Dreyfus Municipal Bond Infrastructure Fund, Inc.
Form NSAR-B
April 26, 2017

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088 D000000 Y
SIGNATURE   MAUREEN E. KANE
TITLE       VP & ASST SECRETARY
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c., Break-Free Armor Corp., Monadnock Lifetime Products, Inc., a Delaware corporation, Armor Holdings LP, LLC, Armor Holdings GP, LLC, Armor Holdings Properties, Inc. and NAP Property Managers, LLC in favor of Bank of America, N.A. , as Administrative Agent for the Lenders (filed as Exhibit 10.10 to our Current Report on Form 8-K dated August 22, 2001 and incorporated herein by reference). *10.14 Amendment to the Amended and Restated Credit Agreement dated as of December 9, 2002. @+10.15 Employment Agreement between Jonathan M. Spiller and Armor Holdings, Inc., dated as of January 1, 2002 (incorporated by reference to Exhibit 10.1 to our Form 10-Q Quarterly Report for the fiscal quarter ended March 31, 2002). @+10.16 Employment Agreement between Robert R. Schiller and Armor Holdings, Inc., dated as of January 1, 2002 (incorporated by reference to Exhibit 10.2 to our Form 10-Q Quarterly Report for the fiscal quarter ended March 31, 2002). @+10.17 Employment Agreement between Stephen E. Croskrey and Armor Holdings, Inc., dated as of January 1, 2002 (incorporated by reference to Exhibit 10.3

to our Form 10-Q Quarterly Report for the fiscal quarter ended March 31, 2002). @+10.18 Employment Agreement between Warren B. Kanders and Armor Holdings, Inc., dated as of January 1, 2002 (incorporated by reference to Exhibit 10.4 to our Form 10-Q Quarterly Report for the fiscal quarter ended March 31, 2002). +10.19 Form of Indemnification Agreement for Directors of the Registrant, dated September 21, 1993 (filed as Exhibit 10.4 to Form 10-KSB, Annual Report of the Company for the fiscal year ended December 31, 1993 and incorporated herein by reference). +10.20 Form of Indemnification Agreement for Officers of the Registrant, dated February 28, 1994 (filed as Exhibit 10.5 to Form 10-KSB, Annual Report 51 of the Company for the fiscal year ended December 31, 1993 and incorporated herein by reference). **+10.21 American Body Armor & Equipment, Inc. 1994 Incentive Stock Plan (incorporated by reference from Form S-8 filed on October 10, 1994, Reg. No. 33-018863). **+10.22 American Body Armor & Equipment, Inc. 1994 Directors Stock Plan (incorporated by reference from Form S-8 filed on October 31, 1994, Reg. No. 33-018863). **+10.23 Armor Holdings, Inc. Amended and Restated 1996 Stock Option Plan (incorporated by reference from the Company's 1997 Definitive Proxy Statement with respect to the Company's 1997 Annual Meeting of Stockholders, held June 12, 1997, as filed with the Commission on May 27, 1997). **+10.24 Armor Holdings Inc. Amended and Restated 1996 Non-Employee Directors Stock Option Plan (incorporated by reference from the Company's 1997 Definitive Proxy Statement with respect to the Company's 1997 Annual Meeting of Stockholders, held June 12, 1997, as filed with the Commission on May 27, 1997). **+10.25 Armor Holdings, Inc. 1998 Stock Option Plan (incorporated by reference to Exhibit 10.19 to the 98 10-K). **+10.26 Armor Holdings, Inc. 1999 Stock Incentive Plan (incorporated by reference from Appendix A to the Company's 1999 Definitive Proxy Statement with respect to the Company's 1999 Annual Meeting of Stockholders, as filed with the Commission on May 21, 1999). **+10.27 Armor Holdings, Inc. 2002 Stock Incentive Plan (incorporated by reference from Appendix A to our 2002 Definitive Proxy Statement with respect to our 2002 Annual Meeting of Stockholders, as filed with the Commission on April 30, 2002). **+10.28 Armor Holdings, Inc. 2002 Executive Stock Plan (incorporated by reference to Exhibit 10.6 to our Form 10-Q Quarterly Report for the fiscal quarter ended March 31, 2002). +10.29 Consulting Agreement between Kanders & Company, Inc. and Armor Holdings, Inc. dated as of January 1, 2002 (incorporated by reference to Exhibit 10.5 to our Form 10-Q Quarterly Report for the fiscal quarter ended March 31, 2002). ***10.30 Amendment No. 1 to the Armor Holdings, Inc. 2002 Stock Incentive Plan *21.1 Subsidiaries of the Registrant *23.1 Consent of PricewaterhouseCoopers LLP. *99.1 Certification of Periodic Report under Section 906 of the Sarbanes-Oxley Act of 2002. -------------------------- * Filed herewith. + Incorporated herein by reference. @ This Exhibit represents a management contract. ** This Exhibit represents a compensatory plan. 52 INDEX TO CONSOLIDATED FINANCIAL STATEMENTS ARMOR HOLDINGS, INC. Report of Independent Certified Public Accountants F-2 Consolidated Balance Sheets F-3 Consolidated Income Statements F-4 Consolidated Statements of Stockholders' Equity and F-5 Comprehensive Income Consolidated Statements of Cash Flow F-6 Notes to the Consolidated Financial Statements F-7 - F-38 F-1 REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS To the Board of Directors and Stockholders of Armor Holdings, Inc.: In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, stockholders' equity and comprehensive income, and cash flows present fairly, in all material respects, the financial position of Armor Holdings, Inc. and its subsidiaries at December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2002 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. As discussed in Note 1 to the consolidated financial statements, effective January 1, 2002, the Company changed its method of accounting for goodwill following adoption of Statement of Financial Accounting Standard No. 142 "Goodwill and Other Intangible Assets." PricewaterhouseCoopers LLP March 30, 2003 Jacksonville, Florida F-2 ARMOR HOLDINGS INC. AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 2002 AND DECEMBER 31, 2001 (IN THOUSANDS, EXCEPT FOR SHARE DATA) DECEMBER 31, 2002 DECEMBER 31, 2001

---------------- ---------------- ASSETS Current Assets: Cash and cash equivalents $ 12,913 $ 47,489 Accounts receivable (net of allowance for doubtful accounts of $1,428 and $1,620) 58,513 50,119 Costs and earned gross profit in excess of billings 234 5,451 Inventories 62,330 50,553 Prepaid expenses and other current assets 12,212 8,947 Current assets of discontinued operations (Note 2) 28,825 37,562 --------- --------- Total current assets 175,027 200,121 Property and equipment (net of accumulated depreciation of $12,919 and $8,096) 47,136 36,704 Goodwill (net of accumulated amortization of $4,024 and $4,024) 98,736 86,808 Patents, licenses and trademarks (net of accumulated amortization of $2,169 and $1,930) 7,521 6,695 Long-term assets of discontinued operations (Note 2) 30,285 51,105 Other assets 9,048 6,624 --------- --------- Total assets $ 367,753 $ 388,057 ========= ========= LIABILITIES AND STOCKHOLDERS'EQUITY Current liabilities: Current portion of long-term debt $ 1,813 $ 1,773 Short term debt 599 709 Accounts payable 23,770 21,444 Accrued expenses and other current liabilities 25,116 25,796 Income taxes payable 5,913 -- Current liabilities of discontinued operations (Note 2) 17,225 7,676 --------- --------- Total current liabilities 74,436 57,398 Long-term debt, less current portion 5,072 4,225 Long-term liabilities of discontinued operations (Note 2) 168 415 --------- --------- Total liabilities 79,676 62,038 Commitments and contingencies Stockholders' equity: Preferred stock, $.01 par value, 5,000,000 shares authorized; no shares issued and outstanding -- -- Common stock, $.01 par value; 50,000,000 shares authorized; 33,593,977 and 33,065,904 issued; 29,456,692 and 30,857,019 outstanding at December 31, 2002 and December 31, 2001, respectively 336 331 Additional paid-in capital 307,487 301,995 Retained earnings 34,056 51,745 Accumulated other comprehensive loss (4,169) (4,473) Treasury stock (49,633) (23,579) --------- --------- Total stockholders' equity 288,077 326,019 --------- --------- Total liabilities and stockholders' equity $ 367,753 $ 388,057 ========= ========= The accompanying notes are an integral part of these consolidated financial statements. F-3 ARMOR HOLDINGS INC. AND SUBSIDIARIES CONSOLIDATED INCOME STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 2002, 2001 AND 2000 (IN THOUSANDS, EXCEPT FOR PER SHARE DATA) DECEMBER 31, 2002 DECEMBER 31, 2001 DECEMBER 31, 2000 ---------------- ---------------- ---------------- REVENUES: Products $ 179,946 $ 149,868 $ 139,904 Mobile Security 125,171 47,232 -- --------- --------- --------- Total Revenues 305,117 197,100 139,904 --------- --------- --------- COSTS AND EXPENSES: Cost of sales 210,745 126,330 85,457 Operating expenses 49,836 38,659 30,286 Amortization 245 2,142 1,704 Integration and other non-recurring charges 5,926 3,296 2,588 --------- --------- --------- OPERATING INCOME 38,365 26,673 19,869 Interest expense, net 923 3,864 1,849 Other expense (income), net 51 (82) (67) --------- --------- --------- INCOME FROM CONTINUING OPERATIONS BEFORE PROVISION FOR INCOME TAXES 37,391 22,891 18,087 PROVISION FOR INCOME TAXES 16,054 8,207 7,240 --------- --------- --------- INCOME FROM CONTINUING OPERATIONS 21,337 14,684 10,847 --------- --------- --------- DISCONTINUED OPERATIONS (NOTE 2): (LOSS) INCOME FROM DISCONTINUED OPERATIONS BEFORE (BENEFIT) (41,468) (7,066) 8,303 PROVISION FOR INCOME TAXES (BENEFIT) PROVISION FOR INCOME TAXES (2,442) (2,510) 2,102 --------- --------- --------- (LOSS) INCOME FROM DISCONTINUED OPERATIONS (39,026) (4,556) 6,201 --------- --------- --------- NET (LOSS) INCOME $ (17,689) $ 10,128 $ 17,048 ========= ========= ========= NET (LOSS)/INCOME PER COMMON SHARE - BASIC INCOME FROM CONTINUING OPERATIONS $ 0.70 $ 0.61 $ 0.48 (LOSS) INCOME FROM DISCONTINUED OPERATIONS (1.28) (0.19) 0.27 --------- --------- --------- BASIC (LOSS) INCOME PER SHARE $ (0.58) $ 0.42 $ 0.75 ========= ========= ========= NET (LOSS)/INCOME PER COMMON SHARE - DILUTED INCOME FROM CONTINUING OPERATIONS $ 0.69 $ 0.59 $ 0.46 (LOSS) INCOME FROM DISCONTINUED OPERATIONS (1.26) (0.18) 0.27 --------- --------- --------- DILUTED (LOSS) INCOME PER SHARE $ (0.57) $ 0.41 $ 0.73 ========= ========= ========= WEIGHTED AVERAGE SHARES - BASIC 30,341 23,932 22,630 ========= ========= ========= WEIGHTED AVERAGE SHARES - DILUTED 30,957 24,768 23,356 ========= ========= ========= The accompanying notes are an integral part of these consolidated financial statements. F-4 ARMOR HOLDINGS INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME YEARS ENDED DECEMBER 31, 2000, 2001 AND 2002 (IN THOUSANDS)

ACCUMULATED COMMON STOCK ADDITIONAL OTHER PAR PAID-IN RETAINED COMPREHENSIVE TREASURY SHARES VALUE CAPITAL EARNINGS LOSS STOCK TOTAL ------ ----- -------- -------- ---- ----- ----- Balance, December 31, 1999 24,514 $245 $145,480 $ 26,615 $(1,351) $(13,106) $157,883 Exercise of stock options 333 3 1,470 1,473 Tax benefit from exercises of options 867 867 Issuance of stock for acquisitions 217 2

2,437 2,439 Repurchase of stock (12,606) (12,606) -------- Comprehensive income: Net income 17,048 17,048 Foreign currency translation adjustments, net of taxes of $179 (333) (333) -------- Total Comprehensive income 16,715 ------ ----- -------- -------- ------- -------- -------- Balance, December 31, 2000 25,064 $250 $150,254 $ 43,663 $(1,684) $(25,712) $166,771 Exercise of stock options 1,063 11 10,101 10,112 Tax benefit from exercises of options 3,116 3,116 Issuance of treasury shares for exercises of options (119) (1) (123) (2,046) 2,856 686 Issuance of common stock 5,765 58 117,969 118,027 Issuance of stock for acquisitions and additional 20,691 consideration for earnouts 1,293 13 20,678 Repurchase of stock (723) (723) Comprehensive income: -------- Net income 10,128 10,128 Foreign currency translation adjustments, net of taxes of $713 (2,789) (2,789) -------- Total Comprehensive income 7,339 ------ ----- -------- -------- ------- -------- -------- Balance, December 31, 2001 33,066 $331 $301,995 $ 51,745 $(4,473) $(23,579) $326,019 Exercise of stock options 528 5 4,135 4,140 Tax benefit from exercises of options 832 832 Sale of put options 525 525 Repurchase of stock (26,054) (26,054) Comprehensive income: -------- Net income (17,689) (17,689) Foreign currency translation adjustments, net of taxes of $364 304 304 -------- Total Comprehensive income (17,385) ------ ----- -------- -------- -------- -------- -------- Balance, December 31, 2002 33,594 $336 $307,487 $ 34,056 $(4,169) $(49,633) $288,077 ====== ===== ======== ======== ======== ======== ======== The accompanying notes are an integral part of these consolidated financial statements. F-5 ARMOR HOLDINGS INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOW YEARS ENDED DECEMBER 31, 2002, 2001 AND 2000 (IN THOUSANDS) YEAR ENDED -- DECEMBER 31, 2002 DECEMBER 31, 2001 DECEMBER 31, 2000 -- CASH FLOWS FROM OPERATING ACTIVITIES: Income from continuing operations $ 21,337 $ 14,684 $ 10,847 Adjustments to reconcile income from continuing operations to cash used in operating activities: Depreciation and amortization 5,580 5,614 3,462 Loss on disposal of fixed assets 200 191 110 Deferred income taxes 359 (373) 769 Changes in operating assets and liabilities, net of acquisitions: Increase in accounts receivable (2,554) (14,880) (3,600) Increase in inventories (9,381) (3,948) (4,579) (Increase) decrease in prepaid expenses and other assets (2,246) 1,049 (6,396) (Decrease) increase in accounts payable, accrued expenses and other current liabilities (3,754) 7,181 381 Increase in income taxes payable 6,745 6,667 (2,928) ---------- --------- --------- Net cash provided by (used in) operating activities 16,286 16,185 (1,934) ---------- --------- --------- CASH FLOWS FROM INVESTING ACTIVITIES: Purchase of patents and trademarks (69) - (83) Purchase of property and equipment (5,902) (5,644) (4,063) Additional consideration for purchased businesses (9,375) (3,270) Purchases of investments - - (1,682) Proceeds from sale of equity securities - 843 857 Purchase of businesses, net of cash acquired (8,818) (39,365) (14,220) ---------- --------- --------- Net cash used in investing activities (24,164) (47,436) (19,191) ---------- --------- --------- CASH FLOWS FROM FINANCING ACTIVITIES: Proceeds from the issuance of common stock - 117,979 - Proceeds from the exercise of stock options 4,227 10,160 1,473 Repurchases of treasury stock (26,054) (723) (12,606) Proceeds from the sale of put options 525 - - Proceeds from issuance of treasury shares for the exercise of stock options - 686 - Cash paid for deferred loan costs - (545) (256) Cash paid for offering costs (326) - - Repayments of long-term debt (730) (676) (1,115) Repayments of debt assumed in acquisitions - (1,315) (1,132) Borrowings under line of credit 32,372 98,286 75,647 Repayments under line of credit (32,447) (130,981) (43,434) ---------- --------- --------- Net cash (used in) provided by financing activities (22,433) 92,871 18,577 Effect of exchange rate changes on cash and cash equivalents (126) (1,459) (333) Net cash used in discontinued operations (4,139) (14,336) (2,754) ---------- --------- --------- NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS (34,576) 45,825 (5,635) CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD 47,489 1,664 7,299 ---------- --------- --------- CASH AND CASH EQUIVALENTS, END OF PERIOD $ 12,913 $ 47,489 1,664 ========== ========= ========= CASH AND CASH EQUIVALENTS, END OF PERIOD CONTINUING OPERATIONS $ 12,913 $ 47,489 $ 1,664 DISCONTINUED OPERATIONS 3,638 6,230 5,593 ---------- --------- --------- $ 16,551 $ 53,719 $ 7,257 ========== ========= ========= The accompanying notes are an integral part of these consolidated financial statements. F-6 ARMOR HOLDINGS INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS BACKGROUND AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES The Company and nature of business. Armor Holdings, Inc. (the "Company" or "Armor") is a leading manufacturer and provider of security products, vehicle armor systems and security risk management services. Armor's products and services are used by military, law enforcement, security and corrections personnel throughout the world, as well as governmental agencies, multinational corporations and non-governmental organizations. The Company is organized and operated under three business segments: Armor

Holdings Products; Armor Mobile Security; and ArmorGroup Services. ArmorGroup Services has been classified as discontinued operations. The amounts disclosed in the footnotes are related to continuing operations unless otherwise indicated. CONTINUING OPERATIONS Armor Holdings Products. Our Armor Holdings Products Division manufactures and sells a broad range of high quality, branded law enforcement equipment, such as concealable and tactical body armor, hard armor, duty gear, less-lethal munitions, anti-riot products, police batons, emergency lighting products, forensic products, firearms accessories and weapon maintenance products. Our products are marketed under brand names that are well-known and respected in the military and law enforcement communities such as American Body Armor(TM), Safariland(R), B-Square(TM), Break-Free(R), Defense Technology/Federal Laboratories(TM), MACE(R), PROTECH(TM), NIK(R)Public Safety, Monadnock(TM) Lifetime Products, Identicator(TM), Lightning Powder(R), SpeedFeed(TM), and 911EP(R). We sell our manufactured products primarily to law enforcement agencies through a worldwide network of over 350 distributors and sales agents, including approximately 200 in the United States. Our extensive distribution capabilities and commitment to customer service and training have enabled us to become a leading provider of security equipment to law enforcement agencies. Armor Mobile Security. Our Armor Mobile Security Division manufactures and installs ballistic and blast protected armoring systems for military vehicles, commercial vehicles, military aircraft, and missile components. Under the brand name O'Gara-Hess & Eisenhardt, we are the sole-source provider to the U.S. military for the supply of armoring and blast protection systems for the High Mobility Multi-purpose Wheeled Vehicle (the "HMMWV"). We have also entered into an agreement to provide systems technical support for HMMWVs. There is currently an installed base of approximately 3,500 up-armored HMMWVs. We provide spare parts and maintenance services for the installed HMMWVs and we expect that our maintenance services may increase if the U.S. military substantially increases its HMMWV purchases or substantially increases its use of the current installed base. Additionally, the Armor Mobile Security Division has been subcontracted to develop a ballistically armored and sealed truck cab for the High Mobility Artillery Rocket System ("HIMARS"), a program currently in development for the U.S. Army. The Division also markets armor sub-systems for other tactical wheeled vehicles. We armor a variety of commercial vehicles, including limousines, sedans, sport utility vehicles, commercial trucks and cash-in-transit vehicles, to protect against varying degrees of ballistic and blast threats. DISCONTINUED OPERATIONS Services Division. Our Services Division provides a broad range of sophisticated security risk management solutions to multinational corporations in diverse industries such as natural resources, financial F-7 ARMOR HOLDINGS INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED services and consumer products, and to governmental and non-governmental agencies such as the U.S. Departments of State and Defense, the United Nations, United States Agency for International Development ("USAID") and Britain's Department for International Development. Our clients typically have personnel and other investments in unstable and often more risky areas of the world. Through our offices on five continents, we provide our multinational clients with a diversified portfolio of security solutions to assist them in mitigating risks to their operations around the world. Our highly trained, multilingual, and experienced security personnel work closely with our clients to create and implement solutions to complex security problems. These services include security planning, advice and management, security systems integration, intellectual property asset protection, due diligence investigations and training programs in counterintelligence, counter-surveillance, advanced driving techniques and ballistics. We believe that many of our security services, while often representing a small portion of our clients' overall cost of doing business, are critical to our clients' success. We believe that this creates a consistent demand for our premium services at attractive margins. Principles of consolidation. The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. In consolidation, all material intercompany balances and transactions have been eliminated. Results of operations of companies acquired in transactions accounted for under the purchase method of accounting are included in the financial statements from the date of the acquisition. Cash and cash equivalents. We consider all highly liquid investments purchased with maturities of three months or less, at date of purchase, to be cash equivalents. Concentration of credit risk. Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents and trade accounts receivable. The Company maintains its cash and cash equivalents with what it believes to be various high quality banks. Amounts held in individual banks may periodically exceed, for brief time periods, federally insured amounts. Our accounts receivable consist of amounts due from customers and distributors located throughout the world. International product sales generally require cash in advance or confirmed letters of credit on United States ("U.S.") banks. We maintain reserves for potential credit losses. As of December 31, 2002 and 2001, management believes that we have no significant concentrations of credit risk. Inventories. Inventories are stated at the lower of cost or market determined on the first-in, first-out ("FIFO") method. Fair value of financial instruments. The carrying value of cash and cash equivalents, accounts receivable, other receivables, accounts payable, and short and long-term debt approximates fair value at December 31, 2002 and 2001. Property and equipment. Property and equipment are carried at cost less accumulated depreciation. Upon disposal of property and equipment, the appropriate accounts are reduced by the related cost and accumulated depreciation. The resulting gains and losses are reflected in consolidated earnings. Depreciation is computed using the straight-line method over the estimated lives of the related assets as follows: Buildings and improvements......................... 5 - 39 years Machinery and equipment............................ 3 - 7 years F-8 ARMOR HOLDINGS INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED Goodwill. Goodwill represents the excess of the purchase price over the fair value of the net assets acquired in a purchase business combination. Goodwill and other intangible assets are stated on the basis of cost. The $46.3 million in goodwill resulting from acquisitions made by the Company subsequent to June 30, 2001 was immediately subjected to the non-amortization provisions of SFAS 142. See also "Impairment and Recent Accounting Pronouncements " which follows. Patents, licenses and trademarks. Patents, licenses and trademarks were primarily acquired through acquisitions accounted for by the purchase method of accounting. Such assets are amortized on a straight-line basis over their remaining lives useful lives. Impairment. Long-lived assets including certain identifiable intangibles, and the goodwill, are reviewed for annually impairment or whenever events or changes in circumstances indicate that the carrying amount of the asset in question may not be recoverable including, but not limited to, a deterioration of profits for a business segment that has long-lived assets, and when other changes occur which might impair recovery of long-lived assets. Management has reviewed our long-lived assets and has taken an impairment charge of $31.1 million to reduce the carrying value of the Services Division to estimated realizable value. The method used to determine the existence of an impairment would be generally by discounted operating cash flows estimated over the remaining useful lives of the related long-lived assets or estimated realizable amounts on assets of discontinued operations. Impairment is measured as the difference between fair value and unamortized cost at the date impairment is determined. Research and development. Research and development costs are included in operating expenses as incurred and for the years ended December 31, 2002, 2001 and 2000, approximated $2,968,000, $2,353,000 and $2,590,000, respectively. Estimates. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts in the financial statements and accompanying notes. Significant estimates inherent in the preparation of the accompanying consolidated financial statements include the carrying value of long-lived assets, valuation allowances for receivables, inventories and deferred income tax assets, liabilities for potential litigation claims and settlements; and contract contingencies and obligations. Actual results could differ from those estimates. Income taxes. We account for income taxes pursuant to Statement of Financial Accounting Standards ("SFAS") No. 109, "Accounting for Income Taxes". Under the asset and liability method specified thereunder, deferred taxes are determined based on the difference between the financial reporting and tax bases of assets and liabilities. Deferred tax liabilities are offset by deferred tax assets relating to net operating loss carryforwards and deductible temporary differences. Future benefits obtained either from utilization of net operating loss carryforwards or from the reduction in the income tax asset valuation allowance existing on September 20, 1993 have been and will be applied to reduce reorganization value in excess of amounts allocable to identifiable assets. At December 31, 2002 and 2001, our consolidated foreign subsidiaries have unremitted earnings of approximately $3.0 million and $1.3 million, respectively on which we have not recorded a provision for United States Federal income taxes since these earnings are considered to be permanently reinvested. Such foreign earnings have been F-9 ARMOR HOLDINGS INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED taxed according to the regulations existing in the countries in which they were earned. Revenue recognition. We record products revenue at the time of shipment. Returns are minimal and do not materially effect the financial statements. We record revenue from its Mobile Security Division when the vehicle is shipped, except for larger commercial contracts typically longer than four months in length and the contract for the delivery of HMMWVs to the U.S. Government which continues through 2005. Revenue from such contracts is recognized on the percentage of completion, units-of-work performed method. HMMWV units sold to the U.S. Government are considered complete when the onsite Department of Defense officer finishes the inspection of the HMMWV and approves it for delivery. Should such contracts be in a loss position, the entire estimated loss would be recognized for the balance of the contract at such time. Current contracts are profitable. We record service revenue as services are provided on a contract by contract basis. Revenues from service contracts are recognized over the term of the contract. Advertising. We expense advertising costs as expense in the period in which they are incurred. Earnings per share. Basic earnings per share is computed by dividing net income by the weighted-average number of common shares outstanding. Diluted earnings per share is computed by dividing net income by the weighted-average number of common shares outstanding compounding the effects of all potentially dilutive common stock equivalents, principally options, except in cases where the effect would be anti-dilutive. Comprehensive income and foreign currency translation. In accordance with SFAS No. 130, "Reporting Comprehensive Income", assets and liabilities denominated in a foreign currency are translated into U.S. dollars at the current rate of exchange existing at year-end and revenues and expenses are translated at the average monthly exchange rates. The cumulative translation adjustment, net of tax, which represents the effect of translating assets and liabilities of our foreign operations is recorded as a reduction of equity of $4,169,000 and $4,473,000 for the years ended December 31, 2002 and 2001, respectively, and is classified as accumulated other comprehensive loss. The current year change in the accumulated amount, net of tax, is included as a component of comprehensive income. Stock options and Grants. SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123") establishes a fair value based method of accounting for stock-based employee compensation plans; however, it also allows an entity to continue to measure compensation cost for those plans using the intrinsic value based method of accounting prescribed by Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees." Under the fair value based method, compensation cost is measured at the grant date based on the value of the award and is recognized over the service period, which is usually the vesting period. Under the intrinsic value based method, compensation costs is the excess, if any, of the quoted market price of the stock at the grant date or other measurement date over the amount an employee must pay to acquire the stock. We have elected to continue to account for its employee stock compensation plans under APB Opinion No. 25 with pro forma disclosures of net earnings and earnings per share, as if the fair value based method of accounting defined in SFAS No. 123 had been applied. F-10 ARMOR HOLDINGS INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED If compensation cost for stock option grants had been determined based on the fair value on the grant dates for 2002, 2001 and 2000 consistent with the method prescribed by SFAS No. 123, the Company's net earnings and earnings per share would have been adjusted to the pro forma amounts indicated below: 2002 2001 2000 -------- ------- ------- (IN THOUSANDS, EXCEPT PER SHARE DATA) Net income as reported $(17,689) $10,128 $17,048 Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects (5,053) (2,435) (803) -------- ------- ------- $(22,742) $ 7,693 $16,245 ======== ======= ======= Earnings per share: Basic - as reported $ (0.58) $ 0.42 $ 0.75 ======== ======= ======= Basic - pro forma $ (0.75) $ 0.32 $ 0.72 ======== ======= ======= Diluted - as reported $ (0.57) $ 0.41 $ 0.73 ======== ======= ======= Diluted - pro forma $ (0.74) $ 0.31 $ 0.70 ======== ======= ======= Reclassifications. Certain reclassifications have been made to the 2001 and 2000 financial statements in order to conform to the presentation adopted for 2002. These reclassifications had no effect on net income or retained earnings. Recent accounting pronouncements. In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 141, "Business Combinations." SFAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. This statement specifies that certain acquired intangible assets in a business combination be recognized as assets separately from goodwill and that existing intangible assets and goodwill be evaluated for these new separation requirements. The adoption of this statement did not have a material impact on our consolidated financial statements. In June 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 142 changes the accounting for goodwill from an amortization method to an impairment-only approach. Amortization of goodwill, including goodwill recorded in past business combinations, ceased upon adoption of this statement. In addition, this statement requires that goodwill be tested for impairment at least annually at the reporting unit level. We implemented SFAS No. 142 on January 1, 2002. In connection with the adoption of SFAS 142, we completed in the second quarter the transitional goodwill impairment test that compared the fair value of each reporting unit to its carrying value and determined that no impairment existed. The goodwill resulting from acquisitions made by us subsequent to June 30, 2001 was immediately subject to the non-amortization provisions of SFAS 142. Had we been accounting for goodwill under SFAS 142 for all periods presented, our net income and earnings per share would have been as follows: F-11 ARMOR HOLDINGS INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED DECEMBER 31,2002 DECEMBER 31, 2001 DECEMBER 31, 2000 ---------------- ---------------- ----------------- (IN THOUSANDS, EXCEPT PER SHARE DATA) Reported net (loss)income $ (17,689) $ 10,128 $ 17,048 Add back goodwill amortization, net of tax -- 3,044 2,943 ---------- ---------- ---------- Actual/pro forma adjusted net(loss)income $ (17,689) $ 13,172 $ 19,991 ========== ========== ========== Basic earnings per share Reported basic (loss) income per share $ (0.58) $ 0.42 $ 0.75 Goodwill amortization, net of tax -- 0.13 0.13 ---------- ---------- ---------- Actual/pro forma basic (loss) income per share $ (0.58) $ 0.55 $ 0.88 ========== ========== ========== Diluted earnings per share Reported diluted (loss) income per share $ (0.57) $ 0.41 $ 0.73 Goodwill amortization, net of tax -- 0.12 0.13 ---------- ---------- ---------- Actual/pro forma diluted (loss) income per share $ (0.57) $ 0.53 $ 0.86 ========== ========== ========== In August 2001, the FASB issued Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations" (SFAS 143). SFAS 143 establishes accounting standards for recognition and measurement of a liability for an asset retirement obligation and the associated asset retirement cost. SFAS 143 requires the recognition of the fair value of a liability for an asset retirement obligation in the period in which it is incurred if a reasonable estimate of fair value can be made. If a reasonable estimate of fair value cannot be made in the period the asset retirement obligation is incurred, the liability shall be recognized when a reasonable estimate of fair value can be made. The fair value of a liability for an asset retirement obligation is the amount at which that liability could be settled in a current transaction between willing parties, that is, other than in a forced or liquidation transaction. SFAS 143 is effective for financial statements issued for fiscal years beginning after June 15, 2002. The provisions of SFAS 143 will become effective for us on January 1, 2003. The effects of adopting this standard will not have a material effect on the US. In October 2001, the FASB issued Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" (SFAS 144). SFAS 144 establishes a "primary-asset" approach to determine the cash flow estimation period for a group of assets and liabilities that represents the unit of accounting for a long-lived asset to be held and used. SFAS 144 requires that a long-lived asset to be (1) abandoned, (2) exchanged for a similar productive asset, or (3) distributed to owners in a spin-off be considered held and used until it is abandoned, exchanged, or distributed. SFAS 144 requires (1) that spin-offs and exchanges of similar productive assets to be recorded at the lower of carrying value or fair value, and that such assets be classified as held and used until disposed of and (2) that any impairment loss resulting from a spin-off or exchange of similar productive assets be recognized upon asset disposition. SFAS 144 also states that the total assets and total liabilities of discontinued business segments shall be presented in separate captions in assets and liabilities. SFAS 144 also provides that future losses, if any, of discontinued business segments shall be reported as incurred. Effective January 1, 2002, we adopted SFAS 144. The reclassification of the Services division to discontinued operations and subsequent reduction in its carrying value was a result of our adoption of SFAS 144 (See Note 2). F-12 ARMOR HOLDINGS INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED In April 2002, the FASB issued Statement of Financial Accounting Standards No. 145, "Recission on FASB 4, 44 and 64, Amendment of FASB Statement No. 13 and Technical Corrections" (SFAS 145). Under SFAS 145, gains and losses related to the extinguishment of debt should no longer be segregated on the income statement from continuing operations. The provisions of SFAS 145 are effective for fiscal years beginning after May 15, 2002 with early adoption encouraged. The effects of adopting this standard will not have a material effect on us. In June 2002, the FASB issued Statement of Financial Accounting Standard 146, "Accounting for Costs Associated with Exit or Disposal Activities" (SFAS 146). SFAS 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." FAS 146 is effective for exit or disposal activities initiated on or after December 31, 2002. The effects of adopting this standard will not have a material effect on the us. In December 2002, the FASB issued Statement of Financial Accounting Standard 148, "Accounting for Stock-Based Compensation - Transition and Disclosure" (SFAS 148). SFAS 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of Statement of Financial Accounting Standard 123, "Accounting for Stock-Based Compensation" (SFAS 123), to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The disclosure requirements of SFAS 148 are included in this document. F-13 ARMOR HOLDINGS INC. AND

SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED 2. DISCONTINUED OPERATIONS On July 15, 2002, we announced plans to sell the Services division and the retention of Merrill Lynch & Company to assist in the sale. In accordance with Statement of Accounting Standards 144, Accounting for Impairment or Disposal of Long-Lived Assets, the assets and liabilities of the Services division have been classified as held for sale, with its operating results in the current and prior periods reported in discontinued operations for the year ended December 31, 2002, 2001 and 2000. USDS, Inc., a subsidiary providing certain training services, formerly reported as a part of the Services Division is not included in the amounts classified as assets held for sale. The assets and liabilities as well as the operating results of USDS, Inc. have been reclassified to the Armor Holdings Products Division where management oversight currently resides. On January 24, 2003, we executed an agreement to negotiate exclusively with an undisclosed party for the sale the Security consulting business of our ArmorGroup Services Divisiion, headquartered in London. Separately, on January 16, 2003 we executed an agreement to negotiate exclusively with an undisclosed party for the sale of the ArmorGroup Integrated Systems business of our ArmorGroup Services Division. The terms of both transactions and the identities of both buyers are protected by confidentiality agreements. These two transactions represent approximately 94% of the net assets of the Services Division, currently reported as Discontinued Operations. Both transactions are subject to, among other conditions, ongoing due diligence and the execution of definitive purchase agreements. Based upon our analysis and discussions with our advisors regarding the estimated realizable value of the Services Division, we reduced the carrying value of the Services Division, and recorded an impairment charge of $30.3 million. This impairment charge consisted of approximately $6.1 million in estimated disposal costs and a $24.2 million non-cash goodwill reduction. The reduction in the carrying value of the Services Division is Management's estimate based upon all of the best information currently available, including discussions with its investment bankers. The actual proceeds from the disposal of our Services Division may differ materially from our current estimates and therefore could result in either a gain or a loss upon final disposal. In January 2001, our Services Division was classified as discontinued operations approved a restructuring plan to close its U.S. investigative businesses, realign the division's organization, eliminate excess facilities and reduce overhead in its businesses worldwide. In connection with this restructuring plan, the division performed a review of its long-lived assets to identify potential impairments. Pursuant to this restructuring plan, ArmorGroup i) eliminated 26 employees, primarily from its investigative businesses, ii) eliminated an additional 24 employees from its security business, iii) incurred lease and other exit costs as a result of the closure of its investigative businesses, and iv) wrote-down the value of both tangible and intangible assets as a result of the impairment review. All of the significant actions contemplated by the restructuring plan have been completed. As a result of the restructuring plan, we recorded a pre-tax charge of $10.3 million. As of December 31, 2002, we had a remaining liability of $270,000 after fiscal year 2002 utilization of $84,000 relating to lease termination costs. The remaining liability has been classified in accrued expenses in and other current liabilities discontinued operations on the consolidated balance sheet. F-14 ARMOR HOLDINGS INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED The following is a summary of the operating results of the discontinued operations for the year ended December 31, 2002, 2001 and 2000. DECEMBER 31, 2002 DECEMBER 31, 2001 DECEMBER 31, 2000 ---------------- ---------------- ---------------- (IN THOUSANDS) Revenue $ 98,263 $ 94,928 $ 81,051 Cost of sales 75,779 65,021 52,042 -------- -------- -------- Gross Profit 22,484 29,907 29,009 Operating expenses 30,588 24,496 20,055 Amortization expenses -- 1,519 1,725 Charge for impairment of long-lived assets 30,296 -- -- Restructuring and related charges -- 10,257 -- Equity in earnings of investees -- -- (87) Integration and other non-recurring charges 2,623 776 702 -------- -------- -------- Operating (loss) income (41,023) (7,141) 6,614 Interest expense, net 346 143 47 Other expense (income), net 99 (218) (1,736) -------- -------- -------- (Loss) income from discontinued operations before provision (benefit) for income taxes (41,468) (7,066) 8,303 (Benefit) provision for income taxes (a) (2,442) (2,510) 2,102 -------- -------- -------- (Loss) income from discontinued operations $(39,026) $ (4,556) $ 6,201 ======== ======== ======== (a) Fiscal 2002 income taxes exclude additional expense of $1,475,000 per paragraphs 26 and 27 of SFAS No. 109 included in income from continuing operations on a consolidated basis. See Note 13. F-15 ARMOR HOLDINGS INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED The following is a summary of the assets and liabilities of our discontinued operations: DECEMBER 31, 2002 DECEMBER 31, 2001 ----------------- ----------------- (IN THOUSANDS) Assets Cash and cash equivalents $ 3,638 $ 6,230 Accounts receivable, net 16,228 24,040 Other current assets 8,959 7,292 ------- ------- Total current assets 28,825 37,562 Property, plant and equipment, net 12,481 9,358 Goodwill, net 12,995 36,865 Other assets 4,809 4,882 ------- ------- Total assets of discontinued operations $59,110 $88,667 ======= ======= Liabilities Current portion of long-term debt $ 186 $ 282 Short-term debt 350 681 Accounts payable 2,405 2,692 Accrued expenses and other current liabilities 14,284 4,021 ------- ------- Total current liabilities 17,225 7,676 Long-term debt 168 415 ------- ------- Total liabilities of discontinued operations $17,393 $ 8,091 ======= ======= 3. COMPREHENSIVE INCOME The components of comprehensive income, net of tax benefits of $364,000, $713,000 and $179,000 for the years ended December 31, 2002, 2001 and 2000, are listed below: DECEMBER 31, 2002 DECEMBER 31, 2001 DECEMBER 31, 2000 ---------------- ---------------- ---------------- (IN THOUSANDS) Net (loss) income $(17,689) $ 10,128 $ 17,048 Other comprehensive loss: Foreign currency translations, net of tax 304 (2,789) (333) -------- -------- -------- Comprehensive (loss) income: $(17,385) $ 7,339 $ 16,715 ======== ======== ======== F-16 ARMOR HOLDINGS INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED 4. BUSINESS COMBINATIONS We have completed numerous purchase business combinations for cash and/or shares of our common stock and assumption of liabilities in certain cases. In the three years in the period ended December 31, 2002, the following acquisitions were completed: TOTAL SHARES VALUE OF CONSIDERATION ISSUED SHARES ------------ ------ ------ (IN THOUSANDS, EXCEPT SHARES ISSUED) 2002 ---- Aggregate 2002 acquisitions (1) $ 8,818 -- -- Additional purchase price paid/issued for acquisition earnouts 9,375 -- -- -------- --------- -------- $18,193 -- -- 2001 ---- Aggregate 2001 acquisitions (2) $59,887 1,224,302 $ 19,604 Additional purchase price paid/issued for acquisition earnouts 3,904 68,888 1,087 -------- --------- -------- $ 63,791 1,293,190 $ 20,691 ======== ========= ======== 2000 ---- Aggregate 2000 acquisitions (3) $14,220 -- $ -- Additional purchase price paid/issued for acquisition earnouts 200 14,996 200 -------- --------- -------- $14,420 14,996 $ 200 ======== ========= ======== (1) Includes Speedfeed, Inc., Foldable Products Group, B-Square, Inc., Evi-Paq, Inc., Trasco Bremen and 911 Emergency Products. (2) Includes O'Gara-Hess & Eisenhardt Companies, Guardian and Identicator. (3) Includes Breakfree, Inc., Monadnock Lifetime Products and Lightning Powder. F-17 ARMOR HOLDINGS INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED Businesses acquired are included in consolidated results including discontinued operations from the date of acquisition. Pro forma results of the 2002 and 2000 acquisitions are not presented as they would not differ by a material amount from actual results. The following unaudited pro forma consolidated results are presented to show the results on a pro forma basis as if the 2001 acquisitions had been made as of January 1, 2001 and January 1, 2000: 2001 2000 ---------------- -------------- (IN THOUSANDS, EXCEPT PER SHARE DATA) Revenues $ 370,842 $ 333,375 Net income $ 6,453 $ 14,325 Basic earnings per share $ 0.26 $ 0.61 Diluted earnings per share $ 0.25 $ 0.59 Weighted average shares - basic 24,579 23,639 Weighted average shares - diluted 25,415 24,365 The changes in the carrying amount of goodwill for the year ended December 31, 2002, are as follows: Products Mobile Security Total -------------------------------------- (in thousands) Balance at January 1, 2001 $52,845 $33,963 $86,808 Goodwill acquired during year 7,298 4,630 11,928 ------- ------- ------- Balance at December 31, 2002 $60,143 $38,593 $98,736 ------- ------- ------- 5. INVENTORIES The components of inventory as of December 31, 2002 and 2001 are as follows: 2002 2001 ------- ------- (IN THOUSANDS) Raw materials $30,211 $28,796 Work-in-process 15,733 12,941 Finished goods 16,386 8,816 ------- ------- $62,330 $50,553 ======= ======= F-18 ARMOR HOLDINGS INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED 6. PROPERTY AND EQUIPMENT Property and equipment as of December 31, 2002 and 2001 are summarized as follows: 2002 2001 -------- -------- (IN THOUSANDS) Land $ 5,557 $ 3,571 Buildings and improvements 23,964 16,083 Machinery and equipment 30,534 25,146 -------- -------- Total 60,055 44,800 Accumulated Depreciation (12,919) (8,096) -------- -------- $ 47,136 $ 36,704 ======== ======== Depreciation expense for the years ended December 31, 2002, 2001 and 2000 was approximately $4,953,000, $3,031,000, and $2,074,000 respectively. In the statement of operations on continuing operations for the years ended December 31, 2002, 2001 and 2000, depreciation expense has been reduced by $130,000 in each year for the amortization of the proceeds received under an economic development grant received from the Department of Housing and Urban Development. F-19 ARMOR HOLDINGS INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED 7. ACCRUED EXPENSES AND OTHER CURRENT LIABILTIES Accrued expenses and other current liabilities as of December 31, 2002 and 2001 are summarized as follows: 2002 2001 ------- ------- (IN THOUSANDS) Accrued expenses $16,988 $18,269 Customer Deposits 6,302 7,002 Deferred consideration for acquisitions 1,826 525 ------- ------- $25,116 $25,796 ======= ======= 8. DEBT 2002 2001 ------ ------ (IN THOUSANDS) Credit facility (a) $ -- $ -- Ontario Industrial

Development Authority Variable Rate Demand Industrial Development Revenue Bonds, Series 1989 2,800 3,000 payable in annual installments of $200 to $300, through August 1, 2014, with interest paid monthly at varying rates Note payable in scheduled installments through 2013, with an interest rate of 5%. 1,582 -- Economic Development Revenue Bonds, payable in scheduled installments through September 2016, with a variable interest rate approximating 85% of the bond equivalent yield of the 13 week U.S. Treasury bills (not to exceed 12%) which approximated 1.5% and 2.75% at December 31, 2002 and 2001, respectively. 1,075 1,150 Note to former officer payable in monthly principal and interest installments of $7 through December 31, 2009 with an imputed interest rate of 9.25% 399 438 Minimum guaranteed royalty to former officer payable in monthly principal and interest installments of $4 through August 2005, with an imputed interest rate of 9.2% 114 152 Minimum guaranteed royalty to former officer payable in monthly principal and interest installments of $36 through April 2005, with an imputed interest rate of 7.35% 915 1,258 ------ ------ $6,885 $5,998 Less current portion (1,813) (1,773) ------ ------ $5,072 $4,225 ====== ====== Credit Facility (a) - On August 22, 2001, we entered into an Amended and Restated Credit Agreement (the "Credit Agreement") with Bank of America, Canadian Imperial Bank of Commerce, First Union National Bank, Suntrust Bank, Republic Bank, Keybank National Association, and ING (U.S.) Capital LLC. Pursuant to the Credit Agreement, the lenders established a $120,000,000 line of credit for our benefit expiring on February 12, 2004. The Credit Agreement, among other things, provides for (i) total maximum borrowings of $120,000,000 and (ii) the capability for borrowings in foreign currencies. All borrowings under the Credit Agreement bear interest at either (i) a base rate, plus an applicable margin ranging from .000% to .375%, depending on certain conditions, (ii) a eurodollar rate, plus an applicable margin ranging from 1.125% to 1.875%, depending on certain conditions, or (iii) with respect F-20 ARMOR HOLDINGS INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED to foreign currency loans, a fronted offshore currency rate, plus an applicable margin ranging from 1.125% to 1.875%, depending on certain conditions. In addition, the Credit Agreement includes both negative and affirmative covenants customary for a credit facility of this nature, such as a limitation on capital expenditures, foreign indebtedness, minimum fixed charge coverage and a restriction against paying dividends. The Credit Agreement also provides that Bank of America will make swing-line loans to us of up to $5,000,000 for working capital purposes and will issue letters of credit on our behalf of up to $20,000,000. As of December 31, 2002, we had no outstanding borrowings under our Credit Facility, and Bank of America had issued $11.4 million in letters of credit on our behalf under the Credit Agreement. All indebtedness under the Credit Agreement will mature on February 12, 2004. We had approximately $6.9 million in other long-term debt, net of current portion, consisting primarily of $3.9 million in industrial development revenue bonds. As part of the Credit Agreement, all of our direct and indirect domestic subsidiaries agreed to guarantee our obligations under the Credit Agreement. The Credit Agreement is collateralized by (1) a pledge of all of the issued and outstanding shares of stock of certain domestic subsidiaries of the Company pursuant to a pledge agreement and (2) a pledge of 65% of the issued and outstanding shares of our first tier foreign subsidiaries. The Credit Agreement includes both negative and affirmative covenants customary for a credit facility of this nature, such as a limitation on capital expenditures, foreign indebtedness, minimum fixed charge coverage and a restriction against paying dividends. Maturities of long-term debt are as follows: YEAR ENDED (IN THOUSANDS) ---------- 2003 $ 1,813 2004 917 2005 550 2006 393 2007 443 Thereafter 2,769 ------- $ 6,885 ======= 9. INTEGRATION AND OTHER NON-RECURRING CHARGES As a result of its acquisition program, we incurred integration and other non-recurring charges of approximately $5.9 million, $3.3 million and $2.6 million for the years ending December 31, 2002, 2001 and 2000, respectively. These costs related to the relocation of assets and personnel, severance costs, systems integration, domestic and international tax restructuring as well as integrating the sales and marketing functions for the acquired companies. 10. COMMITMENTS AND CONTINGENCIES Employment contracts. We are party to several employment contracts at year ending December 31, 2002 with certain members of management. Such contracts are for varying periods and include restrictions on competition after termination. These agreements provide for salaries, bonuses and other F-21 ARMOR HOLDINGS INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED benefits and also specify and delineate the granting of various stock options. Legal/litigation matters. In 1997 we terminated several agreements with a Dutch company, Airmunition International, B.V. (AMI), and with a British company, Crown Limited (Crown). AMI and Crown started an action against us before the Netherlands Arbitration Institute in Rotterdam, Holland claiming breach of contract and unauthorized use of confidential information and seeking damages of $20.5 Million. The case is currently pending, and while we are contesting the allegations vigorously, we are unable to predict the outcome of this matter. Although we do not have insurance coverage for this matter, at this time, we do not believe this matter will have a material impact on our financial position, operations or liquidity. On January 16, 1998, our Services Division ceased operations in Angola. The cessation of operations in Angola was dictated by that government's decision to deport all of our expatriate management and supervisors. As a result of the cessation of operations in Angola, our Services Division became involved in various disputes with SHRM S.A.("SHRM"), its minority joint venture partner relating to the Angolan joint venture known as Defense System International Africa ("DSIA"). On March 6, 1998, SIA (a subsidiary of SHRM) filed a complaint against Defense Systems France, SA ("DSF") before the Commercial Court of Nanterre (Tribunal de Commerce de Nanterre) seeking to be paid an amount of $577,286 corresponding to an alleged debt of DSIA to SIA. On June 27, 2000, the judge of the Paris Commercial Court ruled SHRM did not provide evidence required to establish its standing and the proceedings brought by SHRM were cancelled. On October 3, 2000, a winding up petition was served by DSF against DSIA. On October 31, 2000, SHRM filed a counterclaim seeking to have this winding up petition dismissed. On November 28, 2000, SHRM appealed the June 27, 2000 judgement rendered by the Paris Commercial Court, claiming that the Paris Commercial Court no longer had jurisdiction over the case. On September 18, 2001, the Paris Commercial Court stayed the proceeding pending the outcome of the appeal. A hearing with the Court of Appeal on the standing of SHRM and on the merits was held on October 24, 2002. The Commercial Court of Nanterre has stayed the proceedings before it, pending the decisions of the Court of Appeal and the Paris Commercial Court. In February 2003, the Court of Appeal ruled against SHRM and its parent entity, Compass Group, effectively ending all further proceedings on the merits of Compass'claims. The decision is appealable by Compass. In 1999 and prior to our acquisition of OHEAC in 2001, O'Gara-Hess & Eisenhardt Armoring do Brasil Ltda. (OHE Brazil) was audited by the Brazilian federal tax authorities and assessed over Ten Million Reals (US$2.8 Million based on the exchange rate as of December 31, 2002). OHE Brazil has appealed the tax assessment and the case is pending. To the extent that there may be any liability, we believe that we are entitled to indemnification from Kroll, Inc. under the terms of our purchase agreement dated April 20, 2001, despite the denial by Kroll, Inc. of any such liability, because the events occurred prior to our purchase of the O'Gara Companies from Kroll, Inc. Additionally, Kroll, Inc. has provided us with a US$1.5 Million letter of credit until August 21, 2008 in order to collateralize Kroll's indemnification obligation, which is capped at US$5 Million with respect to this matter. At this time, we do not believe this matter will have a material impact on our financial position, operations or liquidity. In 1999 and prior to our acquisition of OHEAC in 2001, several of the former employees of Kroll O'Gara Company de Mexico, S.A. de C.V. (O'Gara Mexico), a subsidiary of OHEAC, commenced labor claims against O'Gara Mexico seeking damages for unjustified termination. These cases are still pending before F-22 ARMOR HOLDINGS INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED the labor board in Mexico City. The terminated employees are seeking back pay and benefits since the date of termination amounting to approximately US $2,890,998, and accruing at approximately US $50,400 per month. To the extent that there may be any liability, we believe that we are entitled to indemnification from Kroll, Inc. under the terms of our purchase agreement dated April 20, 2001, despite the denial by Kroll, Inc. of any such liability, because the events occurred prior to our purchase of the O'Gara Companies from Kroll, Inc. Although we do not have any insurance coverage for this matter, at this time, we do not believe this matter will have a material impact on our financial position, operations or liquidity. In August 2001, Defense Technology Corporation of America ("DTC"), one of our subsidiaries, received a civil subpoena from the United States Environmental Protection Agency requesting information pursuant to Section 104(e) of the Comprehensive Environmental Response, Compensation and Liability Act regarding the possible impact of the Casper, Wyoming tear gas facility on the environment. DTC responded to the request, and to date the EPA has not taken any further action with respect to the matter. At this time, we do not believe this matter will have a material impact on our financial position, operations or liquidity. In December 2001, OHE France sold its industrial bodywork business operated under the name Labbe/Division de O'Gara Hess & Eisenhardt France/ Carrosserie Industriells to SNC Labbe. Subsequent to the sale the Labbe Family Trust (LFT), owner of the leasehold interest upon which the Carrosserie business is operated, sued OHE France and SNC Labbe claiming that transfer of the leasehold was not valid because the LFT had not given its consent to the transfer as required under the terms of the lease. Further, LFT seeks to have OHE France, as the sole tenant, maintain and repair the leased building. The approximate cost of renovating the building is estimated to be between US $3.2 and US $6.4 million based on the exchange rate as of December 31, 2002. The case is currently pending, and while we are contesting the allegations vigorously, we are unable to predict the outcome of this matter. Although we do not have any insurance coverage for this matter, at this time, we do not believe this matter will have a material impact on our financial position, operations or liquidity. In December 2001, an action was filed against us in the Regional Court of Nuremberg, Germany alleging unauthorized use of the trademarks "First Defense" and "First Defense Aerosol Pepper Projector." The case is currently pending, and while we are contesting the allegations vigorously, we are unable to predict the outcome of this matter. Although we do not have any insurance coverage for this matter, at this time, we do not believe this matter will have a material impact on our financial position, operations or liquidity. On or about March 22, 2002, O'Gara-Hess & Eisenhardt Armoring Company (OHEAC), one of our subsidiaries, received a civil subpoena from the Department of Defense (DOD) requesting documents and information concerning various quality control documentation regarding parts delivered by its subcontractors and vendors in support of the High Mobility Multipurpose Wheeled Vehicles (HMMWV) armored at its Fairfield, Ohio facility for the period October 1, 1999 through May 1, 2001. OHEAC has complied fully with the subpoena. In early 2003, OHEAC was advised that the Department of Justice (DOJ) was also investigating separate claims against OHEAC filed by individuals that involve the same time frame and issues covered by the DOD subpoena. OHEAC is responding to the government's questions and expects to meet with the DOJ to discuss the current status of the investigation and explore closure. Given the stage of these investigations, it is not possible F-23 ARMOR HOLDINGS INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED to predict the outcome of this matter. To the extent that there may be any liability, we believe that we are entitled to indemnification from Kroll, Inc. under the terms of our purchase agreement dated April 20, 2001, despite the denial by Kroll, Inc. of any such liability, because the events occurred prior to our purchase of the O'Gara Companies from Kroll, Inc. At this time, we do not believe this matter will have a material impact on our financial position, operations or liquidity. In June 2002, O'Gara Hess & Eisenhardt France S.A. (OHE France) received a tax reassessment from the French tax authorities for the tax years ended on March 31, 1999, 2000 and 2001 totaling approximately (Euro) 720,940 (Euro) (US$755,761 based on the exchange rate as of December 31, 2002). OHE France has appealed the tax assessment and the case is pending. To the extent that there may be any liability, we believe that we are entitled to indemnification from Kroll, Inc. under the terms of our purchase agreement dated April 20, 2001, despite the denial by Kroll, Inc. of any such liability, because the events occurred prior to our purchase of the O'Gara Companies from Kroll, Inc. At this time, we do not believe this matter will have a material impact on our financial position, operations or liquidity. On October 18, 2002 we were notified by the Internal Revenue Service that our tax return for the tax year ended December 31, 2000 had been selected for examination. Further, on January 30, 2003 we were notified that our tax return for the tax year ended December 31, 2001 had been selected for examination. The examinations are currently pending, and at this time we are unable to predict the outcome of these matters. In October 2002, we were sued in the United States District Court for the District of Wyoming. The plaintiffs in that lawsuit asserted various state law tort claims and federal environmental law claims under the Resource Conservation and Recovery Act and the Clean Air Act stemming from DTC's Casper, Wyoming tear gas plant. The plaintiffs have not yet quantified their alleged damages. The plaintiffs have filed their suit as a potential class action, but have not yet sought judicial certification of the class. The alleged actions took place over time periods during which we were covered by different insurance policies. We have notified our insurance carriers of the suit. Our prior insurance carrier has agreed, under a full reservation of rights, including with respect to any liability which relates to the time its policy was in effect, to provide a defense and to address the question of liability indemnification in the future. Our current insurance carrier has declined defense and indemnification coverage. While we do not carry specific environment insurance coverage, we have reserved the right to challenge our insurance carrier's determination. The case is currently pending, and while we are contesting the allegations vigorously, we are unable to predict the outcome of this matter. At this time, we do not believe this matter will have a material impact on our financial position, operations or liquidity. In addition to the above, in the normal course of business, we are subjected to various types of claims and currently have on-going litigations in the areas of products liability and general liability. Our products are used in a wide variety of law enforcement situations and environments. Some of our products can cause serious personal or property injury or death if not carefully and properly used by adequately trained personnel. We believe that we have adequate insurance coverage for most claims that are incurred in the normal course of business. In such cases, the effect on our financial statements is generally limited to the amount of our insurance deductible or self-insured retention. Our annual insurance premiums and self insurance retention amounts have risen significantly over the past several years and may continue to do so to the extent we are able to purchase insurance F-24 ARMOR HOLDINGS INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED coverage. At this time, we do not believe any such claims or litigations will have a material impact on our financial position, operations and liquidity. 11. OTHER INCOME On May 31, 2000, we sold our investment in JSGS which is Jardine Securicor Gurkha Services Limited for a pre-tax gain of approximately $1.7 million included in other income. 12. INFORMATION CONCERNING BUSINESS SEGMENTS AND GEOGRAPHICAL SALES We are a leading manufacturer and provider of security products, vehicle armor systems, and security training services. Our products and services are used by military, law enforcement, security and corrections personnel throughout the world, as well as governmental agencies, multinational corporations and non-governmental organizations. Our continuing operations are organized and operated under two business segments: Armor Holdings Products and Armor Mobile Security. Our Services division has been classified as discontinued operations and is no longer included in this presentation (See Note 2). Armor Holdings Products. Our Armor Holdings Products division manufactures and sells a broad range of high quality equipment marketed under brand names that are well known and respected in the military and law enforcement communities. Products manufactured by this division include concealable and tactical body armor, hard armor, duty gear, less-lethal munitions, anti-riot products, police batons, emergency lighting products, forensic products firearms accessories and weapon maintenance products. USDS, Inc., a small subsidiary providing certain training services formerly reported as a part of the Services division, is not included in the amounts classified as assets held for sale or discontinued operations and has been reclassified to our Armor Holdings Products division where management oversight currently resides. Armor Mobile Security. Our Armor Mobile Security division manufactures and installs ballistic and blast protection armoring systems for military vehicles, commercial vehicles, military aircraft and missile components. Under the brand name O'Gara-Hess & Eisenhardt ("O'Gara"), we are the sole-source provider to the U.S. military for the supply of armoring and blast protection systems as well as maintenance services for the High Mobility Multi-purpose Wheeled Vehicle (HMMWV, commonly known as the Humvee). Additionally, we have been subcontracted to develop a ballistically armored and sealed truck cab for the High Mobility Artillery Rocket System (HIMARS) currently in development for the U.S. Army. We armor a variety of commercial vehicles including limousines, sedans, sport utility vehicles, commercial trucks and cash-in-transit vehicles, to protect against varying degrees of ballistic and blast threats. The Armor Mobile Security division was created in connection with our acquisition of O'Gara on August 22, 2001 (the "O'Gara acquisition"). We have invested substantial resources outside of the United States and plan to continue to do so in the future. The Armor Mobile Security division has invested substantial resources in Europe and South America. These operations are subject to the risk of new and different legal and regulatory requirements in local jurisdictions, tariffs and trade barriers, potential difficulties in staffing and managing local operations, currency risks, potential imposition of restrictions on investments, potentially adverse tax consequences, including imposition or increase of withholding and F-25 ARMOR HOLDINGS INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED other taxes on remittances and other payments by subsidiaries, and local economic, political and social conditions. Governments of many developing countries have exercised and continue to exercise substantial influence over many aspects of the private sector. Government actions in the future could have a significant adverse effect on economic conditions in a developing country or may otherwise have a material adverse effect on us and our operating companies. We do not have political risk insurance in the countries in which we currently conduct business. Moreover, applicable agreements relating to our interests in our operating companies are frequently governed by foreign law. As a result, in the event of a dispute, it may be difficult for us to enforce our rights. Accordingly, we may have little or no recourse upon the occurrence of any of these developments. F-26 ARMOR HOLDINGS INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED Revenues, operating income and total assets for each of our continuing segments are as follows: 2002 2001 2000 --------- --------- --------- (IN THOUSANDS) Revenues: Products $ 179,946 $ 149,868 $ 139,904 Mobile Security 125,171 47,232 -- --------- --------- --------- Total revenues $ 305,117 $ 197,100 $ 139,904 ========= ========= ========= Income (loss) from operations: Products $ 30,978 $ 26,845 $ 27,803 Mobile Security 14,375 6,673 -- Corporate (6,988) (6,845) (7,934) --------- --------- --------- Total income from operations $ 38,365 $ 26,673 $ 19,869 ========= ========= ========= Total assets: Products $ 179,367 $ 147,313 $ 129,432 Mobile Security 105,446 102,127 -- Corporate 23,830 49,950 9,596 --------- --------- --------- Total assets $ 308,643 $ 299,390 $ 139,028 ========= ========= ========= F-27 ARMOR HOLDINGS INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED The following financial information with respect to revenues, operating income from continuing operations (geographic operating income from continuing operations before amortization expense and integration and other non-recurring charges) and total assets to principal geographic areas are as follows: 2002 2001 2000 --------- --------- --------- (IN THOUSANDS) Revenues: North America $ 225,365 $ 144,981 $ 117,199 South America 19,879 6,449 3,434 Africa 1,219 582 167 Europe/Asia 58,654 45,088 16,078 Other -- -- 3,026 --------- --------- --------- $ 305,117 $ 197,100 $ 139,904 ========= ========= ========= Geographic operating income: North America $ 34,032 $ 23,290 $ 19,376 South America 1,702 473 982 Africa 428 192 57 Europe/Asia 8,374 8,156 3,019 Other -- -- 727 --------- --------- --------- $ 44,536 $ 32,111 $ 24,161 ========= ========= ========= Total assets: North America $ 264,767 $ 268,019 $ 132,744 South America 5,456 5,811 -- Africa -- -- -- Europe/Asia 38,420 25,560 6,284 --------- --------- --------- $ 308,643 $ 299,390 $ 139,028 ========= ========= ========= A reconciliation of consolidated geographic operating income from continuing operations to consolidated operating income from continuing operations follows: 2002 2001 2000 ------- ------- ------- (IN THOUSANDS) Consolidated geographic operating income: $44,536 $32,111 $24,161 Amortization (245) (2,142) (1,704) Integration and other non-recurring charges (5,926) (3,296) (2,588) ------- ------- ------- Operating income $38,365 $26,673 $19,869 ======= ======= ======= F-28 ARMOR HOLDINGS INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED 13. INCOME TAXES Income tax expense (benefit) from continuing operations for the years ended December 31, 2002, 2001, and 2000 consisted of the following: 2002 2001 2000 ------- ------ ------ (IN THOUSANDS) Current Domestic $13,306 $ 7,017 $6,239 Foreign 2,389 1,563 232 ------- ------- ------ Total current $15,695 $ 8,580 $6,471 ------- ------- ------ Deferred Domestic $ (25) $ (319) $ 769 Foreign 384 (54) 0 ------- ------- ------ Total deferred $ 359 $ (373) $ 769 ------- ------- ------ Total provision for Income Taxes $16,054 $ 8,207 $7,240 ------- ------- ------ Significant components of our net deferred tax asset related to continuing operations as of December 31, 2002 and 2001 are as follows: 2002 2001 -------- -------- (IN THOUSANDS) Deferred tax assets: Reserves not currently deductible $2,697 $1,910 Operating loss carryforwards 1,769 666 Accrued expenses 220 0 Foreign tax credits 2,939 0 Research and development and other credits 206 222 Tax on unremitted foreign earnings 1,255 1,619 ------ ------ 9,086 4,417 Deferred tax asset valuation allowance (75) (75) ------ ------ Deferred tax asset, net of valuation allowance $9,011 $4,342 Deferred tax liability: Goodwill not amortized for financial statement purposes under SFAS 142 (954) (239) Property and equipment (475) (318) ------ ------ Net deferred tax asset $7,582 $3,785 ====== ====== Effective with the change in control of the Company by Kanders Florida Holdings, Inc. on January 18, 1996, the utilization of the United States portion of the NOL became restricted to approximately $300,000 per year. As of December 31, 2002, we had U.S. and foreign NOLs of approximately $4.6 million. The U.S. portion of the net NOLs expire in varying amounts in fiscal years 2006 to 2019. At December 31, 2002, we also have tax credits of $206,000 subject to certain limitations due to the acquisition of Safariland, LTD. The Company also has approximately $2.9 million in foreign tax credits expiring in 2006. Certain deferred tax assets including net operating losses and tax credits could become limited if there is a change of control as defined in IRC Section 382. F-29 ARMOR HOLDINGS INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED The realization of deferred tax assets may be based on the utilization of carrybacks to prior taxable periods, the anticipation of future taxable income and the utilization of tax planning strategies. Management has determined that it is more likely than not that certain deferred tax assets can be supported by carrybacks to federal taxable income in the federal carryback period and by expected future taxable income. US taxes have not been provided for on unremitted foreign earnings of approximately $3 million from continuing operations. These earnings are considered to be permanently reinvested in non-US operations. We are not permanently reinvested in some jurisdictions and have established a deferred tax asset of $1,255,000. Net deferred tax assets described above have been included in the accompanying consolidated balance sheets as follows: 2002 2001 ------ ------- Other current assets $2,697 $1,910 Other assets 4,885 1,875 ------ ------ Total deferred tax assets $7,582 $3,785 ====== ====== The following reconciles the income tax expense computed at the Federal statutory income tax rate to the provision for income taxes recorded in the income statement for the years ended December 31, 2002, 2001 and 2000: 2002 2001 2000 ------ ------ ------ Provision for income taxes at statutory federal rate 35.0% 35.0% 35.0% State and local income taxes, net of Federal benefit 3.8% 3.2% 1.4% Foreign income taxes .7% (.1%) - Valuation allowances from discontinued operations 3.8% - - Other permanent items (.4%) (2.2%) 3.6% ----- ----- ----- 42.9% 35.9% 40.0% ===== ===== ===== F-30 ARMOR HOLDINGS INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED 14. STOCKHOLDERS' EQUITY Preferred stock. On July 16, 1996, Our shareholders authorized a series of preferred stock with such rights, privileges and preferences as the Board of Directors shall from time to time determine. We have not issued any of this preferred stock. Stock options and grants. In 1994, We implemented an incentive stock plan and an outside directors' stock plan. These plans collectively provide for the granting of options to certain key employees as well as providing for the grant of common stock to outside directors and to all full time employees. Pursuant to such plans, 1,050,000 shares of common stock were reserved and made available for distribution. The option prices of stock which may be purchased under the incentive stock plan are not less than the fair market value of common stock on the dates of the grants. Effective January 19, 1996, all stock grants awarded under the 1994 incentive stock plan were accelerated and considered fully vested. In 1996, we implemented an incentive stock plan and an outside directors' stock plan. These plans collectively provide for the granting of options to certain key employees and directors. Pursuant to such plans, as amended, 2,200,000 shares of common stock were reserved and made available for distribution. The option prices of stock which may be purchased under the incentive stock plan are not less than the fair market value of common stock on the dates of the grants. During 1998, we implemented a new non-qualified stock option plan. Pursuant to the new plan, 725,000 shares of common stock were reserved and made available for distribution. On January 1, 1999, we distributed all 725,000 shares allocated under the plan. In 1999, we implemented the 1999 Stock Incentive Plan (the "1999 Plan"). We reserved 2,000,000 shares of its Common Stock for the 1999 Plan. The 1999 Plan provides for the granting of options to employees, officers, directors, consultants, independent contractors and advisors of the Company. The option prices of stock which may be purchased under the 1999 Plan are not less than the fair market value of common stock on the dates of the grants. During 2002, we implemented two new stock option plans. The 2002 Stock Incentive Plan, authorizes the issuance of up to 2,700,000 shares of our common stock upon the exercise of stock options or in connection with the issuance of restricted stock and stock bonuses. The 2002 Stock Incentive Plan authorizes the granting of stock options, restricted stock and stock bonuses to employees, officers, directors and consultants, independent contractors and advisors of Armor Holdings and its subsidiaries. The 2002 Executive Stock Plan provides for the grant of a total of 470,000 stock options and stock awards to our key employees. The terms and provisions of the 2002 Executive Stock Plan are substantially the same as the 2002 Stock Incentive Plan, except that we may only grant non-qualified stock options under the 2002 Executive Stock Plan. The 2002 Executive Stock Plan was adopted on March 13, 2002 and all shares available for grant under the 2002 Executive Stock Plan were granted to our executive officers on March 13, 2002. On December 18, 2002, we sold a put option on 500,000 shares to an institutional counterparty with an exercise price of $13.99 per share and an expiration date of March 31, 2002 for $525,000. We have a maximum potential obligation under the put options to purchase 500,000 shares of our common stock at an exercise price of $13.99 for an aggregate of $7.0 million. Although certain other events can trigger exercise these put options are generally excercisable only at maturity on March 31, 2002. We have the right to settle the put options by cash settlement, physical settlement of the F-31 ARMOR HOLDINGS INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED options or by net share settlement using shares our common stock. In accordance with EITF Issue No. 00-19, we have recorded the sale of the put options in equity and as such, changes in fair value of the options have not been recognized in the financial statements. We may, from time to time, enter into additional put and call option arrangements. Under SFAS 123, the fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions for the years ended December 31, 2002, 2001 and 2000: 2002 2001 2000 ------ ------ ------ Expected life of option 4 yrs 4 yrs 4 yrs Dividend yield 0% 0% 0% Volatility 52.2% 44.7% 30.9% Risk free interest rate 3.94% 4.52% 5.76% The increase in volatility in from fiscal 2000 to fiscal 2002 is primarily due to the increase demand for the stock, which drove up the price and increased the volatility. The weighted average fair value of options granted during 2002, 2001 and 2000 are as follows: 2002 2001 2000 -------- ------- ------ (IN THOUSANDS, EXCEPT PER SHARE DATA) Fair value of each option granted $ 10.08 $ 6.17 $ 4.79 Total number of options granted 1,895 892 185 Total fair value of all options granted $ 19,098 $ 5,501 $ 886 Outstanding options, consisting of ten-year incentive and non-qualified stock options, vest and become exercisable over a three-year period from the date of grant. The outstanding options expire ten years from the date of grant or upon retirement from the Company, and are contingent upon continued employment during the applicable ten-year period. F-32 ARMOR HOLDINGS INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED A summary of the status of stock option grants as of December 31, 2002 and changes during the years ending on those dates is presented below: WEIGHTED AVERAGE OPTIONS EXERCISE PRICE ------- ------------- Outstanding at December 31, 1999 3,545,258 $ 9.21 Granted 185,000 $14.37 Exercised (333,075) $ 4.57 Forfeited

(102,344) $10.98 ---------- Outstanding at December 31, 2000 3,294,839 $ 9.91 Granted 892,159 $15.24 Exercised (1,173,227) $ 9.37 Forfeited (29,737) $15.51 ---------- Outstanding at December 31, 2001 2,984,034 $11.60 Granted 1,894,660 $22.96 Exercised (507,868) $ 8.41 Forfeited (86,168) $16.75 ---------- Outstanding at December 31, 2002 4,284,658 $ 7.81 ========== Options exercisable at December 31, 2002 2,099,307 $ 6.42 ========== F-33 ARMOR HOLDINGS INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED The following table summarizes information about stock options outstanding at December 31, 2002: 12/31/2002 REMAINING OPTIONS OPTIONS LIFE IN EXERCISE PRICE RANGE OUTSTANDING EXERCISABLE YEARS -------------------- ----------- ----------- ----- 0.97 - 3.75 93,357 93,357 3.0 7.50 - 9.94 255,292 255,292 5.0 10.00 - 10.63 141,671 138,337 5.2 11.00 - 11.63 762,844 759,510 5.8 12.00 - 12.03 65,002 58,334 5.2 13.19 - 14.00 309,668 223,668 7.3 14.17 - 14.70 444,492 187,322 8.7 15.05 - 15.90 347,994 94,331 8.8 16.31 - 16.50 62,667 9,000 8.0 17.00 - 17.54 105,170 30,156 8.3 21.75 - 21.75 125,000 -- 9.1 23.09 - 23.93 689,501 225,000 9.2 24.07 - 25.80 882,000 25,000 9.5 --------- --------- Total 4,284,658 2,099,307 ========= ========= Remaining non-exercisable options as of December 31, 2002 become exercisable as follows: 2003 775,961 2004 991,358 2005 168,032 2006 250,000 F-34 ARMOR HOLDINGS INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED Earnings per share. The following details the earnings per share computations on a basic and diluted basis for the years ended December 31, 2002, 2001 and 2000: 2002 2001 2000 -------- ------- ------- (IN THOUSANDS, EXCEPT PER SHARE DATA) Numerator for basic and diluted earnings per share: Net (loss) income available to common shareholders $(17,689) $10,128 $17,048 -------- ------- ------- Denominator: Basic earnings per share weighted average shares outstanding 30,341 23,932 22,630 Effect of dilutive securities: Effect of shares issuable under stock option and stock grant plans, based on the treasury stock method 616 836 726 -------- ------- ------- Diluted earnings per share Adjusted weighted-average shares outstanding 30,957 24,768 23,356 -------- ------- ------- Basic earnings per share $ (0.58) $ 0.42 $ 0.75 ======== ======= ======= Diluted earnings per share $ (0.57) $ 0.41 $ 0.73 ======== ======= ======= 15. SUPPLEMENTAL CASH FLOW INFORMATION: 2002 2001 2000 ------ ------ ------ (In Thousands) Cash paid during the year for: Interest $ 527 $ 3,878 $ 1,762 ====== ======= ======= Income taxes $5,753 $ 4,656 $ 7,240 ====== ======= ======= 2002 2001 2000 ------ ------ ------ (In Thousands) Acquisitions of businesses, net of cash acquired: Fair value of assets acquired $ 16,134 $ 57,932 $ 4,807 Goodwill 8,478 37,578 12,336 Liabilities assumed (15,794) (36,541) (2,923) Stock issued -- (19,604) -- -------- -------- ------- Total cash paid $ 8,818 $ 39,365 14,220 ======== ======== ======= Debt assumed in acquisition of property -- -- $ 3,500 F-35 ARMOR HOLDINGS INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED 16. QUARTERLY RESULTS (UNAUDITED) The following table presents summarized unaudited quarterly results of operations for the Company for fiscal 2002 and 2001. We believe all necessary adjustments have been included in the amounts stated below to present fairly the following selected information when read in conjunction with the Consolidated Financial Statements and Notes thereto included elsewhere herein. Future quarterly operating results may fluctuate depending on a number of factors. Results of operations for any particular quarter are not necessarily indicative of results of operations for a full year or any other quarter. FISCAL 2002 -- FIRST SECOND THIRD FOURTH QUARTER QUARTER QUARTER QUARTER -------------- -------------- ------------ --------------- (IN THOUSANDS, EXCEPT PER SHARE DATA) Revenue $ 69,604 $ 71,605 $80,557 $83,351 Gross profit $ 21,974 $ 22,701 $24,610 $25,087 Net income $5,960 $4,075 $(14,707) $(13,017) Basic earnings per share $ 0.19 $ 0.13 $(0.50) $(0.44) Diluted earnings per share $ 0.19 $ 0.13 $(0.49) $(0.44) FISCAL 2001 --- FIRST SECOND THIRD FOURTH QUARTER QUARTER QUARTER QUARTER ------------- -------------- ------------ ------------- (IN THOUSANDS, EXCEPT PER SHARE DATA) Revenue $ 30,168 $ 38,100 $ 48,664 $ 80,168 Gross profit $ 12,190 $ 15,865 $ 17,227 $ 25,488 Net income $ (3,396) $4,298 $3,823 $5,403 Basic earnings per share $ (0.15) $ 0.19 $ 0.16 $ 0.21 Diluted earnings per share $ (0.14) $ 0.18 $ 0.16 $ 0.20 17. EMPLOYEE BENEFITS PLAN In October 1997, we formed a 401(k) plan, (the "Plan") which provides for voluntary contributions by employees and allows for a discretionary contribution by us in the form of cash. We made contributions of approximately $395,500, $272,700 and $243,000 to the Plan in 2002, 2001 and 2000 respectively. F-36 ARMOR HOLDINGS INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED 18. RELATED PARTY TRANSACTIONS In fiscal 2000 we subcontracted for certain security guard services with Alpha, Inc., wholly owned by a shareholder of the Company, who is also a director of Gorandel Trading Limited. In fiscal 2000, security guard service fees of approximately

$2,444,000 were paid to Alpha. In August of 2000, we acquired Alpha. The purchase price was approximately $1.0 million in cash consisting of both a current and deferred portion. In fiscal 2002 and 2001 we paid paid $100,000 and $400,000 of the deferred portion of the purchase price respectively. Effective as of January 1, 2002, Kanders & Company, Inc. ("Kanders & Co."), a corporation controlled by Warren B. Kanders, the Chairman of our Board, entered into an agreement with us to provide certain investment banking, financial advisory and related services for a five year term that will expire December 31, 2006. Kanders & Co. will receive a mutually agreed upon fee on a transaction by transaction basis during the term of this agreement. The aggregate fees under this agreement will not exceed $1,575,000 during any calendar year. We also agreed to reimburse Kanders & Co. for reasonable out-of-pocket expenses including Kanders & Co.'s expenses for office space, an executive assistant, furniture and equipment, travel and entertainment, reasonable fees and disbursements of counsel, and consultants retained by Kanders & Co. During the fiscal year ended December 31, 2002, we paid Kanders & Co. $525,000 for investment banking services. We also reimbursed Kanders & Co. for out-of-pocket expenses in the aggregate amount of $302,000 during the fiscal year ended December 31, 2002. We also granted Kanders & Co. (i) options to purchase 35,000 shares of our common stock at an exercise price per share equal to $23.93, and (ii) a restricted stock grant of 10,447 shares of common stock valued at $15.04 per share (iii) a restricted stock grant of 100,000 shares of common stock valued at $15.04 per share. These grants were made during fiscal 2002 in consideration for consulting services provided by Kanders & Co. in connection with certain transactions during fiscal 2001. During the fiscal year ended December 31, 2002 we paid our Director Nicholas Sokolow's law firm Sokolow, Dunaud, Mercadier & Carreras $28,000 for legal services in connection with various acquisitions. F-37 ARMOR HOLDINGS INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED 19. OPERATING LEASES We are party to certain real estate, equipment and vehicle leases. Several leases include options for renewal and escalation clauses. In most cases, management expects that in the normal course of business leases will be renewed or replaced by other leases. Approximate total future minimum annual lease payments under all noncancelable leases of continuing operations are as follows: YEAR (IN THOUSANDS) ---------------------- -------------------- 2003 $1,141 2004 840 2005 365 2006 66 2007 51 Thereafter -- -------------------- $2,463 ==================== We incurred rent expense of approximately $1,200,000, $765,000 and $394,000 during the years ended December 31, 2002, December 31, 2001 and December 31, 2000. F-38 SIGNATURES Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized. ARMOR HOLDINGS, INC. /s/ Jonathan M. Spiller --------------------------------- Jonathan M. Spiller President, Chief Executive Officer and Director Dated: March 31, 2003 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: /s/ Jonathan M. Spiller /s/ Warren B. Kanders --------------------------------- --------------------------------- Jonathan M. Spiller Warren B. Kanders President and Chief Executive Chairman of the Board of Directors Officer and Director March 31, 2003 Principal Executive Officer March 31, 2003 /s/ Robert R. Schiller /s/ Nicholas Sokolow --------------------------------- --------------------------------- Robert R. Schiller Nicholas Sokolow Executive Vice President Director and Chief Financial Officer March 31, 2003 March 31, 2003 /s/ Burtt R. Ehrlich /s/ Thomas W. Strauss --------------------------------- --------------------------------- Burtt R. Ehrlich Thomas W. Strauss Director Director March 31, 2003 March 31, 2003 /s/ Alair A. Townsend /s/ Deborah A. Zoullas --------------------------------- --------------------------------- Alair A. Townsend Deborah A. Zoullas Director Director March 31, 2003 March 31, 2003 91 CERTIFICATIONS I, Jonathan M. Spiller, certify that: 1. I have reviewed this annual report on Form 10-K of Armor Holdings, Inc.; 2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report; 3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report; 4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have: a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared; b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date; 5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions): a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and 6. The registrant's other certifying officers and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses. Date: March 31, 2003 /s/ Jonathan M. Spiller ---------------------- President and Chief Executive Officer 92 I, Robert R. Schiller, certify that: 1. I have reviewed this annual report on Form 10-K of Armor Holdings, Inc.; 2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report; 3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report; 4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have: a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared; b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date; 5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions): a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and 6. The registrant's other certifying officers and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses. Date: March 31, 2003 /s/ Robert S. Schiller ---------------------- Executive Vice President and Chief Financial Officer 93