTECTION, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**For the Three Month Period Ended March 31, 2006**  
**(Unaudited)**

|  | <b>2006</b>         | <b>2005</b>         |
|--|---------------------|---------------------|
|  | <b>(000 s)</b>      |                     |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>  |                     |                     |
| Net loss from operations   | \$ (665,633 )       | \$ (3,982,910 )     |
| <b>Adjustments to reconcile net loss to net cash (used in) provided by operating activities:</b> |                     |                     |
| Depreciation and Amortization  | 183,558             | 73,837              |
| Common stock issued for services   | 316,000             |                     |
| Change in assets and liabilities:  |                     |                     |
| Increase (decrease) in accounts receivable   | 2,616,853           | (452,310 )          |
| Increase (decrease) in inventories   | (1,100,332 )        | (4,094,983 )        |
| Increase (decrease) in other current assets  | (103,948 )          | (158,291 )          |
| Increase (decrease) in accounts payable  | 4,862,535           | 82,934              |
| Increase (decrease) in other accrued liabilities   | 354,955             | (774,763 )          |
| Increase (decrease) in contract liabilities  | (400,639 )          | 211,223             |
| Increase (decrease) in Deferred Revenue  | 1,135,393           | 3,703,737           |
| <b>Net cash provided (used) in operating activities</b>  | <b>7,198,742</b>    | <b>(5,391,526 )</b> |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>  |                     |                     |
| Purchase of property and equipment   | (641,960 )          | (498,312 )          |
| <b>Net cash used in investing activities</b>   | <b>(641,960 )</b>   | <b>(498,312 )</b>   |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>   |                     |                     |
| Issuance of common stock, net  |                     | 346,124             |
| Issuance of Preferred Series D Stock   |                     | 15,800,000          |
| Preferred Stock Dividends paid   | (377,553 )          |                     |
| Proceeds from (Payments on) loans, net   | (1,250,000 )        | (4,360,975 )        |
| <b>Net cash provided (used) by Financing Activities</b>  | <b>(1,627,552 )</b> | <b>11,785,149</b>   |
| <b>Net increase (decrease) in cash</b>   | <b>4,929,229</b>    | <b>5,895,311</b>    |
| <b>CASH - beginning of period</b>  | <b>1,217,509</b>    | <b>2,264,406</b>    |
| <b>CASH - end of period</b>  | <b>\$ 6,146,738</b> | <b>\$ 8,159,717</b> |
| <b>Interest Paid</b>   | <b>285,806</b>      | <b>114,800</b>      |
| <b>Taxes Paid</b>  |                     |                     |

The accompanying Notes are an integral part of these Financial Statements.

See Accountant's Review Report

**FORCE PROTECTION, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**March 31, 2006**

(Unaudited)

**NOTE 1 PRESENTATION OF CONSOLIDATED INTERIM INFORMATION**

In the opinion of the management of Force Protection, Inc. and its wholly-owned subsidiaries, the accompanying unaudited consolidated financial statements include all normal adjustments considered necessary to present fairly the financial position as of March 31, 2006, and the results of operations and cash flows for the three month period ended March 31, 2006. Interim results are not necessarily indicative of results for a full year.

The consolidated financial statements and notes are presented as permitted by Form 10-Q, and do not contain certain information included in Force Protection Inc. s audited consolidated financial statements and notes for the fiscal year ended December 31, 2005.

The consolidated financial statements include the accounts of Force Protection, Inc., and the Company s two wholly-owned subsidiaries, Force Protection Industries, Inc. (formerly Technical Solutions Group, Inc.) and TSG International, Inc. for the three month period ended March 31, 2006. All inter-company balances and transactions are eliminated in consolidation.

**NOTE 2 GOING CONCERN**

The Company s financial statements have been prepared on a going concern basis, which contemplates continuity of operations, realization of assets and liquidation of liabilities in the normal course of business. The Company had cumulative recurring losses of \$50,132,899 as of March 31, 2006 and while the Company returned to operating profitability for the period ended March 31, 2006 its ability to operate as a going concern will depend upon the Company s ability to generate positive cash flows from operations and/or to obtain outside sources of working capital. Management is aware of these requirements and is undertaking specific measures to address these liquidity concerns. Specifically, to increase revenues the Company has focused on increasing its production capacity to maximize revenues from vehicles sales and has continued to expand its integrated logistics support function to meet the increased demand for spare parts and other support services. The efforts by the Company in these regards have been dramatic as the Company has been able to increase its average monthly vehicle production from four vehicles in early 2005 to an average of 15 vehicles per month during the three month period ended March 31, 2006. In addition the Company is undertaking to increase its gross profitability by reducing the direct costs to manufacture its products by focusing on continual improvement of manufacturing processes and reducing rework and waste resulting from internal inefficiencies. At the same time, the Company is working to reduce the percentage of its G&A expenses through workforce balancing and cost planning initiatives. As a result of such efforts, the Company experienced net positive cash flows from operations for the three month period ended March 31, 2006 of \$7,198,742 and the Company expects this trend to continue. Finally, to provide additional liquidity, the Company continues to explore various asset-based debt financing options, including long term loans, revolving lines of credit and accounts receivable factoring arrangements. Notwithstanding the foregoing, there can be no assurance that the Company will be successful in obtaining such financing, that it will have sufficient funds to execute its business plan or that it will generate positive operating results. The financial statements do not include any adjustments relating to the recoverability and classification of asset carrying amounts or the amount and classification of liabilities that might result should the Company be unable to continue as a going concern.



**NOTE 3 INVENTORIES**

Inventory at March 31, 2006 consisted of the following:

|  | <b>March 31<br/>2006</b> | <b>Dec. 31<br/>2005</b> |
|--|--------------------------|-------------------------|
| Raw materials and supplies                     | 11,487,681               | 15,222,503              |
| Work in process                                | 22,747,708               | 17,762,554              |
| Less: Allowance for obsolescence and shrinkage | (648,281 )               | (498,281 )              |
| Net Inventories                                | 33,587,108               | 32,486,776              |

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**NOTE 4 PROPERTY AND EQUIPMENT**

Property, Plant and Equipment at March 31, 2006 consisted of the following:

|                                    | <b>March 31</b> | <b>Dec 31</b> |
|------------------------------------|-----------------|---------------|
|                                    | <b>2006</b>     | <b>2005</b>   |
| Furniture and fixtures             | 227,613         | 227,613       |
| Leasehold improvements             | 308,557         | 59,928        |
| Machinery and equipment            | 2,417,767       | 2,204,436     |
| Test Equipment                     | 16,790          | 16,790        |
| Manuals                            | 104,798         | 104,798       |
| Vehicles                           | 56,464          | 56,464        |
| Demo vehicles                      | 425,845         | 425,845       |
| Less depreciation and amortization | (960,729 )      | (771,171 )    |
| Net property and equipment         | 2,597,105       | 2,138,703     |

Depreciation expense for the period ended March 31, 2006 was \$183,558 compared with \$73,837 for the same period in 2005.

**NOTE 5 COMMITMENTS + CONTINGENCIES****Compensation of Executive Officers & Directors**

On January 27, 2005, the Company entered into an agreement with Mr. Gordon McGilton to act as its Chief Quality Officer. Under the terms of such agreement, Mr. McGilton is to receive a base salary of \$180,000 plus an annual bonus of \$180,000 and reimbursement for travel, lodging and other out of pocket expenses incurred during employment. The Company also agreed to provide Mr. McGilton stock options once it adopts a stock option plan. Effective April 18, 2005, the Company appointed Mr. McGilton as its Chief Executive Officer. During 2005 Mr. McGilton received in kind compensation in the amount of \$20,000 in the form of a Vortex jet boat which the Company gave Mr. McGilton title to. This in kind compensation was for work performed for the Company by Mr. McGilton as an independent contractor during 2001 and 2002. Effective January 1, 2006 the Company modified Mr. McGilton's compensation to include cash compensation of \$35,000 per month, relocation expense of \$30,000 upon separation for the Company, a one time grant of 300,000 shares of the Company's unregistered common stock and options to purchase 1,000,000 shares of the Company's stock at an exercise price of \$0.72 per share, such options to vest on January 1, 2007 (or earlier upon the occurrence of specified events). Mr. McGilton joined the board of directors on April 18, 2005. Mr. McGilton received no compensation for his services as a director during 2005.

On February 4, 2005, the Company entered into an agreement with Mr. Ted McQuinn to act as President of its subsidiary Force Protection Industries, Inc. Under the terms of such agreement, Mr. McQuinn is to receive compensation of \$180,000 per year, plus an annual grant (for a period of three years) of unregistered common stock valued at \$100,000 and a one time grant of unregistered common stock valued at \$20,000. Mr. McQuinn resigned effective March 31, 2006.



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On November 15, 2004, the Company entered into an employment agreement with Mr. R. Scott Ervin to act as its General Counsel. Under the terms of such agreement, Mr. Ervin is to receive compensation of \$118,000 per year, plus relocation expenses of \$15,000, plus a grant of unregistered common stock valued at \$108,000. Effective January 1, 2005 the annual compensation under such agreement was increased to \$140,000. On January 27, 2005, Mr. Ervin was appointed by the Board to act as Interim Chief Executive Officer during the Company's search for a Chief Executive Officer. Upon the appointment of the new Company Chief Executive Officer on April 18, 2005, Mr. Ervin ceased to serve as the Interim Chief Executive Officer but continues to serve as General Counsel and a member of the board of directors. Mr. Ervin received no compensation for his services as a director during 2005. On November 14, 2005 the Board appointed Mr. Ervin to serve as the Acting Chief Financial Officer following the resignation of the former CFO. Effective February 10, 2006, the Company increased Mr. Ervin's compensation to \$180,000 per annum.

On November 8, 2004 the Company entered into an employment agreement with Director Mr. Gale Aguilar to act as the Interim Chief Executive Officer. Under the terms of such agreement, Mr. Aguilar is to receive compensation of \$180,000 per year, plus a grant of unregistered stock valued at \$82,000. Mr. Aguilar's employment agreement was terminated effective January 27, 2005. Mr. Aguilar received no compensation for his services as a director during 2005.

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

### **Legal Proceedings**

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

### **Liquidated Damages**

During the second quarter of 2005, the Company announced the award of contract M67854-05-D-5091 by the U.S. Marine Corps for delivery of one hundred twenty-two Cougar Joint EOD Rapid Response Vehicles ( JERRV ) to be delivered during 2005 and 2006. As part of such contract, the Company received \$6,699,996 as the initial contract milestone payment for accelerated delivery costs. Under the terms of the JERRV contract, the customer has the right to recover this milestone payment in the form of liquidated damages on each vehicle in the event any of the vehicles are delivered after the contractually agreed delivery date. The amount of liquidated damages is \$54,918 per vehicle for each vehicle delivered late (representing the total milestone payment of \$6,699,996 divided by the 122 JERRV Cougars to be delivered under the contract). The Company has established a provision of \$219,872 against this contingency.

### **Other Accrued Liabilities**

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The Company's other accrued liabilities include the following:

|                                      | 2006         | 2005         |
|--------------------------------------|--------------|--------------|
| Compensation and benefits            | 1,714,978    | 1,341,101    |
| Accrued Dividends on Preferred Stock | 42,390       | 260,080      |
| Other                                |              | 17,270       |
|                                      | \$ 1,757,368 | \$ 1,618,451 |

**Accruals for Warranty and Pricing**

Accruals for warranty and pricing contingencies include the following:

|                                 | 2006         | 2005         |
|---------------------------------|--------------|--------------|
| Non- Recurring Warranty         |              | 1,306,018    |
| General Warranty                | 619,947      | 380,044      |
| Contract Price re-determination | 812,827      | 367,223      |
| Other                           | 219,872      |              |
|                                 | \$ 1,652,646 | \$ 2,053,285 |

**NOTE 6 DEFERRED REVENUE**

The Company only recognizes revenue from the sales of its vehicles upon formal acceptance by its U.S. Government customer however the Company does receive performance based payments in accordance with agreed milestones under some of its government contracts. The Company records such performance based payments as deferred revenue and carries them on its balance sheet until formal acceptance by the customer. As of March 31, 2006 the Company has booked \$13,734,314 as deferred revenue resulting from its contracts with the U.S. Army and the U.S. Marines.

**NOTE 7 CONTRACT DEFINITIZATION**

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

During the three month period ended March 31, 2006 the Company reached agreement with the U.S. Marine Corps Contracting Officer on a final definitized price for the JERRV contract (M67854-05-D-5091) in the total amount of \$89,739,728 representing a reduction of \$3,364,405 in the originally stated contract price.

**NOTE 8 DEBT**

On November 18, 2005, the Company entered into a Subscription Agreement with Longview Fund, LP and Longview Equity Fund, LP (the Subscribers ) pursuant to which the Company issued to the Subscribers secured promissory notes (the Notes ) having a total face value of \$7,500,000. The Notes matured on February 18, 2006, and paid simple interest at the annual rate of twenty-four percent if not paid in full at that time. In connection with such purchase, the Company executed a Security Agreement pursuant to which the Subscribers were granted a first preferred UCC-1 security interest in all of the Company s assets and property. On February 18, 2006 the Company entered into a Modification

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and Assignment Agreement with the holders of the Notes pursuant to which the Company paid \$1,250,000 of the face value of the notes and extended the maturity date of the balance for an additional 60 days. In addition, the Company consented to the assignment of \$2,500,000 of the Notes to Fort Ashford Funds LLC, including the assignment of all rights and responsibilities of the Subscribers. The Company's Director, Frank Kavanaugh, is the principal owner of Fort Ashford Funds and a substantial shareholder of its common stock. Mr. Kavanaugh's relationship to Fort Ashford Funds was fully disclosed to the Company and

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Mr. Kavanaugh did not participate in the negotiations or decision process in respect of the Modification and Assignment Agreement.

As of March 31, 2006, the Company had \$6,250,000 in short-term debt, representing the face value of the Notes outstanding at that time.

#### **NOTE 9 RECEIVABLES AND FACTORING**

The Company entered into a Purchase and Sale Agreement (the Factoring Agreement ) with GC Financial Services, Inc. dated June 29, 2005 pursuant to which it agreed to sell the U.S. government receivables under its JERRV Contract (M67854-05-D-5091) in an amount not to exceed \$63,000,000. Under the terms of such agreement, the Company receives 98.1% of the value of receivables sold to GC Financial within 24-48 hours of delivery of the invoice. The total amount of factoring expense changed to interest during the three month period ended March 31, 2006 was \$514,234.

#### **NOTE 10 STOCK BASED COMPENSATION**

The Company does not have a formal stock compensation plan, however the Company has issued stock to employees and non-employees from time to time as compensation for services rendered.

During the three month period ended March 31, 2006 the Company granted 300,000 shares of its unregistered stock valued at \$216,000 and options to purchase 1,000,000 shares of the Company's common stock at an exercise price of \$0.72 per share as compensation to its Chief Executive Officer. The options vest on January 1, 2007 (or earlier upon the occurrence of specified events).

On February 25, 2006, the Company issued 47,619 shares of its unregistered common stock to Mr. McQuinn valued at \$100,000 in accordance with the terms of Mr. McQuinn's employment agreement.

During 2005, the Company granted shares of its unregistered stock valued at \$82,000 to the Company's Interim Chief Executive Officer Mr. Aguilar. On February 28, 2006 the Company issued certificates for a total of 117,583 shares of its unregistered common stock representing such stock grants.

#### **NOTE 11 STOCK OPTIONS**

During 2005, the Company issued options to purchase 647,833 shares of its unregistered common stock to certain of its employees at an exercise price of \$1.50 per share. All such options vest in full effective April 15, 2006. In January 2006 the Company issued options to purchase 1,000,000 shares of common stock at an exercise price of \$0.72 per share, such options to vest on January 1, 2007 (or earlier upon the occurrence of specified events).



**NOTE 12 COMMON STOCK WARRANTS**

As of March 31, 2006 the following warrants to purchase shares of the Company's common stock were outstanding:

- warrants to purchase 83,333 shares of unregistered common stock at \$0.84/share expiring Nov. 15, 2008
- warrants to purchase 83,333 shares of unregistered common stock at \$2.40/share expiring Jan. 17, 2007
- warrants to purchase 2,699,167 shares of common stock at \$3.75/share expiring January 19, 2007
- warrants to purchase 150,000 shares of common stock at \$3.75/share expiring May 5, 2007
- warrants to purchase 41,667 shares of unregistered common stock at \$3.96/share expiring January 13, 2007

All of the foregoing warrants are immediately exercisable. The fair value of all these warrants was insignificant at the issuance date.

**NOTE 13 CONVERTIBLE PREFERRED STOCK**

The board of directors has the authority to issue preferred stock in one or more series, and fix for each series, the designation of, and number of shares to be included in each such series. The board of directors is also authorized to set the powers, privileges, preferences, and relative participating, optional or other rights, if any, of the shares of each such series and the qualifications, limitations or restrictions of the shares of each such series.

**Series D Convertible Preferred Stock**

On January 20, 2005, the Company authorized twenty thousand shares of Series D 6% Convertible Preferred Stock. On January 21, 2005, the Company issued 15,800 shares of Series D stock in a private placement. As of March 31, 2006 there were 8,478 shares of Series D stock outstanding. Holders of the Series D stock are entitled to receive cumulative dividends at the rate per share of 6% per annum, payable semi-annually on March 1 and September 1, beginning with the first such date after the original issue date. The Preferred Series D does not have voting rights. Upon any liquidation, dissolution or winding-up of the Corporation, whether voluntary or involuntary, the Holders of the Series D shall be entitled to receive out of the assets of the Company, whether such assets are capital or surplus, for each share of Preferred Stock an amount equal to the Stated Value per share plus any accrued and unpaid dividends thereon and any other fees or liquidated damages owing thereon before any distribution or payment shall be made to the holders of any Junior Securities. Each share of Series D Preferred Stock will convert into the number of shares of the Company's common stock equal to \$1,000 divided by the conversion price at the holder's discretion. The current conversion price is \$2.10. During the three month period ended March 31, 2006 a total of 4,526 shares of Convertible Preferred Series D stock were converted to common.

**NOTE 14 REVERSE STOCK SPLIT**

In January 2005, the Board of Directors approved a 1 (new)-for-12 (old) reverse stock split of the outstanding shares of the Company's common stock. The reverse stock split became effective February 4, 2005. Shareholders approved the action at the Company's annual meeting on December 30, 2004. All references in the Company's quarterly and annual reports to shares of its common stock represent shares adjusted for the effect of the reverse stock split (i.e. they represent post-reverse split shares).

**NOTE 15 OTHER STOCK TRANSACTIONS**

During the three month period ended March 31, 2006 the Company issued the following securities (other than those referred to in Notes 11 & 12 above relating to Stock Based Compensation):

- 2,155,220 shares of common stock pursuant to the conversion of 4,526 shares of Series D Convertible Preferred stock during the three month period ended March 31, 2006.

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On January 21, 2005, the Company issued 15,800 shares of Series D 6% Convertible Preferred Stock ( Series D Stock ) having par value of \$1,000 per share, for gross proceeds of \$15.8 million. Each share of the Series D stock may convert at any time, in the holder's discretion, into 476 shares of common stock at a fixed conversion price of \$2.10 per common share. Holders of the Series D stock are entitled to receive cumulative dividends at the rate per share of 6% per annum, payable semi-annually on March 1 and September 1, beginning with the first such date after the original issue date; such dividends may be paid in cash or shares of stock according to the terms of the Series D Certificate of Designation.

In connection with the sale of the Series D stock, the Company issued warrants to the Series D shareholders to purchase 2,633,333 shares of common stock. The exercise price of the warrants is \$3.75 per share, and can be exercised at any time prior to their expiration on January 19, 2008.

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In connection with the sale of the Series D stock, the Company issued to the transaction placement agent warrants to purchase 65,833 shares of the Company's common stock at an exercise price of \$3.75 per share. The warrants expire on January 19, 2008.

As of December 31, 2005 the Company had issued the following shares of common stock as a result of the Series D convertible preferred stock:

- 1,331,429 shares of common stock pursuant to the conversion by the Series D Holders of 2,796 shares of Series D Convertible Preferred stock during 2005.
- 224,511 shares of common stock valued at \$321,939 as payment of the semi-annual dividend due to the Company's Series D Convertible Preferred stockholders on September 1, 2005.
- 57,186 restricted shares of common stock valued at \$100,076 as payment of the semi-annual dividend due to the Company's Series D Convertible Preferred stockholders on March 1, 2005.

As of March 31, 2006, none of the Warrants issued in connection with the Series D transaction have been exercised.

### NOTE 16 GAIN/LOSS PER SHARE

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

|                                      | 2006      | 2005      |
|--------------------------------------|-----------|-----------|
| Convertible Preferred Stock Series D | 4,037,143 | 6,192,381 |
| Warrants                             | 3,057,500 | 2,994,167 |
| Options                              | 1,456,666 | 456,666   |
| Total                                | 8,551,305 | 9,643,214 |

Earning Per Share Computation:

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|                        | 2006     |   | 2005       |   |
|------------------------|----------|---|------------|---|
| Net Loss               | (665,633 | ) | (3,982,910 | ) |
| Preferred Dividends    | (159,864 | ) | (158,830   | ) |
| Pro forma Net Loss     | (825,497 | ) | (4,141,740 | ) |
| Basic Loss per share   | \$ (0.02 | ) | \$ (0.13   | ) |
| Diluted Loss per share | \$ (0.02 | ) | \$ (0.13   | ) |

**NOTE 17 CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

The Company's Chief Executive Officer, Mr. McGilton, is a principle of APT Leadership, a consulting firm the Company hired to provide various business consulting services, training seminars and certain business software. During the three month period ended March 31, 2006, APT Leadership has billed the Company a total of \$139,344 for such services, training and software.

On November 18, 2005, the Company entered into a Subscription Agreement with Longview Fund, LP and Longview Equity Fund, LP (the "Subscribers") pursuant to which the Company issued to the Subscribers secured promissory notes (the "Notes") having a total face value of \$7,500,000. The Notes matured on February 18, 2006, and paid simple interest payable at the annual rate of twenty-four percent if not paid in full at that time. In connection with such purchase, the Company executed a Security Agreement pursuant to which the Subscribers were granted a first preferred UCC-1 security interest in all of the Company's assets and property. On February 18, 2006 the Company entered into a Modification and Assignment Agreement with the holders of the Notes pursuant to which the Company paid \$1,250,000 of the face value of the notes and extended the maturity date of the balance for an additional 60 days. In addition, the Company consented to the assignment of \$2,500,000 of the Notes to Fort Ashford Funds LLC, including the assignment of all rights and responsibilities of the Subscribers. The Company's Director, Frank Kavanaugh, is the principal owner of Fort Ashford and a substantial shareholder of its common stock. Mr. Kavanaugh's relationship to Fort Ashford was fully disclosed to the Company and Mr. Kavanaugh did not participate in the negotiations or decision process in respect of the Modification and Assignment Agreement. During the three month period ended March 31, 2006 the Company paid a total of \$150,000 in interest and fees in connection with such Notes to Fort Ashford Funds of which \$99,152 was expensed and the remainder was recorded as prepaid.

**NOTE 18 INCOME TAXES**

There has been no provision for U.S. federal, state, or foreign income taxes for any period because the Company has incurred losses or has loss carryforwards in all periods and for all jurisdictions.

**ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS**

**CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS**

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

**SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

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

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The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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

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

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

We recognize revenue upon formal acceptance of vehicles by customers. We receive performance based payments from the U.S. Army and U.S. Marines and record such payments as deferred revenue, carrying them on our balance sheet as such until acceptance by the customer.

In December 2004, FASB issued Statement No. 123(R), Share-Based Payment, which establishes accounting standards for transactions in which an entity receives employee services in exchange for (a) equity instruments of the entity or (b) liabilities that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of equity instruments. Effective in the third quarter of 2005, SFAS 123(R) will require us to recognize the grant-date fair value of stock options and equity based compensation issued to employees in the statement of operations. The statement also requires that such transactions be accounted for using the fair-value-based method, thereby eliminating use of the intrinsic method of accounting in APB No. 25, Accounting for Stock Issued to Employees, which was permitted under Statement 123, as originally issued. To date, we have expensed stock based compensation on the intrinsic method. We are currently evaluating the impact of Statement No. 123 (R) on our financial condition and results of operations.

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



Principles of Consolidation: The consolidated financial statements include the accounts of Force Protection, Inc., and our two wholly owned subsidiaries, Force Protection Industries, Inc. (formerly Technical Solutions Group, Inc.) and TSG International, Inc. for the three month period ended March 31, 2006. All inter-company balances and transactions are eliminated in consolidation.

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

Inventories: Inventories are stated at the lower of cost or market. The cost is determined under the first-in, first-out, or FIFO, base valuation method.

Property, Plant and Equipment: Property and equipment are stated at cost or at the value of the operating agreement. We capitalize additions and improvements which include all material, labor and engineering cost to design, install or improve the asset. Routine repairs and maintenance are expensed as incurred. The capitalization threshold is \$2,000 and a useful life greater than one year. Depreciation and amortization are computed using the straight-line method over the following estimated useful lives:

|                         |          |
|-------------------------|----------|
| Leasehold improvements  | 20 years |
| Furniture and fixtures  | 3 years  |
| Machinery and equipment | 7 years  |
| Tooling and molds       | 7 years  |
| Vehicles                | 5 years  |

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

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

Revenue Recognition: Our revenue is derived principally from the sale of our vehicles and associated spare parts and training services. Revenue from products and services is recognized at the time goods are shipped or services are provided to the customer, with an appropriate provision for returns and allowances. We receive performance based payments based on completion of specific milestones. These payments are recorded as Deferred Revenue and recognized on the profit and loss statement upon customer acceptance of the completed vehicle. It is our policy to not recognize revenue until customer acceptance. All advance payments are treated as deferred revenue .

Dividend Policy: We have never declared or paid a cash dividend on our common stock, and we do not anticipate paying any cash dividends on our common stock in the foreseeable future. Any future determination to pay cash dividends on our common stock will be at the discretion of our board of directors and will depend upon our financial condition, operating results, capital requirements, restrictions contained in our agreements and other factors which our board of

directors deems relevant. Under the terms of the Certificate of Designation for our Series D Convertible Preferred stock, we are obligated to pay a 6% dividend in cash or shares of common stock on the outstanding shares of Series D stock.

FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview: The Company returned to operating profitability for the three month period ended March 31, 2006, due to the increased production of our vehicles and the increased efficiency of our operations. Sales for this period from all sources generated gross revenue of \$34,802,585 against which we incurred total cost of goods of \$28,164,816 generating a gross profit of \$6,637,769. We incurred G&A expenses of \$5,859,538 plus R&D expenses in the amount of \$663,590 resulting in an operating profit of \$114,641. During this three month period, we delivered a total of 44 vehicles (1 Buffalo and 43 Cougar JERRV), and on February 3, 2006 we announced the award of a Letter Contract from the U.S. Army for the delivery of 19 Buffalo Vehicles with an option for an additional 22 vehicles,

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having a total estimated value of \$35,000,000. In addition to operating profitability, we experienced positive cash flows from operations of \$7,118,898 during the three month period ended March 31, 2006.

The following table sets forth our consolidated statements of operations for the three month period ended March 31 for the years 2005 and 2006. The discussion and analysis that follows should be read in conjunction with our consolidated financial statements and related notes included elsewhere in this report.

### Consolidated Statement of Operations

|                         | <b>Three Month Period Ended</b> |                       |                   |                 |   |
|-------------------------|---------------------------------|-----------------------|-------------------|-----------------|---|
|                         | <b>March 31, 2006</b>           | <b>March 31, 2005</b> | <b>Difference</b> | <b>% Change</b> |   |
| Revenues                | \$ 34,802,585                   | 5,853,423             | 28,949,162        | 495             | % |
| Cost of Sales           | 28,164,816                      | 6,395,319             | 21,769,497        | 340             | % |
|                         | Gross Profit 6,637,769          | (541,896 )            | 7,179,665         | 1325            | % |
|                         | G.P. % 19                       | %                     | (10 )%            |                 |   |
| G&A Expense             | \$ 5,859,538                    | 2,991,444             | 2,868,094         | 96              | % |
| R&D Expense             | 663,590                         | 210,855               | 452,735           | 215             | % |
|                         | Total G&A 6,523,128             | 3,202,299             | 3,320,829         |                 |   |
| Operating Profit (Loss) | \$ 114,641                      | (3,744,195 )          | 3,858,836         |                 |   |
| Interest Expense        | \$ (807,324 )                   | (277,256 )            | (530,068 )        |                 |   |
| Other Income/(Expense)  | 27,049                          | 38,541                | (11,492 )         |                 |   |
| Net Income (Loss)       | \$ (665,634 )                   | (3,982,910 )          | 3,317,276         |                 |   |

**Revenue:** Revenue for the three month period ended March 31, 2006 was \$34,802,585 representing an increase of 495% compared to the same period in 2005. The increase during this period was due to the increased level of vehicle production we have achieved compared with last year, which is primarily the result of the JERRV contract, awarded in May 2005. Our revenue is derived from the sale of our Buffalo and Cougar vehicles and the sale of spare parts and other support services, however we do not record any income until our products are formally accepted by our customers. The revenue reported during this three month period thus includes amounts we carried on our balance sheet during prior reporting periods as deferred revenue pending acceptance of the final products by the U.S. Army and the U.S. Marines. During the three month period ended March 31, 2006, we received approximately \$33,000,000 from vehicle sales and \$1,800,000 from the sale of spare parts and other support services. The revenue from the sale of spare parts has continued to increase over past quarters, driven by the increasing number of our vehicles delivered and deployed to areas of operations. We intend to continue to develop this spare parts business as an increasingly important part of our revenue base.

**Cost of Sales:** Cost of sales for the three month period ended March 31, 2006 was \$28,164,816 representing an increase of \$21,769,497 compared to the same period in 2005. The increase during this period was due to the increased level of vehicle production, and the corresponding increased cost of direct and indirect labor and material associated with our manufacturing activities. The cost of sales for the three month period ended March 31, 2006 was 81% of gross

revenues for such three month period representing a 19% gross profit for this period, compared with cost of sales of 110% of gross revenues for the same period in 2005. This improvement in our gross profit is the result in part of increasing efficiency of our manufacturing operations. As we continue to expand our production capacity, we expect to achieve increased cost efficiency from volume purchasing, improvements in our

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manufacturing processes and the allocation of indirect costs across a broader production base, resulting in a projected decrease in the cost of sales as a percentage of gross revenue.

General and Administrative Expenses: General and Administrative expenses for the three month period ended March 31, 2006 were \$6,523,128 representing an increase of \$3,320,829 compared to the same period in 2005. The G&A expenses for the period ended March 31, 2006 included \$663,590 in research and development expense. We expect our General and Administrative expenses to increase over time as we continue to expand our production capacity to meet increasing sales demand, however we expect the percentage of our G&A expenses in relation to gross revenues to decrease as we achieve greater efficiencies in our operations. Thus, for example, during the three month period ended March 31, 2006, our General and Administrative expense was 19% of our gross revenue as compared with 54% for the same period in 2005.

Net Gain/(Loss): Net Loss for the three month period ended March 31, 2006 was \$665,633 representing an improvement over the net loss of \$3,982,910 incurred during the same period in 2005. The improved performance is due primarily to higher production volumes and improved operating cost efficiencies.

Backlog: On April 23, 2004 we announced a contract award to deliver Cougar Hardened Engineer Vehicles, or HEV, to the U. S. Marine Corps, of which fourteen were initially funded under the contract. On March 8, 2005 the U.S. Marine Corps exercised its option to increase the number of HEV vehicles by fourteen, for a total of twenty-eight vehicles. As of March 31, 2006 we delivered a total of twenty-seven HEV vehicles, and have a remaining backlog of one Cougar HEV vehicle to be delivered under this contract, with a value of approximately \$400,000. On May 17, 2004 we announced the award of a contract to deliver twenty-one Buffalo vehicles to the U.S. Army and in October 2004 we were awarded a separate contract by the U.S. Army for an additional fifteen Buffalo vehicles. Initial deliveries under these two Buffalo contracts began during 2004 and 2005, and as of March 31, 2006 we have delivered all thirty-six Buffalo vehicles, leaving no backlog under these two contracts with the U.S. Army. During the second quarter of 2005 we announced the award of a new contract by the U.S. Marine Corps for delivery of one hundred twenty-two Cougar Joint EOD Rapid Response Vehicles ( JERRV ) to be delivered during 2005 and 2006, with a total value (with associated spares parts and training) of \$90,000,000. As of March 31, 2006, we have delivered 61 JERRV vehicles and have a remaining backlog of 61 vehicles under the JERRV contract with an approximate value of \$45,000,000, including associated spares and support. During the three month period ended December 31, 2005, we also announced a new order from the U.S. Marine Corps. for the purchase of four Buffalo vehicles (with associated spares, service and training) for a total contract price of \$3,852,026.00. We delivered all four of these Buffalo vehicles under such contract during 2005.

On February 3, 2006 we announced the award of a Letter Contract from the U.S. Army for the delivery of 19 Buffalo Vehicles with an option for an additional 27 vehicles. The Army subsequently reduced the number of the additional vehicles from 27 to 22, for a total of 41. The Letter Contract is subject to definitization of terms. Additionally, on March 2, 2006 we announced the award of a contract with the U. S. Army, whereby we agree to provide the Army with authorized stock list supplies to service its Buffalo route clearance vehicle for the sum of up to \$5 million.

Future Results: During the remainder of calendar year 2006 we expect to have incurred the majority of our presently anticipated infra-structure expansion costs and to achieve a substantially increased level of vehicle production capacity, resulting in increased revenues and profitability for such upcoming period. Set out below is a table showing actual and projected deliveries of our vehicles during 2004, 2005 and 2006 based on our internal estimates although our actual results may vary depending upon parts and material availability, actual production schedules, production efficiencies and other contingencies discussed in this report.

**Vehicle Deliveries 2004, 2005 & 2006**

|              | <b>Actual<br/>2004</b> | <b>Q1-2005</b> | <b>Q2-2005</b> | <b>Q3-2005</b> | <b>Q4-2005</b> | <b>Q1-2006</b> | <b>Projected<br/>Q2-2006</b> | <b>Q3-2006</b> | <b>Q4-2006</b> |
|--------------|------------------------|----------------|----------------|----------------|----------------|----------------|------------------------------|----------------|----------------|
| Buffalo      | 9                      | 2              | 22             | 3              | 4              | 1              | 12                           | 12             | 12             |
| Cougar HEV   | 5                      | 8              | 2              | 8              | 4              | 0              | 0                            | 0              | 0              |
| Cougar JERRV | 0                      | 0              | 0              | 2              | 16             | 43             | 62                           | 60             | 60             |
| Total        | 14                     | 10             | 24             | 13             | 24             | 44             | 74                           | 72             | 72             |

TRENDS, RISKS AND UNCERTAINTIES

The results of our operations for the period ended March 31, 2006 reflect the continued transition from net losses associated with our start up period to profitability as we evolve to become a manufacturing facility with stable production capability. During 2004 we were awarded contracts by the U.S. Army for a total of thirty six Buffalos and by the U.S. Marines for twenty eight Cougars, and were able to build 14 vehicles during that year. In 2005 we produced a total of total of 71 vehicles, representing an increase of 407%. During the three month period ended March 31, 2006, we produced a total of 44 vehicles, representing an annualized increase of 248%, and we are on track to achieve a minimum production capacity of 24 vehicles per month. During 2005, as we were working to complete our 2004 backlog, we also undertook the work necessary to increase our production capacity to meet the demand for our vehicles under the JERRV contract for one hundred twenty-two Cougars awarded in May 2005. This included substantial vehicle and automotive engineering work, manufacturing engineering development, hiring and training workers and the expansion of our manufacturing and administrative facilities. While the JERRV contract reflects a broader, growing demand for our vehicles, we continued to face the challenge of expanding our manufacturing capacity to fully exploit this opportunity. During 2005 we moved aggressively to meet this challenge by expanding our facilities, improving our operating systems and refining our manufacturing processes. These activities required a significant commitment of short term resources, but have positioned us to reap a long-term benefit. The results for the first quarter of 2006 demonstrate that we are beginning to be in a position to reap such benefits, in the form of increased liquidity and operating profitability.

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

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

LIQUIDITY AND CAPITAL RESOURCES

Current Liquidity: For the three month period ended March 31, 2006, we had a starting cash balance of \$1,217,509 and an ending cash balance of \$6,146,738 representing a net increase in our cash position for such period of \$4,929,229. During this period we incurred positive cash flows from operations of \$7,198,742 and used \$1,627,553





in connection with our financing activities, including paying \$1,250,000 of the principal amount due under our short term debt.

Future Liquidity: During the three month period ended March 31, 2006 we experienced positive cash flows from operations of \$7,118,898 and were able to retire a portion of our short term debt. During this period, we continued to manage our accounts payable, and continued to factor our U.S. Government receivables under the Purchase and Sale Agreement with GC Financial Services, Inc. which allows us to receive payment within 24-48 hours of vehicle deliveries and reduces the impact of the government contract payment cycle on our short term liquidity. During the remainder of 2006 we expect the infra-structure expenses we have incurred in connection with our production ramp-up will begin to level off or decline and that we will continue to experience increased levels of positive cash flows from operations as we increase the volume of vehicle production. Such positive cash flows will allow us to pay down all or a portion of our short term debt and reduce the level of our accounts payable. In addition, we are also undertaking to secure long-term, asset-based debt financing to provide liquidity to support our continued development and growth.

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

#### Inflation & Material Cost

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

### ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

#### *COMMODITY PRICES*

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

*FOREIGN CURRENCY*

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

*INTEREST RATES*

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

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

#### **ITEM 4 CONTROLS AND PROCEDURES**

##### **Disclosure Controls and Procedures**

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

##### **Changes in Internal Controls over Financial Reporting**

There were no changes in our internal control over financial reporting that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

##### **Code of Ethics**

We have adopted a Code of Ethics that applies to all executive officers and other employees. Our Code of Ethics is available for review on our website at [www.forceprotectioninc.com](http://www.forceprotectioninc.com).

#### **PART II OTHER INFORMATION**

##### **ITEM 1 LEGAL PROCEEDINGS**

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

### **ITEM 1A RISK FACTORS**

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

#### *RISKS RELATED TO OUR BUSINESS*

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

We have historically generated substantial losses, which, if continued, could make it difficult to fund our operations or successfully execute our business plan, and could adversely affect our stock price. We experienced net losses of \$5,321,624 for the year ended December 31, 2003, \$10,245,833 for the year ended December 31, 2004 and

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\$16,565,668 for the year ended December 31, 2005. We have generated significant net losses in recent periods, and experienced negative cash flows from operations in the amount of \$4,069,735 for the year ended December 31, 2003, \$13,763,396 for the year ended December 31, 2004 and \$18,296,127 for the year ended 2005. In recent years, some of the losses were incurred as a result of investments in new product development, inefficiencies while we built up our operations and marketing costs. While we have increased our investments, most notably in inventory, we anticipate that we will continue to generate net losses and we may not be able to achieve or sustain profitability on a quarterly or annual basis in the future. In addition, because large portions of our expenses are fixed, we generally are unable to reduce expenses significantly in the short-term to compensate for any unexpected delay or decrease in anticipated revenues. As a result, we may continue to experience net losses, which will make it difficult to fund our operations and achieve our business plan, and could cause the market price of our common stock to decline.

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

We are an early stage production company. We acquired our subsidiary, Force Protection Industries, Inc. (formerly Technical Solutions Group, Inc.) in July 2002 and have only recently begun generating significant revenues. We generated revenues from our current products of \$6,247,285 for the year ended December 31, 2003, \$10,272,757 for the year ended December 31, 2004 and \$49,712,829 for the year ended December 31, 2005. The sale of our mine protected vehicles and associated spare parts provided 100% of the sales, 100% of the cost of goods sold and 100% of the loss in 2004 and 2005. Our ability to successfully commercialize our products will depend on, among other things, successful completion of our ongoing development activities, geo-political events, ability to cost effectively manufacture and distribute our products, and the relative cost to the customer of our system as compared to alternative competitive products. Because we focus on emerging markets, market reaction can be difficult to predict. Many of our planned products incorporate technologies or approaches that have not yet achieved broad market acceptance. In addition, we have a limited history of competing in the intensely competitive defense industry. Our technology may not be successfully commercialized or marketed. As a result, we may never achieve or sustain profitable operations.

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

The financial statements in our annual report on Form 10-K for the year ended December 31, 2005, have been prepared assuming we will continue as a going concern. During the year ended December 31, 2003, we incurred a net loss of \$5,321,624, during the year ended December 31, 2004 we incurred a net loss of \$10,245,833 and during the year ended December 31, 2005 we incurred a net loss of \$16,565,668. Conditions exist which raise substantial doubt about our ability to continue unless we are able to generate sufficient cash flows to meet our obligations and sustain our operations. The financial statements do not include any adjustment that might result from the outcome of this uncertainty.

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

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

currently outstanding will be further diluted.

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

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

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

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

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

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

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



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

Some of our product components are manufactured in South Africa and supplied from other foreign countries. If import tariffs or taxes increase for any reason, our cost of goods would increase. Our financial performance may be affected by changes in political, social and economic environment. The role of the central and local governments in the economy is significant. Policies toward economic liberalization, and laws and policies affecting foreign

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companies, foreign investment, currency exchange rates and other matters could change, resulting in greater restrictions on our ability to do business with suppliers based in other countries. The government could impose surcharges, increase tax rates, or revoke, terminate or suspend operating licenses without compensating us. Also, South Africa and other countries, from time to time, experience instances of civil unrest and hostilities. Confrontations have occurred between the military, insurgent forces, and civilians. If for these or any other reason, we lose our ability to sub-contract or manufacture the components to its products, or the cost of doing business increases, our business, financial condition, and results of operations would be materially and adversely affected.

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

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

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

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

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

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

We are subject to federal, state, local and foreign laws, and regulations regarding protection of the environment, including air, water, and soil. Our manufacturing business involves the use, handling, storage, and contracting for recycling or disposal of, hazardous or toxic substances or wastes, including environmentally sensitive materials, such as batteries, solvents, lubricants, degreasing agents, gasoline and resin. We must

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comply with certain requirements for the use, management, handling, and disposal of these materials. We do not maintain insurance for pollutant cleanup and removal. If we are found responsible for any hazardous contamination, we may have to pay expensive fines or penalties or perform costly clean-up. Even if we are charged, and later found not responsible, for such contamination or clean up, the cost of defending the charges could be high. If we do not comply with government regulations, we may be unable to ship our products or have to pay expensive fines or penalties. We are subject to regulation by county, state and federal governments, governmental agencies, and regulatory authorities from several different countries. If we fail to obtain regulatory approvals or suffer delays in

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obtaining regulatory approvals, we may not be able to marketing our products and services, and generate product and service revenues. Further, we may not be able to obtain necessary regulatory approvals. Although we do not anticipate problems satisfying any of the regulations involved, we cannot foresee the possibility of new regulations, which could adversely affect our business. Further our products are subject to export limitations and we may be prevented from shipping our products to certain nations or buyers.

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

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

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

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

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

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

### *RISKS RELATED TO OUR STOCK*

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

Trading in our securities is subject to the Securities and Exchange Commission's penny stock rules and it is anticipated that trading in our securities will continue to be subject to the penny stock rules for the foreseeable future. The Securities and Exchange Commission has adopted

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

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

Our securities are quoted on the Over-the-Counter Bulletin Board. The Over-the-Counter Bulletin Board is an inter-dealer, over-the-counter market that provides significantly less liquidity than the NASDAQ Stock Market or national or regional exchanges. Securities traded on the Over-the-Counter Bulletin Board are usually thinly traded, highly volatile, have fewer market makers and are not followed by analysts. The Securities and Exchange Commission's order handling rules, which apply to NASDAQ-listed securities, do not apply to securities quoted on the Over-the-Counter Bulletin Board. Quotes for stocks included on the Over-the-Counter Bulletin Board are not listed in newspapers. Therefore, prices for securities traded solely on the Over-the-Counter Bulletin Board may be difficult to obtain and holders of our securities may be unable to resell their securities at or near their original acquisition price, or at any price.

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

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

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

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

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

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

## **ITEM 2 UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

We do not have a formal stock compensation plan, however we have issued stock to employees and non-employees from time to time as compensation for services rendered.

During the three month period ended March 31, 2006, we granted 300,000 shares of unregistered stock valued at \$216,000 and options to purchase 1,000,000 shares of common stock at an exercise price of \$0.72 per share as compensation to our Chief Executive Officer. The options vest on January 1, 2007 or earlier upon the occurrence of specified events.

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On February 25, 2006, we issued 47,619 shares of our unregistered common stock to Mr. McQuinn valued at \$100,000 in accordance with the terms of Mr. McQuinn's employment agreement.

### **ITEM 3 - DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

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

Not applicable.

### **ITEM 5 - OTHER INFORMATION**

#### NOTE REGARDING OUR AUDITORS

During 2004, the accounting firm of Jaspers and Hall, PC purchased the assets of Michael Johnson and Company, LLC - our former independent auditors. To maintain continuity in the audit procedure, we chose to use the services of Jaspers and Hall after such purchase, as the preceding company was familiar with our financial records. Our Board of Directors has confirmed the withdrawal of Michael Johnson & Co., LLC as our principal accountants and ratified the appointment of Messrs Jaspers + Hall, PC to serve as our independent public accountants for the fiscal year ending December 31, 2005.

There have been no disagreements with Jaspers + Hall on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure which, if not resolved to Jaspers + Hall's satisfaction, would have caused them to make reference to the subject matter of such disagreements in connection with their report on our consolidated financial statements for such year. Jaspers + Hall's report on our consolidated financial statements for the fiscal year ended December 31, 2005 did not contain an adverse opinion or disclaimer of opinion, or was modified as to uncertainty, audit scope or accounting principles, however, they were modified to include an explanatory paragraph wherein they expressed substantial doubt about our ability to continue as a going concern.

During the year ended December 31, 2005 and through the date hereof, we did not consult with Jaspers + Hall, PC with respect to the application of accounting principles to a specified transaction, either completed or proposed, or the type of audit opinion that might be rendered on our financial statements.

### **ITEM 6 - EXHIBITS**

#### EXHIBIT INDEX

#### NUMBER DESCRIPTION

- |     |   |
|-----|---|
| 2.1 | Agreement and Plan of Merger (included as Attachment A to exhibit 99.2 to the Form DEF 14A filed November 19, 2004, and incorporated herein by reference).  |
| 3.1 | Articles of Incorporation (included as Attachment B to exhibit 99.2 to the Form DEF 14A filed November 19, 2004, and incorporated herein by reference).   |
| 3.2 | By-Laws (included as Attachment C to exhibit 99.2 to the Form DEF 14A filed November 19, 2004, and incorporated herein by reference).   |
| 3.3 | Amended Articles of Incorporation (included as Attachment D to exhibit 99.2 to the Form DEF 14A filed November 19, 2004, and incorporated herein by reference).                                     |
| 4.1 | Certificate of Designation for Series D Convertible Preferred Stock, dated January 19, 2006 (included as exhibit 4.1 to the Form 8-K filed January 27, 2006, and incorporated herein by reference). |





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- 4.2 Form of Common Stock Purchase Warrant, dated January 19, 2006, (included as Exhibit 4.2 to the Form 8-K filed January 27, 2006, and incorporated herein by reference).
- 4.3 Securities Purchase Agreement, dated January 19, 2006 (included as Exhibit 4.3 to the Form 8-K filed January 27, 2006, and incorporated herein by reference).
- 4.4 Registration Rights Agreement, dated January 19, 2006 (included as Exhibit 4.4 to the Form 8-K filed January 27, 2006, and incorporated herein by reference).
- 4.5 Amended and Restated Certificate of Designation for Series B Convertible Preferred Stock (included as exhibit 4.1 of the Form 8-K filed February 15, 2006, and incorporated herein by reference).
- 4.6 Amended and Restated Certificate of Designation for Series C Convertible Preferred Stock (included as exhibit 4.2 of the Form 8-K filed February 15, 2006, and incorporated herein by reference).
- 4.7 Bridge Facility between the Company and GC Financial Services, Inc., dated September 29, 2006 (included as Exhibit 4.1 to the Form 8-K filed July 8, 2006, and incorporated herein by reference).
- 4.8 Demand Note between the Company and GC Financial Services, Inc., dated September 29, 2006 (included as Exhibit 4.2 to the Form 8-K filed July 8, 2006, and incorporated herein by reference).
- 10.1 Sonic Jet Corporation 2000 Stock Option Plan & Advisory and Consulting Agreement, dated May 1, 2000 (included as Appendix A to the Form 14C filed March 31, 2000, and incorporated herein by reference).
- 10.2 Series B Convertible Preferred Stock Purchase Agreement between the Company and Ashford Capital, LLC, dated December 27, 2001 (included as exhibit 10.1 to the Form 8-K filed January 7, 2002, and incorporated herein by reference).
- 10.3 Series C Convertible Preferred Stock Purchase Agreement between the Company and eFund Capital Partners, LLC, dated December 27, 2001 (included as exhibit 10.2 to the Form 8-K filed on January 7, 2002, and incorporated herein by reference).
- 10.4 Letter Agreement between the Company and Ashford Capital, LLC, dated April 15, 2003 (included as exhibit 4.9 to the Form 10-QSB filed November 18, 2003, and incorporated herein by reference).
- 10.5 Industrial Lease between the Company and Aerospace/Defense, Inc., dated September 2, 2003 (included as Exhibit 10.12 to the Form 10-QSB filed August 13, 2004, and incorporated herein by reference).
- 10.6 Modification of Business Asset Sale, License Agreement & Assignment of Rights between the Company and Rockwell Power Systems, Inc., dated September 15, 2003 (included as exhibit 2.3 to the Form 10-QSB filed November 18, 2003, and incorporated herein by reference).
- 10.7 Non-Employee Directors and Consultants Retainer Stock Plan, dated March 31, 2003 (included as exhibit 4 to the Form S-8 filed November 7, 2003, and incorporated herein by reference).
- 10.8 Investment Agreement between the Company and Dutchess Private Equities Fund, L.P., dated January 26, 2004 (included as exhibit 10.8 to the SB-2 filed January 27, 2004, and incorporated herein by reference).
- 10.9 Registration Rights Agreement between the Company and Dutchess Private Equities Fund, L.P., dated January 26, 2004 (included as exhibit 10.9 to the SB-2 filed January 27, 2004, and incorporated herein by reference).
- 10.10 Placement Agent Agreement between the Company, Charleston Capital, LLC, and Dutchess Private Equities Fund, L.P., dated January 27, 2004 (included as exhibit 10.10 to the SB-2 filed on January 27,

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2004, and incorporated herein by reference).

- 10.11 Form of Subscription Agreement between the Company and Gamma Opportunity Capital Partners, LP, Longview Fund, LP, Alpha Capital Aktiengesellschaft, Domino International Ltd, Magellan International Ltd, and Mountain Ridge Capital LLC, dated March 23, 2004 (included as exhibit 4 to the Form 8-K filed on March 26, 2004, and incorporated herein by reference).
- 10.12 Royalty Agreement between the Company and J.J. van Eck, dated April 1, 2004 (included as exhibit 10.13 to the Form 10-QSB filed August 13, 2004, and incorporated herein by reference).
- 10.13 Contract between the Company and the U.S. Marines, dated April 21, 2004 (included as exhibit 10.14 to the 10-QSB filed August 13, 2004, and incorporated herein by reference).
- 10.14 Term Sheet between the Company and GC Financial Services, Inc., dated September 16, 2004 (included as exhibit 10.14 to the 10-QSB filed November 15, 2004, and incorporated herein by reference).
- 10.15 Employment Agreement between the Company and Thomas Thebes (included as Exhibit 10.10 to the Form 10-QSB filed August 13, 2004, and incorporated herein by reference).
- 10.16 Letter re: Industrial Lease Agreement between the Company and Aerospace/Defense, Inc., dated July 13, 2004 (included as Exhibit 10.11 to the Form 10-QSB filed August 13, 2004, and incorporated herein by reference).
- 10.17 Employment Agreement between the Company and Garth Barrett, dated August 12, 2004 (included as exhibit 10.16 to the 10-QSB filed November 15, 2004, and incorporated herein by reference).
- 10.18 Employment Agreement between the Company and Gale Aguilar, dated November 8, 2004 (included as Exhibit 10.1 to the Form 8-K/A filed November 10, 2004, and incorporated herein by reference).
- 10.19 Employment Agreement between the Company and Frank Kavanaugh, dated November 15, 2004 (included as exhibit 10.15 to the 10-QSB filed November 15, 2004, and incorporated herein by reference).
- 10.20 Letter Contract awarded to the Company by the Department of the Army dated November 18, 2004 (as described in the 8-K filed November 24, 2004, and incorporated herein by reference).
- 10.21 Promissory Note between the Company and Dutchess Private Equity Fund, II, LP dated December 3, 2004 (included as Exhibit 10.1 to the Form 8-K filed December 8, 2004, and incorporated herein by reference).
- 10.22 Employment Agreement between the Company and Gordon McGilton, dated January 27, 2005 (included as Exhibit 10.22 to the Form 10-KSB/A filed April 22, 2005, and incorporated herein by reference).
- 10.23 Employment Agreement between the Company and Ted McQuinn, dated February 4, 2005 (included as Exhibit 10.23 to the Form 10-KSB/A filed April 22, 2005, and incorporated herein by reference).
- 10.24 Order for Supplies or Services between the Company and U.S. Department of Defense, dated May 13, 2005 (included as Exhibit 10.1 to the Form 8-K filed May 18, 2005, and incorporated herein by reference).
- 10.25 Order for Supplies or Services between the Company and U.S. Department of Defense, dated May 18, 2005 (included as Exhibit 10.1 to the Form 8-K filed May 23, 2005, and incorporated herein by reference).
- 10.26 Order for Supplies or Services and Delivery Order between the Company and U.S. Department of Defense, dated September 23, 2005 (included as Exhibit 10.1 to the Form 8-K filed September 27, 2005, and incorporated herein by reference).

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- 10.27 Purchase and Sale Agreement the Company and GC Financial Services, Inc., dated September 29, 2005 (included as Exhibit 10.1 to the Form 8-K filed July 8, 2005, and incorporated herein by reference).
- 10.28 Security Agreement the Company and GC Financial Services, Inc., dated September 29, 2005 (included as Exhibit 10.2 to the Form 8-K filed July 8, 2005, and incorporated herein by reference).
- 10.29 Purchase Order between the Company and Ricardo Engineering, dated September 29, 2005 (included as Exhibit 10.1 to the Form 8-K filed July 19, 2005, and incorporated herein by reference).
- 10.30 Solicitation/Contract/Order for Commercial Items and Delivery Order between the Company and the United States Marine Corps, dated September 7, 2005 (included as Exhibit 10.1 to the Form 8-K filed September 9, 2005, and incorporated herein by reference).
- 10.31 Engineering Services Agreement between the Company and TecStar, dated August 22, 2005 (filed herewith).
- 31.1 Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of the Interim Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Officers pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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**SIGNATURES**

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

### FORCE PROTECTION, INC.

Date: May 15, 2006

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

Date: May 15, 2006

By: /s/ R. Scott Ervin  
R. Scott Ervin  
Interim Chief Financial Officer  
Principal Accounting Officer

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

### Signatures

| Name                                   | Title  | Date         |
|--|--|--------------|
| /s/ Frank Kavanaugh<br>Frank Kavanaugh | Chairman, Board of Directors                                     | May 15, 2006 |
| /s/ Gordon McGilton<br>Gordon McGilton | Director, and<br>Chief Executive Officer                         | May 15, 2006 |
| /s/ R. Scott Ervin<br>R. Scott Ervin   | Director, General Counsel and<br>Interim Chief Financial Officer | May 15, 2006 |
| /s/ Raymond Pollard<br>Raymond Pollard | Director, Chief Operating Officer                                | May 15, 2006 |
| /s/ Jack Davis<br>Jack Davis           | Director   | May 15, 2006 |
| /s/ Gale Aguilar<br>Gale Aguilar       | Director   | May 15, 2006 |

