ARMOR HOLDINGS INC
Form 10-Q
October 26, 2005
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2005, or
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM TO .

Commission File Number 0-18863

ARMOR HOLDINGS, INC.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	59-3392443 (IRS Employer Identification No.)
13386 International Parkway Jacksonville, Florida (Address of principal executive offices)	32218 (Zip Code)

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

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

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

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

The number of shares outstanding of the registrant's Common Stock as of October 17, 2005 is 34,908,517.

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

The accompanying unaudited condensed consolidated financial statements of Armor Holdings, Inc. and its wholly-owned subsidiaries include all adjustments which management considers necessary for a fair presentation of operating results and financial position as of September 30, 2005 and for the three month and nine month periods ended September 30, 2005 and September 30, 2004.

These unaudited condensed consolidated financial statements should be read in conjunction with the financial statements included in our Annual Report on Form 10-K and amendments thereto for the fiscal year ended December 31, 2004.

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

	September 30, 2005 (unaudited)	December 31, 2004 *
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 71,146	$ 421,209
Short-term investment securities	355,800	—
Accounts receivable (net of allowance for doubtful accounts of $8,342 and $3,077)	234,368	175,452
Inventories	198,648	176,208
Prepaid expenses and other current assets	46,975	46,935
Total current assets	906,937	819,804
PROPERTY AND EQUIPMENT (net of accumulated depreciation of $34,777 and $27,917)	79,799	77,307
GOODWILL (net of accumulated amortization of $4,024 and $4,024)	273,571	262,013
PATENTS, LICENSES AND TRADEMARKS (net of accumulated amortization of $13,041 and $6,830)	132,213	112,459
OTHER ASSETS	14,352	20,768
TOTAL ASSETS	$ 1,406,872	$ 1,292,351

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

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS — CONTINUED
(IN THOUSANDS, EXCEPT FOR SHARE DATA)

	September 30, 2005 (unaudited)	December 31, 2004 *
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current portion of long-term debt	$ 422	$ 621
Short-term debt	344,411	343,756
Accounts payable	86,080	69,601
Accrued expenses and other current liabilities	109,543	107,247
Income taxes payable	2,129	9,001
Total current liabilities	542,585	530,226
LONG-TERM LIABILITIES:		
Long-term debt, less current portion	153,313	156,751
Other long-term liabilities	2,012	1,951

Deferred income taxes	42,658	38,227
Total liabilities	740,568	727,155
COMMITMENTS AND CONTINGENCIES (NOTE 12)		
STOCKHOLDERS' EQUITY:		
Preferred stock, $.01 par value, 5,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock, $.01 par value; 75,000,000 and 75,000,000 shares authorized; 40,965,455 and 40,133,870 issued and 34,905,233 and 34,073,648 outstanding at September 30, 2005 and December 31, 2004, respectively	410	402
Additional paid-in capital	515,140	504,809
Retained earnings	220,408	125,481
Accumulated other comprehensive income	2,663	6,821
Treasury stock	(72,317)	(72,317)
Total stockholders' equity	666,304	565,196
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 1,406,872	$ 1,292,351

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

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

	Three Months Ended		Nine Months Ended	
	September 30, 2005	September 30, 2004	September 30, 2005	September 30, 2004
REVENUES:				
Aerospace & Defense	$ 339,113	$ 160,238	$ 856,271	$ 371,019
Products	75,911	64,659	221,274	184,242
Mobile Security	32,640	31,906	106,726	86,874
Total revenues	447,664	256,803	1,184,271	642,135
COSTS AND EXPENSES:				
Cost of revenues	348,238	185,457	897,733	456,771
Cost of vest exchange program / warranty revision	19,400	5,000	19,400	5,000
Selling, general and administrative expenses	34,723	22,695	104,073	69,332
Amortization	2,141	984	6,217	2,937

Integration		673		551		2,307		2,034
Other charges		—		381		—		7,702
OPERATING INCOME		42,489		41,735		154,541		98,359
Interest expense, net		1,379		1,400		5,138		5,185
Other (income) expense, net		(1,370)		154		(3,340)		(121)
INCOME FROM CONTINUING OPERATIONS BEFORE PROVISION FOR INCOME TAXES		42,480		40,181		152,743		93,295
PROVISION FOR INCOME TAXES		15,997		16,307		57,816		39,072
INCOME FROM CONTINUING OPERATIONS		26,483		23,874		94,927		54,223
LOSS FROM DISCONTINUED OPERATIONS, NET OF TAX		—		—		—		(38)
NET INCOME	$	26,483	$	23,874	$	94,927	$	54,185
NET INCOME PER COMMON SHARE — BASIC								
INCOME FROM CONTINUING OPERATIONS	$	0.76	$	0.73	$	2.76	$	1.79
LOSS FROM DISCONTINUED OPERATIONS		—		—		—		0.00
BASIC EARNINGS PER SHARE	$	0.76	$	0.73	$	2.76	$	1.79
NET INCOME PER COMMON SHARE — DILUTED								
INCOME FROM CONTINUING OPERATIONS	$	0.74	$	0.70	$	2.66	$	1.72
LOSS FROM DISCONTINUED OPERATIONS		—		—		—		0.00
DILUTED EARNINGS PER SHARE	$	0.74	$	0.70	$	2.66	$	1.72
WEIGHTED AVERAGE SHARES — BASIC		34,714		32,861		34,453		30,221
WEIGHTED AVERAGE SHARES — DILUTED		35,959		34,198		35,675		31,498

See notes to condensed consolidated financial statements.

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

	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004
CASH FLOW FROM OPERATING ACTIVITIES:		
Income from continuing operations	$ 94,927	$ 54,223
Adjustments to reconcile income from continuing operations to cash provided by operating activities:		
Depreciation and amortization	16,077	9,954
Loss on disposal of fixed assets	717	426
Deferred income taxes	(5,362)	2,785
Fair value gain for put options	(5,048)	—
Non-cash charge for acceleration of performance-based restricted stock awards	—	6,294
Non-cash impairment charge	—	1,408
Changes in operating assets and liabilities, net of acquisitions:		
Increase in accounts receivable	(55,790)	(52,331)
Increase in inventories	(16,575)	(58,848)
Decrease (increase) in prepaid expenses and other assets	12,569	(7,723)
Increase in accounts payable, accrued expenses and other current liabilities	21,685	39,318
(Decrease) increase in income taxes payable	(3,723)	28,235
Net cash provided by operating activities	59,477	23,741
CASH FLOW FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(11,055)	(11,061)
Purchase of patents and trademarks	(123)	(117)
Purchases of short-term investment securities	(658,100)	(150,275)
Proceeds from sales of short-term investment securities	302,300	27,575
Sale of put options	6,614	—
Purchase of equity investment	—	(5,275)
Proceeds from sale of equity investment	—	5,823
Collection of note receivable	—	975
Decrease in restricted cash	—	2,600
Sale of business, net of cash disposed	—	125
Additional cash received from sale of business	300	—
Additional consideration for purchased businesses	(4,981)	(2,323)
Purchase of businesses, net of cash acquired	(46,805)	(8,373)
Net cash used in investing activities	(411,850)	(140,326)
CASH FLOW FROM FINANCING ACTIVITIES:		
Proceeds from the exercise of stock options	10,384	11,448
Proceeds from the issuance of common stock	—	142,500
Cash paid for common stock offering costs	—	(1,339)
Taxes paid for withheld shares on restricted stock issuances	(5,796)	(1,724)
Repayments of long-term debt	(383)	(34,339)
Borrowings under lines of credit	13,006	18,507
Repayments under lines of credit	(12,869)	(18,054)
Net cash provided by financing activities	4,342	116,999
Effect of exchange rate changes on cash and cash equivalents	(2,032)	240
Net cash used in discontinued operations	—	(717)

Net decrease in cash and cash equivalents		(350,063)		(63)
Cash and cash equivalents, beginning of period		421,209		111,850
Cash and cash equivalents, end of period	$	71,146	$	111,787

See notes to condensed consolidated financial statements.

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

NOTE 1 — BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of Armor Holdings, Inc. and its wholly-owned subsidiaries (the ‘‘Company’’, ‘‘we’’, ‘‘our’’, ‘‘us’’) have been prepared in accordance with accounting princip generally accepted in the United States of America (‘‘U.S. GAAP’’) for interim information and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X, and do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments considered necessary to present a fair presentation have been included. The results of operations for the three month and nine month periods are not necessarily indicative of the results to be expected for the full year and should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K and amendments thereto for the year ended December 31, 2004. The amounts disclosed in the footnotes are related to continuing operations unless otherwise indicated. Certain prior year amounts have been reclassified to conform to the current year presentation.

NOTE 2 — DISCONTINUED OPERATIONS

On July 2, 2004, we sold the security consulting division of our litigation support services subsidiary, New Technologies Armor, Inc. (‘‘NTI’’), which was the last remaining business in discontinued operations. The remaining division in NTI, consisting primarily of training services, has been included as part of the Products Division segment, where management now resides. This business represented the last remaining business in our ArmorGroup Services Division (the ‘‘Services Division’’). We had no discontinued operations at September 30, 2005.

A summary of the operating results of the discontinued operations for the three and nine month periods ended September 30, 2005 and 2004, is as follows:

	Three Months Ended		Nine Months Ended	
	September 30, 2005	September 30, 2004	September 30, 2005	September 30, 2004
	(in thousands)		(in thousands)	
Revenues	$ —	$ —	$ —	$ 1,733
Cost of revenues	—	—	—	697
Selling, general and administrative expenses	—	—		821

Operating income		—		—		—		215
Interest expense, net		—		—		—		2
Other expense, net		—		—		—		273
Loss from discontinued operations before benefit for income taxes		—		—		—		(60)
Benefit for income taxes		—		—		—		(22)
Loss from discontinued operations	$	—	$	—	$	—	$	(38)

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

NOTE 3 — COMPREHENSIVE INCOME

The components of comprehensive income, net of tax benefit of $142,000 and tax provision of zero for the three months ended September 30, 2005 and 2004, respectively, and net of tax benefit of $554,000 and tax provision of zero for the nine months ended September 30, 2005 and 2004, respectively, are listed below:

	Three Months Ended				Nine Months Ended			
	September 30, 2005		September 30, 2004		September 30, 2005		September 30, 2004	
	(in thousands)				(in thousands)			
Net income	$	26,483	$	23,874	$	94,927	$	54,185
Other comprehensive (loss) income:								
Foreign currency translations, net of tax		(94)		507		(4,158)		(51)
Comprehensive income:	$	26,389	$	24,381	$	90,769	$	54,134

NOTE 4 — INVENTORIES

The components of inventory as of September 30, 2005 and December 31, 2004, are summarized as follows:

	September 30, 2005		December 31, 2004	
	(in thousands)			
Raw material	$	122,744	$	97,528
Work-in-process		40,673		51,137
Finished goods		35,231		27,543

Total inventories	$	198,648	$	176,208

NOTE 5 — ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

Accrued expenses and other current liabilities as of September 30, 2005 and December 31, 2004, are summarized as follows:

	September 30, 2005		December 31, 2004	
	(in thousands)			
Accrued expenses and other current liabilities	$	71,631	$	69,494
Vest exchange program / warranty revision accrual		20,515		1,375
Customer deposits		15,272		32,317
Deferred consideration for acquisitions		2,125		4,061
Total accrued expenses and other current liabilities	$	109,543	$	107,247

NOTE 6 — DERIVATIVE FINANCIAL INSTRUMENTS

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

On October 29, 2004, we completed the placement of $300 million aggregate principal amount of the 2% Senior Subordinated Convertible Notes due November 1, 2024 (the ‘‘2% Convertible Notes’’). On November 5, 2004, Goldman, Sachs & Co. exercised its option to purchase an additional $45 million principal amount of the 2% Convertible Notes. The 2% Convertible Notes will bear interest at a rate of 2.00% per year, payable on November 1 and May 1 of each year beginning on May 1, 2005 and ending on November 1, 2011. The 2% Convertible Notes will be subject to accretion of the principal amount beginning on November 1, 2011, at a rate that provides holders with an aggregate annual yield to maturity of 2.00%, as defined in the agreement. The 2% Convertible Notes will bear contingent interest during any six-month period beginning November 1, 2011, of 15 basis points paid in cash if the average trading price of the notes is above certain levels. As defined in SFAS 133, ‘‘Accounting for Derivative Instruments and Hedge Activities’’ the contingent interest feature of the 2% Convertible Notes is an embedded derivative that is not considered clearly and closely related to the host contract. The fair value of this bifurcated derivative at September 30, 2005, and December 31, 2004, is immaterial to our financial position based on documentation we received from our investment bank.

We hedge the fair value of our 8.25% $150 million Senior Subordinated Notes due 2013 (the ‘‘8.25% Notes’’) using interest rate swaps. We enter into these derivative contracts to manage fair value changes which could be caused by our exposure to interest rate changes. On September 2, 2003, we entered into interest rate swap agreements, designated as fair value hedges as defined under SFAS 133 with an aggregate notional amount totaling $150 million. The agreements were entered into to exchange the fixed interest rate on the 8.25% Notes for a variable interest rate equal to six-month LIBOR (4.2% at September 30, 2005), set in arrears, plus a spread ranging from 2.735% to 2.75% fixed semi-annually on the fifteenth of February and August each year through maturity. The agreements are subject to other terms and conditions common to transactions of this type. These fair value hedges qualify for hedge accounting using the short-cut method since the swap terms match the critical terms of the 8.25% Notes. Accordingly, changes in the fair value of the interest rate swap agreements offset changes in the fair value of the 8.25% Notes due to changes in the market interest rate. As a result, no ineffectiveness is expected to be recognized in our earnings associated with the interest rate swap agreements on the 8.25% Notes. The fair value of the interest rate swap agreements was approximately $2.7 million and $6.0 million at September 30, 2005 and December 31, 2004, respectively, and is included in other assets and long-term debt on the accompanying condensed consolidated balance sheets.

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

NOTE 7 — GOODWILL AND IDENTIFIED INTANGIBLE ASSETS

Under Statement of Financial Accounting Standards No. 142, ‘‘Goodwill and Other Intangible Assets’’ (‘‘SFAS 142’’), goodwill and intangible assets with indefinite lives are no longer amortized, but are tested for impairment at least annually or more often if indicators of impairment arise. The changes in the carrying amount of goodwill for the nine months ended September 30, 2005 are as follows:

	Aerospace & Defense	Products	Mobile Security	Corporate	Total
			(In thousands)		
Balance at December 31, 2004	$ 154,313	$ 101,292	$ 6,408	$ —	$ 262,013
Goodwill acquired during period	—	5,439	—	1,729	7,168
Finalization of purchase price allocation	—	3,162	—	—	3,162
Foreign currency translation and other adjustments	780	358	90	—	1,228
Balance at September 30, 2005	$ 155,093	$ 110,251	$ 6,498	$ 1,729	$ 273,571

Included in patents, licenses and trademarks in the accompanying consolidated balance sheets are the following intangible assets as of September 30, 2005:

	Customer Relationships	Technology	Marketing	Total
		(In thousands)		
Gross amount	$ 60,665	$ 19,496	$ 65,093	$ 145,254
Accumulated amortization	(7,269)	(2,977)	(2,795)	(13,041)
Net amount	$ 53,396	$ 16,519	$ 62,298	$ 132,213

Included in Marketing are approximately $60.2 million of marketing-related intangible assets that have indefinite lives.

The purchase price allocations for the acquisitions of Bianchi International and Specialty Defense, acquired in the fourth quarter of 2004, were completed during 2005. The purchase price allocation of Second Chance Body Armor, Inc. (‘‘Second Chance’’), acquired in July 2005, is not final and we are awaiting the final valuation report related to intangible assets. We do not anticipate any material changes as a result of the completion of the valuation in the fourth quarter of 2005.

NOTE 8 — INFORMATION CONCERNING BUSINESS SEGMENTS AND GEOGRAPHICAL REVENUES

We are a leading manufacturer and provider of specialized security products; training and support services related to these products; vehicle armor systems; military helicopter seating systems, aircraft and land vehicle safety systems; protective equipment for military personnel; and other technologies used to protect humans in a variety of life-threatening or catastrophic situations. Our products and systems are used domestically and internationally by military, law enforcement, security and corrections personnel, as well as governmental agencies, multinational corporations and individuals. Effective in the first quarter 2004, we instituted a new segment reporting format to include three reportable business segments: Aerospace & Defense Group, the Products Division and the Mobile Security Division. Our Services Division has been classified as discontinued operations and is no longer included in this presentation (See Note 2).

Aerospace & Defense Group. The Aerospace & Defense Group supplies human safety and survival systems to the U.S. military and major aerospace and defense prime contractors. Our core markets are land, marine and aviation safety and military personnel protection. The most significant business within the Aerospace & Defense Group is armoring a variety of light, medium and heavy wheeled vehicles for the military. We are the sole-source provider to the U.S. military of the armor and blast protection systems (up-armoring) for their M1114 High Mobility Multi-purpose Wheeled Vehicles (Up-Armored HMMWV, commonly known as the Humvee). We also provide spare parts and logistical and field support services for Up-Armored HMMWVs previously shipped by us. We also provide blast and ballistic protection kits for the standard HMMWV which are installed in the field. Additionally, we develop ballistic and blast

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

protected armored and sealed truck cabs for other military tactical wheeled vehicles. For example, we design, develop and manufacture armor systems for military vehicles, including such platforms as the Heavy Expanded Mobility Tactical Truck (‘‘HEMTT’’), Palletized Load System (‘‘PLS’’), Heavy Equipment Transporter (‘‘HET’’), M915 and Armored Security Vehicle (‘‘ASV’’).

The Aerospace & Defense Group develops and supplies personnel equipment, including small arms protection inserts (‘‘SAPI’’) and other engineered ceramic body armor, helmets, and other protective and duty equipment. Our products include, among others, Modular Lightweight Load-Carrying Equipment (‘‘MOLLE’’) systems, Outer Tactical Vests (‘‘OTVs’’), Warrior Helmets and Advanced Combat Helmets. We are currently the largest supplier of MOLLE systems for the U.S. Army which is a modular rucksack that can be configured in a number of ways depending on the needs of the military mission. We also manufacture OTVs which, when used with SAPI plates, provide enhanced protection against bullets, mines, grenades and mortar and artillery shells. SAPI plates have been adopted by the U.S. military as a key element of the protective equipment worn by U.S. troops.

The Aerospace & Defense Group develops and sells military helicopter seating systems, helicopter cockpit airbag systems, aircraft armor kits, emergency bailout parachutes and survival equipment worn by military aircrew. The primary customers for these products are the U.S. Army, U.S. Marine Corps, Boeing and Sikorsky Aircraft.

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

Armor Mobile Security. Our Armor Mobile Security Division manufactures and installs armoring systems for commercial vehicles to protect against varying degrees of ballistic and blast threats. We armor a variety of commercial vehicles, including limousines, sedans, sport utility vehicles, commercial trucks and cash-in-transit vehicles. Our customers in this business include U.S. federal law enforcement and intelligence agencies, foreign heads of state, multinational corporations, as well as high net worth individuals and cash-in-transit operators.

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 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.

Corporate. Our Corporate Division includes the corporate management and expenses associated with managing the overall company. These expenses include compensation and benefits of corporate management and staff, legal and professional fees, and administrative and general expenses, which are not allocated to the business units.

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

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

	Three Months Ended		Nine Months Ended	
	September 30, 2005	September 30, 2004	September 30, 2005	September 30, 2004
	(in thousands)		(in thousands)	
Revenues:				
Aerospace & Defense	$ 339,113	$ 160,238	$ 856,271	$ 371,019
Products	75,911	64,659	221,274	184,242
Mobile Security	32,640	31,906	106,726	86,874
Total revenues	$ 447,664	$ 256,803	$ 1,184,271	$ 642,135
Operating income (loss):				
Aerospace & Defense	$ 56,702	$ 35,146	$ 152,630	$ 86,177
Products (Note A)	(8,678)	6,849	13,658	23,793
Mobile Security	2,556	3,699	13,474	8,619
Corporate	(8,091)	(3,959)	(25,221)	(20,230)
Total operating income	$ 42,489	$ 41,735	$ 154,541	$ 98,359

Note A: The Products Division operating income for the three and nine month periods ending September 30, 2005 includes a pre-tax charge of $19.4 million for the cost of the Supplemental Relief Program ("SRP") (see Note 16). The Products Division operating income for the three and nine month periods ending September 30, 2004 includes a pre-tax charge of $5.0 million for the cost of the warranty revision program.

	September 30, 2005	**December 31, 2004**
	(in thousands)	
Total assets:		
Aerospace & Defense	$ 535,076	$ 490,754
Products	344,670	278,912
Mobile Security	97,849	103,799
Corporate	429,277	418,886
Total assets	$ 1,406,872	$ 1,292,351

Financial information with respect to revenues based on the geographic location of the customer, and property and equipment, net to principal geographic areas, based on the actual location of the principle facility, is as follows:

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

	Three Months Ended		Nine Months Ended	
	September 30, 2005	September 30, 2004	September 30, 2005	September 30, 2004
	(in thousands)		(in thousands)	
Revenues:				
United States of America	$ 402,584	$ 210,523	$ 1,046,309	$ 523,734
North America (excluding the United States of America)	3,293	6,620	7,826	13,414
South America	5,704	4,390	16,031	12,051
Africa	3,579	351	13,579	2,032
Europe/Asia	32,504	34,919	100,526	90,904
Total revenues	$ 447,664	$ 256,803	$ 1,184,271	$ 642,135

	September 30, 2005	**December 31, 2004**
	(in thousands)	
Total property and equipment, net:		
North America	$ 60,210	$ 54,332
South America	1,461	1,461
Europe/Asia	18,128	21,514
Total property and equipment, net	$ 79,799	$ 77,307

NOTE 9 — EARNINGS PER SHARE

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

	Three Months Ended		Nine Months Ended	
	September 30, 2005	September 30, 2004	September 30, 2005	September 30, 2004
	(in thousands, except per share data)			
Numerator for basic and diluted earnings per share:				
Income from continuing operations	$ 26,483	$ 23,874	$ 94,927	$ 54,223
Denominator for basic earnings per share – weighted average shares outstanding	34,714	32,861	34,453	30,221
	1,245	1,337	1,222	1,277

Effect of shares issuable under stock option and stock grant plans, based on the treasury stock method								
Denominator for diluted earnings per share – adjusted weighted average shares outstanding		35,959		34,198		35,675		31,498
Basic earnings per share from continuing operations	$	0.76	$	0.73	$	2.76	$	1.79
Diluted earnings per share from continuing operations	$	0.74	$	0.70	$	2.66	$	1.72

Our 2.00% Convertible Notes include net share settlement of the conversion option and cash settlement of the par amount of $345.0 million. As a result, this requires us to use the treasury stock method to calculate the dilutive effect of our 2.00% Convertible Notes, which had no effect on our diluted share count during the three and nine months ended September 30, 2005.

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

NOTE 10 — STOCKHOLDERS' EQUITY

Statement of Financial Accounting Standard No. 123, ''Accounting for Stock-Based Compensation'' (''SFAS 123''), as amended by Statement of Financial Accounting Standard No. 148, ''Accounting for Stock-Based Compensation — Transition and Disclosure'' (''SFAS 148''), establishes a fair value based method of accounting for stock-based employee compensation plans; however, it also allows an entity to continue to measure compensation cost for those plans using the intrinsic value based method of accounting prescribed by Accounting Principles Board Opinion No. 25, ''Accounting for Stock Issued to Employees'' (''APB 25''). Under the fair value based method, compensation cost is measured at the grant date based on the value of the award and is recognized over the service period, which is usually the vesting period. Under the intrinsic value based method, compensation cost is the excess, if any, of the quoted market price of the stock at the grant date or other measurement date over the amount an employee must pay to acquire the stock. We have elected to continue to account for our employee stock compensation plans under APB 25 with pro forma disclosures of net earnings and earnings per share, as if the fair value based method of accounting defined in SFAS 123 had been applied. If compensation cost for stock option grants had been determined based on the fair value on the grant dates for the three month and nine month periods ended September 30, 2005 and 2004, consistent with the method prescribed by SFAS 123, our net earnings and earnings per share would have been adjusted to the pro forma amounts indicated below:

	Three Months Ended				Nine Months Ended			
	September 30, 2005		September 30, 2004		September 30, 2005		September 30, 2004	
	(in thousands, except per share data)							
Net income as reported	$	26,483	$	23,874	$	94,927	$	54,185
		(227)		(1,368)		(36,489)		(3,902)

Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects								
Add: Employee compensation expense for modification of stock option awards included in reported net income, net of income taxes		—		—		118		57
Pro-forma net income	$	26,256	$	22,506	$	58,556	$	50,340
Earnings per share:								
Basic — as reported	$	0.76	$	0.73	$	2.76	$	1.79
Basic — pro-forma	$	0.76	$	0.69	$	1.70	$	1.67
Diluted — as reported	$	0.74	$	0.70	$	2.66	$	1.72
Diluted — pro-forma	$	0.73	$	0.66	$	1.64	$	1.60

$15.3 million of the stock-based employee compensation expense for the nine months ended September 30, 2005 is related to accelerated vesting of certain existing stock options and $21.2 million is related to certain stock options issued in the nine months ended September 30, 2005.

On June 22, 2005, our stockholders approved the 2005 Stock Incentive Plan (the ‘‘2005 Plan’’). An aggregate of 2,500,000 shares of common stock is reserved for issuance and available for awards under the 2005 Plan. In addition to the limits described further in the 2005 Plan, the 2005 Plan provides that awards other than stock options and stock appreciation rights will be counted against the availability under the 2005 Plan in a 1.8 to 1 ratio. For example, if we issue 100 shares of restricted common stock under the 2005 Plan, we would reduce the availability under the 2005 Plan by 180 shares. Shares of common stock not

actually issued (as a result, for example, of the lapse of an option) are available for additional grants. Shares to be issued or purchased under the 2005 Plan may be either authorized but unissued common stock or treasury shares. Shares issued with respect to awards assumed by us in connection with acquisitions do not count against the total number of shares available under the 2005 Plan.

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

In March 2002, our Board of Directors approved a stock repurchase program authorizing the repurchase of up to a maximum 3.2 million shares of our common stock. In February 2003, the Board of Directors increased this stock repurchase program to authorize the repurchase, from time to time depending upon market conditions and other factors, of up to an additional 4.4 million shares. On March 25, 2005, our Board of Directors increased our existing stock repurchase program to enable us to repurchase, from time to time depending upon market conditions and other factors, up to an additional 3.5 million shares of our outstanding common stock. Through September 30, 2005, we repurchased 3.8 million shares of our common stock under the stock repurchase program at an average price of $12.49 per share, leaving us with the ability to repurchase up to an additional 7.3 million shares of our common stock. We did not repurchase any shares in 2004 or in the nine months ended September 30, 2005. Repurchases may be made in the open market, in privately negotiated transactions utilizing various hedging mechanisms including, among others, the sale to third parties of put options our common stock, or otherwise. At September 30, 2005, we had 34.9 million shares of common stock outstanding.

NOTE 11 — RECENT ACCOUNTING PRONOUNCEMENTS

On December 16, 2004, the Financial Accounting Standards Board (''FASB'') issued FASB Statement No. 123, ''Share Based Payment (revised 2004)'' (''FAS 123R''). FAS 123R revises SFAS 123 and requires companies to expense the fair value of employee stock options and other forms of stock-based compensation. In addition to revising SFAS 123, FAS 123R supersedes APB 25, and amends FASB Statement No. 95, ''Statement of Cash Flows.'' On April 14, 2005, the Securities and Exchange Commission announced the amendment of the adoption compliance date of FAS 123R from the first interim period to the first annual period beginning after June 15, 2005. We will be required to apply the expense recognition provisions of FAS 123R beginning in the first quarter of 2006.

On March 31, 2005, we announced that we accelerated the vesting of certain unvested stock options previously awarded to employees, officers and directors of the Company under various stock option plans effective March 25, 2005, subject to such employees, officers and directors entering into lock-up, confidentiality and non-competition agreements. As a result of this action, options to purchase approximately 1.6 million shares of our common stock that would otherwise have vested over the next one to five years became fully vested. Outstanding unvested options that were not accelerated will continue to vest on their normal schedule.

The decision to accelerate the vesting of these options, which we believe to be in the best interest of our stockholders, was made primarily to reduce non-cash compensation expense that would have been recorded in future periods following our application of FAS 123R. Because we accelerated these options, we expect to reduce our non-cash compensation expense related to these options by approximately $12.3 million (pre-tax) between the first quarter of 2006 and 2009, based on estimated value calculations using the Black-Scholes methodology.

In October 2004, the American Jobs Creation Act of 2004 (''AJCA'') was signed into law. In December 2004, the FASB issued Staff Position No. 109-1 (''FSP 109-1''), Application of FASB Statement No. 109, ''Accounting for Income Taxes'' (''SFAS 109''), to the Tax Deduction on Qualified Production Activities Provided by the AJCA and Staff Position No. 109-2 (''FSP 109-2''), Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the AJCA. FSP 109-1 clarifies that the

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manufacturer's tax deduction provided for under the AJCA should be accounted for as a special deduction in accordance with SFAS 109 and not as a tax rate reduction. FSP 109-2 provides accounting and disclosure guidance for the repatriation of certain foreign earnings to a U.S. taxpayer as provided for in the AJCA. Currently, uncertainty remains as to how to interpret numerous provisions of the AJCA. As such, we are not yet in a position to decide on whether, and to what extent, we might repatriate foreign earnings that have not yet been remitted to the U.S. We expect to be in a position to make a decision on implementation, if any, in the fourth quarter of 2005.

NOTE 12 — LEGAL PROCEEDINGS

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, general liability and intellectual property. 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 coverage. At this time, we do not believe any such claims or pending litigation will have a material impact on our financial position, operations or liquidity.

Zylon®

In April, 2004, two class action lawsuits were filed against us in Florida state court by police organizations and individual police officers, alleging that ballistic-resistant soft body armor (vests) containing Zylon®, manufactured and sold by American Body Armor™, Safariland® and PROTECH®, failed to meet the warranties provided with the vests. On August 12, 2004, the Jacksonville, Florida (Duval County) Circuit Court gave preliminary approval to a settlement reached with the Southern States Police Benevolent Association (‘‘SSPBA’’). After a fairness hearing on November 5, 2004, the Court gave final approval to that agreement which provided, in essence, that (i) purchasers of certain Zylon®-containing vest models could exchange their vests for other vests manufactured by us (the ‘‘Exchange Program’’), (ii) we would continue our internal used-vest testing program (VestCheck®), and (iii) if testing revealed that other Zylon®-containing vests would not meet the warranties provided with the vests, class members who had purchased those other vests would be provided with relief on a reasonably comparable basis as those in the Exchange Program. The other class action suit filed by the National Association of Police Organizations, Inc. (NAPO), in Ft. Myers, Florida (Lee County), was voluntarily dismissed with prejudice on November 16, 2004.

On August 24, 2005, the United States Department of Justice through the National Institute of Justice (‘‘NIJ’’), released its ‘‘Third Status Report to the Attorney General on Body Armor Safety Initiative Testing and Activities’’ (the ‘‘Third NIJ Report’’). The Third NIJ Report contained, among other items, information and testing data on Zylon® and Zylon®-containing vests, and substantially modified compliance standards for all ballistic-resistant vests with the implementation of the NIJ 2005 Interim Requirements for Ballistic-Resistant Body Armor. As a result of the actions of the NIJ, we halted all sales or shipment of any Zylon®-containing vest models effective August 25, 2005, and immediately established a Supplemental Relief Program (the ‘‘SRP’’) that provides either a cash or voucher option to those who purchased Zylon®-containing vests through August 12, 2004. The Jacksonville, Florida Court gave preliminary approval to the SRP on August 31, 2005, and has scheduled a fairness hearing for October 27, 2005, to hear objections and to make a final determination whether to approve the SRP as fair, adequate and reasonable.

Following the NIJ’s announcement, the SSPBA filed another class action suit on behalf of purchasers of Zylon®-containing vests from August 13, 2004 (the date of certification of the prior class) through

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August 29, 2005 (a date after which we had ceased all sales of Zylon®-containing vests). The Jacksonville, Florida Circuit Court has given preliminary approval to a settlement reached with the plaintiffs in this second suit that provides purchasers with either a 100% cash refund or a voucher for 100% of the purchase price redeemable for any of our merchandise. A fairness hearing on the second settlement is also scheduled for October 27, 2005 in Jacksonville, Florida.

We are also voluntarily cooperating with a request for documents and data received from the Department of Justice, which is reviewing the entire body armor industry's use of Zylon®, and a subpoena recently served by the General Services Administration for information relating to Zylon®.

NOTE 13 — GUARANTOR AND NONGUARANTOR FINANCIAL STATEMENTS

On August 12, 2003, we sold $150 million of the 8.25% Notes in private placements pursuant to Rule 144A and Regulation S. The 8.25% Notes are uncollateralized obligations and rank junior in right of payment to our existing and future senior debt. On October 29, 2004, we completed the placement of $300 million aggregate principal amount of the 2% Convertible Notes. On November 5, 2004, Goldman, Sachs & Co. exercised its option to purchase an additional $45 million principal amount of the 2% Convertible Notes. The 8.25% Notes and 2% Convertible Notes are fully and unconditionally guaranteed, jointly and severally on a senior subordinated and uncollateralized basis, by most of our domestic subsidiaries. Each of the subsidiary guarantors is a direct or indirect 100% owned subsidiary of the parent.

The following consolidating financial information presents the consolidating balance sheets as of September 30, 2005 and December 31, 2004, the related condensed consolidating statements of operations for each of the three and nine month periods ended September 30, 2005 and September 30, 2004, and the related condensed consolidating statements of cash flows for the nine month periods ended September 30, 2005 and September 30, 2004 for:

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

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

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

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

Armor Holdings, Inc. and Subsidiaries
Condensed Consolidating Balance Sheet

	September 30, 2005				
	Parent	Guarantor Subsidiaries	Nonguarantor Subsidiaries	Eliminations	Consolidated Total
Assets			(in thousands)		
Current assets:					
Cash and cash equivalents	$ 49,652	$ 8,041	$ 13,453	$ —	$ 71,146
Short-term investment securities	355,800	—	—	—	355,800
Accounts receivable, net	—	212,990	21,378	—	234,368
Intercompany receivables	111,554	106,591	38,399	(256,544)	—
Inventories	—	169,998	28,650	—	198,648
Prepaid expenses and other current assets	2,720	39,815	4,440	—	46,975
Total current assets	519,726	537,435	106,320	(256,544)	906,937
Property and equipment, net	2,180	56,826	20,793	—	79,799
Goodwill, net	—	271,538	2,033	—	273,571
Patents, licenses and trademarks, net	—	132,046	167	—	132,213
Other assets	12,131	2,090	131	—	14,352
Investment in subsidiaries	752,663	117,700	—	(870,363)	—
Total assets	$ 1,286,700	$ 1,117,635	$ 129,444	$ (1,126,907)	$ 1,406,872
Liabilities and stockholders' equity					
Current liabilities:					
Current portion of long-term debt	$ —	$ 274	$ 148	$ —	$ 422
Short-term debt	341,708	—	2,703	—	344,411
Accounts payable	338	79,742	6,000	—	86,080
Accrued expenses and other current liabilities	20,307	66,920	22,316	—	109,543
Income taxes payable	(11,150)	12,194	1,085	—	2,129
Intercompany payables	113,594	62,743	80,207	(256,544)	—
Total current liabilities	464,797	221,873	112,459	(256,544)	542,585
Long-term debt, less current portion	150,714	2,290	309	—	153,313
Other long-term liabilities	—	2,012	—	—	2,012
Deferred income taxes	4,885	36,806	967	—	42,658
Total liabilities	620,396	262,981	113,735	(256,544)	740,568
Stockholders' equity:					
Preferred stock	—	1,450	—	(1,450)	—
Common stock	410	3,193	7,852	(11,045)	410
Additional paid in capital	515,140	532,904	14,778	(547,682)	515,140

Retained earnings (accumulated deficit)	220,408	317,107	(6,921)	(310,186)	220,408
Accumulated other comprehensive income	2,663	—	—	—	2,663
Treasury stock	(72,317)	—	—	—	(72,317)
Total stockholders' equity	666,304	854,654	15,709	(870,363)	666,304
Total liabilities and stockholders' equity	$1,286,700	$1,117,635	$ 129,444	$ (1,126,907)	$1,406,872

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

Armor Holdings, Inc. and Subsidiaries
Condensed Consolidating Balance Sheet

	December 31, 2004				
	Parent	Guarantor Subsidiaries	Nonguarantor Subsidiaries	Eliminations	Consolidated Total
Assets			(in thousands)		
Current assets:					
Cash and cash equivalents	$ 388,727	$ 21,173	$ 11,309	$ —	$ 421,209
Short-term investment securities	—	—	—	—	—
Accounts receivable, net	—	156,122	19,330	—	175,452
Intercompany receivables	173,735	108,313	7,045	(289,093)	—
Inventories	—	142,362	33,846	—	176,208
Prepaid expenses and other current assets	1,611	42,023	3,301	—	46,935
Total current assets	564,073	469,993	74,831	(289,093)	819,804
Property and equipment, net	5,144	47,968	24,195	—	77,307
Goodwill, net	—	259,773	2,240	—	262,013
Patents, licenses and trademarks, net	—	112,288	171	—	112,459
Other assets	18,410	2,209	149	—	20,768
Investment in subsidiaries	592,437	12,730	—	(605,167)	—
Total assets	$1,180,064	$ 904,961	$ 101,586	$ (894,260)	$1,292,351
Liabilities and stockholders' equity					
Current liabilities:					
Current portion of long-term debt	$ —	$ 457	$ 164	$ —	$ 621
Short-term debt	341,579	—	2,177	—	343,756

Accounts payable	640	58,422	10,539	—	69,601
Accrued expenses and other current liabilities	11,216	73,314	22,717	—	107,247
Income taxes payable	(6,454)	11,513	3,942	—	9,001
Intercompany payables	112,741	123,466	52,886	(289,093)	—
Total current liabilities	459,722	267,172	92,425	(289,093)	530,226
Long-term debt, less current portion	153,897	2,377	477	—	156,751
Other long-term liabilities	—	1,951	—	—	1,951
Deferred income taxes	1,249	36,077	901	—	38,227
Total liabilities	614,868	307,577	93,803	(289,093)	727,155
Stockholders' equity:					
Preferred stock	—	1,450	—	(1,450)	—
Common stock	402	3,792	7,854	(11,646)	402
Additional paid in capital	504,809	387,229	14,771	(402,000)	504,809
Retained earnings (accumulated deficit)	125,481	204,913	(14,842)	(190,071)	125,481
Accumulated other comprehensive income	6,821	—	—	—	6,821
Treasury stock	(72,317)	—	—	—	(72,317)
Total stockholders' equity	565,196	597,384	7,783	(605,167)	565,196
Total liabilities and stockholders' equity	$ 1,180,064	$ 904,961	$ 101,586	$ (894,260)	$ 1,292,351

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

Armor Holdings Inc. and Subsidiaries
Condensed Consolidating Statement of Operations

	Three Months ended September 30, 2005				
	Parent	Guarantor Subsidiaries	Nonguarantor Subsidiaries	Eliminations	Consolidated Total
			(in thousands)		
Revenues:					
Aerospace & Defense	$ —	$ 340,548	$ —	$ (1,435)	$ 339,113
Products	—	62,643	13,268	—	75,911
Mobile Security	—	7,633	27,509	(2,502)	32,640
Total revenues	—	410,824	40,777	(3,937)	447,664
Costs and expenses:					
Cost of revenues	—	319,550	32,625	(3,937)	348,238
	—	19,400	—	—	19,400

Cost of vest exchange program / warranty revision					
Selling, general and administrative expenses	8,082	22,590	4,051	—	34,723
Amortization	—	2,139	2	—	2,141
Integration	32	641	—	—	673
Operating (loss) income:	(8,114)	46,504	4,099	—	42,489
Interest expense (income), net	1,331	(142)	190	—	1,379
Other (income) expense, net	(1,255)	35	(150)	—	(1,370)
Equity in earnings of subsidiaries	(32,100)	(1,443)	—	33,543	—
Income before (benefit) provision for income taxes	23,910	48,054	4,059	(33,543)	42,480
(Benefit) provision for income taxes	(2,573)				