

FORCE PROTECTION INC  
Form 10-K  
March 26, 2009

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, DC 20549

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**FORM 10-K**

(Mark One)

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

For the fiscal year ended December 31, 2008

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 001-33253

**FORCE PROTECTION, INC.**

(Exact name of Registrant as Specified in Its Charter)

**Nevada**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**84-1383888**  
(I.R.S. Employer  
Identification No.)

**9801 Highway 78, Building No. 1**  
**Ladson, South Carolina**  
(Address of registrant's principal executive offices)

**29456**  
(Zip Code)

Registrant's telephone number, including area code: **(843) 574-7000**

Securities registered pursuant to Section 12(b) of the Act:

| Title of Each Class                                              | Name of Each Exchange on Which Registered |
|------------------------------------------------------------------|-------------------------------------------|
| Common Stock, \$0.001 par value                                  | The NASDAQ Stock Market LLC               |
| Securities registered pursuant to Section 12(g) of the Act: None |                                           |

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐      Accelerated filer ☒      Non-accelerated filer ☐      Smaller reporting company ☐  
(Do not check if a smaller reporting company)

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

The aggregate market value of the common equity held by non-affiliates of the registrant on June 30, 2008, computed by reference to the closing price for such stock on the Nasdaq Capital Market on such date, was approximately \$146,570,000.

The number of shares outstanding of the registrant's common stock as of March 20, 2009 was 69,289,762 shares.

### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement relating to its 2009 Annual Meeting of Shareholders are incorporated by reference into Part III of this Annual Report on Form 10-K where indicated.

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**PART I**

**ITEM 1. BUSINESS**

Force Protection, Inc. ("Force Protection", the "Company", "we", "our", or "us") is in the business of providing survivability solutions to support armed forces and security personnel in harm's way. We design, manufacture, test, deliver and support our blast- and ballistic-protected products to increase survivability of the users of our products. Our specialty vehicles, which we believe are at the forefront of blast- and ballistic-protected technology, are designed to protect their occupants from landmines, hostile fire, and improvised explosive devices ("IEDs"). In addition, we develop, manufacture, test, deliver and support products aimed at further enhancing the survivability of vehicles against additional threats. Our patented ForceArmor<sup>®</sup> is designed to provide protection against explosively formed projectiles ("EFPs"). We are a key provider of the U.S. military's Mine Resistant Ambush Protected ("MRAP") vehicle program and have sold over 3,000 vehicles under this program. We also provide our Cougar Mastiff, Cougar Ridgback, Cougar Wolfhound, and Buffalo mine-protected vehicles to the United Kingdom Ministry of Defence. In total, across all vehicle programs we have sold approximately 4,000 vehicles.

For the year ended December 31, 2008, we reported net sales of approximately \$1.3 billion, up 49% from our net sales of approximately \$891 million reported for the year ended December 31, 2007. During the period January 1, 2008 through December 31, 2008, we received orders for 474 vehicles. During this same period we delivered 2,067 vehicles under the MRAP and other blast- and ballistic-protected vehicle programs, including vehicles manufactured pursuant to the terms of our arrangement with General Dynamics Land Systems Inc. ("GDLS") (described further in this Item 1, *Major Contracts* below, under "MRAP Competitive Contract.") During the period January 1, 2007 through December 31, 2007, we delivered 1,558 vehicles under blast- and ballistic-protected vehicle programs. During the period January 1, 2008 through December 31, 2008, we delivered approximately \$198 million in spare parts and approximately \$56 million in training and field service support. In December 2008, we initiated our first deliveries of our ForceArmor<sup>®</sup> kits.

**Our Products**

All of our products are aimed at offering improved protection to personnel operating in areas posing threats of blast- or ballistic- attack. Since the early stages of Operation Iraqi Freedom and Operation Enduring Freedom, the U.S. military has sought a wheeled vehicle approach that balances three potentially competing operational or mission dynamics: (i) protection, which refers to the level of crew survivability against blast- and ballistic-attack; (ii) payload, which refers to the load that the vehicles can carry on board the platform, measured in units, such as crew members and cargo; and (iii) performance, which refers to a vehicle's automotive mobility, its ability to provide technological solutions to mission requirements, and its suitability for transportation in existing military aircraft and ships.

We also currently offer ForceArmor<sup>®</sup> as an external bolt-on solution, which provides state-of-the-art protection against attack by EFPs. ForceArmor<sup>®</sup> is designed from commercially available materials that, when combined and packaged into a kit, offer lightweight solutions that can be tailored to bolt on to the outside of any military vehicle platform. It is a modular solution that enables unit commanders to rapidly install or remove the kit depending on the threat they face.

We currently offer the following vehicle types aimed at fulfilling different operational or mission requirements:

the Buffalo platform;

the Cougar platform; and

the Cheetah platform.

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*The Buffalo.* The Buffalo Mine Protected Clearance Vehicle ("MPCV"), with a gross vehicle weight of approximately 40 tons, is our largest vehicle and is designed primarily for use in conducting route clearance operations. During these operations, friendly forces patrol areas and routes of likely enemy IEDs and landmine activity searching for concealed explosive devices. The Buffalo has six wheels and is equipped with a hydraulic arm used to interrogate suspect devices while allowing the crew to disable or destroy the device from within the vehicle. The vehicle's capsule is blast-resistant, and the bottom of its passenger compartment is V-shaped (which we refer to as a "V-shaped hull") and is designed to deflect and dissipate the explosive blast from a landmine or IED away from the passenger compartment, thus helping protect the occupants from harm. With the Buffalo, we have been designated by the U.S. Marine Corps and U.S. Army as the sole-source supplier of vehicles for explosive ordnance disposal ("EOD"), including EOD vehicles that satisfy the Category III (as described in *Industry Overview and Force Protection Market Opportunity* in this Annual Report on Form 10-K) requirements of the MRAP program and the Ground Standoff Mine Detection System ("GSTAMIDS") program. In addition to producing Buffalos for the U.S. military, we have delivered Buffalos to the following foreign customers through the Foreign Military Sales ("FMS") program of the United States Department of Defense ("DoD"): United Kingdom, France, and Italy. On February 21, 2008, we were awarded a contract through the DoD's FMS program to produce four Buffalos for the Italian military. On November 13, 2008, the Canadian military awarded us a contract for 14 vehicles, October 31, 2008, the United Kingdom Military of Defence awarded us a contract for 14 vehicles and on July 11, 2008, the French military awarded us a contract for five vehicles. In total, in 2008 we delivered 81 Buffalos to the U.S. Marine Corps, U.S. Army, French, Italian and United Kingdom customers for mine clearance in Iraq and Afghanistan.

*The Cougar.* The Cougar is a family of medium-sized blast- and ballistic-protected vehicles that can be supplied in 4-wheeled and 6-wheeled variants and in a variety of configurations for the wide range of missions performed by our customers. With a gross vehicle weight that ranges from 11 tons to 26 tons, depending on the variant, the operational applications of the Cougar include troop transport, command and control, route reconnaissance, convoy escort, and casualty evacuation capabilities. Similar to the Buffalo, the Cougar employs a V-shaped hull designed to deflect blast energy, along with a blast- and ballistic-protected steel passenger compartment. The Cougar family of vehicles offers our customers the ability to enhance the protection and payload offered to wheeled vehicle platforms, while still offering acceptable levels of performance. In comparison, armored combat platforms, such as main battle tanks and infantry fighting vehicles, offer substantial levels of protection but lesser relative levels of payload and performance. Light unarmored wheeled vehicles (e.g., utility vehicles such as the High Mobility Multi-Purpose Wheeled Vehicle ("HMMWV"), and other non-tactical wheeled vehicles used for supply and support functions which provide less protection) offer higher levels of performance but lower relative levels of protection. In addition to producing Cougars for the U.S. military, we manufacture several variants for U.S. foreign military allies, including the Canadian military, the Italian military, the United Kingdom Ministry of Defence and the Iraqi National Army.

The Cougar variants:

*The Cougar Mastiff and Ridgback.* The Cougar Mastiff and Ridgback vehicles are part of the Cougar family of vehicles being produced and delivered to the United Kingdom Ministry of Defence through the DoD FMS program. The Cougar Mastiff is a 6-wheeled vehicle with a curb weight of approximately 18 tons offering a payload of roughly seven tons. The vehicle design is based on the Cougar MRAP 6-wheeled vehicle delivered to the U.S. military. It has the same engine, transmission, driveline and is the same length and width. The Mastiff has smooth sides and no crew cab side windows. The vehicle as delivered from Force Protection has base protection similar to the Cougar MRAP, and is final integrated with additional interior and exterior armor as well as the mission integration package in the United Kingdom. The Cougar Ridgback is a

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4-wheeled vehicle with a curb weight of approximately 14 tons offering a payload of roughly four tons. Similarly, the Cougar Ridgback vehicle design is based on the Cougar MRAP 4-wheeled vehicle. It also has smooth sides with no crew compartment side windows and no driver and co-driver doors. The same power plant and drive line that powers the Cougar MRAPs is in the Cougar Ridgback. It has blast- and ballistic-protection similar to the Cougar MRAP, and just like Mastiff the final integration occurs in the United Kingdom where it receives additional armor and its mission integration package. Since the program inception in mid-2006 through December 31, 2008, a total of 282 Cougar Mastiffs and 68 Cougar Ridgbacks were delivered. As of December 31, 2008, there were orders for 24 Cougar Mastiffs and 83 Cougar Ridgbacks in our funded backlog.

*The Cougar Wolfhound TSV.* The Cougar Wolfhound TSV ("TSV") is a 6-wheeled vehicle with a curb weight of approximately 21.5 tons offering a payload of roughly five tons. The vehicle design is based on the Cougar with a flat bed incorporated into the rear of the vehicle to allow for carrying of up to four NATO standard pallets or any other cargo. We developed this vehicle in response to a verbal request from the United Kingdom Ministry of Defence to provide a TSV that would allow supplies and support cargo to be delivered in forward battle areas while affording the crew the same basic protection of the Cougar. On December 14, 2008, we received a letter of commitment in the amount of \$14 million from the United Kingdom Ministry of Defence to allow us to purchase long lead materials for 97 Wolfhound TSVs.

*Cougar Iraqi Light Armored Vehicle.* The Cougar Iraqi Light Armored Vehicle ("ILAV") is a 4-wheeled vehicle with a curb weight of approximately 11 tons. This vehicle was built to meet the specifications called for in the U.S. Army solicitation issued in April 2006. The ILAVs were being solicited to provide a mine protected capability to the Iraqi Army under a Foreign Military Sales case. Pursuant to a subcontract agreement with BAE Systems Land & Armaments L.P. ("BAE Systems"), we agreed to a workshare split with BAE Systems wherein we each manufacture half of the vehicles required and we provide all sustainment services for the fielded vehicles. BAE Systems secured the Indefinite Delivery/Indefinite Quality ("ID/IQ") contract and issued us a subcontract in May 2006. The contract, after modifications on June 30, 2008, allows the U.S. Army to order up to 1,602 ILAV vehicles. As of December 31, 2008, BAE Systems and Force Protection have delivered approximately 605 ILAVs, of which 168 were delivered in 2008. As a result, the U.S. Army may order up to an additional 997 vehicles through June 30, 2010 under this contract.

*Cougar Independent Suspension.* The Cougar Independent Suspension ("Cougar IS") is a 4-wheeled vehicle with a curb weight of approximately 15 tons, designed specifically to provide improved mobility through the use of an independent suspension, while maintaining original Cougar levels of survivability. It also incorporates all design improvements gathered from the original MRAP Cougars previously delivered. In addition, the Cougar IS incorporates internal and external automated fire suppression systems which enhances crew survivability by mitigating fire damage following enemy attack. We believe this vehicle provides a model to be used as the basis for a Cougar remanufacturing program that can allow for incorporation of all design improvements on to previously fielded Cougars.

*The Cheetah.* The Cheetah is a 4-wheeled vehicle with a curb weight of approximately eight tons, designed specifically for reconnaissance, forward command and control, and urban operations. The Cheetah provides performance levels similar to that of a light-wheeled vehicle, while providing protection levels similar to that of our heavier Cougar fleet and payload levels substantially higher than that of the wheeled vehicle fleet currently available to the military. For example, the Cheetah offers mobility comparable to the HMMWV, and is transportable in any transport aircraft in the military inventory, including the C-130 (a four engine turboprop transport aircraft), as well as externally by a variety of helicopters. We believe the Cheetah represents a significant evolution in blast- and ballistic-protected vehicles that may fill a void in vehicle platforms currently available to, and fielded by, the

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military, specifically the gap between light unarmored or even lightly armored wheeled vehicles and the fleet of MRAP vehicles. At present, we have not had any orders for the Cheetah, although on September 15, 2008, we submitted a response to the U.S. Army Tank-Automotive and Armaments Command ("TACOM") request for information seeking a lightweight vehicle providing MRAP levels of survivability with HMMWV levels of mobility.

The Cheetah variants:

*The MRAP All Terrain Vehicle.* The original Cheetah vehicle provides for multiple seating configurations on a straight axle platform. The MRAP All Terrain Vehicle ("M-ATV") variant built off the Cheetah platform offers several significant changes from the basic Cheetah. It rides on an independent suspension providing for additional payload and improved off-road capability. The M-ATV variant is a bit roomier to provide for the additional payload and increased mission capability. Power management has been upgraded to support additional capability in command, control, situational awareness, and on-board health monitoring prognostication for the vehicle and its major sub-systems' performance. The M-ATV Cheetah has also been designed to carry ForceArmor for EFP protection and has been integrated with a Remote Weapons Station. On December 8, 2008, TACOM issued a Request for Proposal requesting M-ATV's. On February 23, 2009, in accordance with the terms of the solicitation, we delivered two production representative vehicles to Aberdeen Proving Grounds, Maryland, for the U.S. Army evaluation and testing under the M-ATV program. Subsequently, on March 11, 2009, we received a \$1 million contract award for the purchase of these two production representative vehicles signaling our continued consideration in the M-ATV program competition.

We also offer products and solutions which are aimed at enhancing the survivability of vehicles against further attacks, such as our Life Cycle Support and Armor Kit / ForceArmor .

*Life Cycle Support.* The tenets of our Total Life Cycle Support business are to emphasize an early focus on ensuring a "design for support to support the design" approach is used for all of our vehicle platforms and includes spare parts, technical manuals and vehicle field service support. This translates into operational system effectiveness for our vehicles as we focus on managing the ten elements of logistics throughout our platform life cycles. These elements include: maintenance planning, manpower/personnel, supply support, support equipment, technical data, training/training support, packaging/handling/storage/transportation, facilities, computer resources support, and design interface. We have established a systems approach within the company to put equal emphasis not just on cost, schedule, and performance, but also on supportability. Our management philosophy ensures that processes and activities are in place to develop, produce, field, sustain, and recycle our vehicles, in accordance with our customer's life cycle model. Our goals are to ensure we provide effective, available, reliable, supportable, and maintainable vehicles, while minimizing life cycle cost.

We offer ongoing life cycle support services in three areas: logistics engineering, acquisition logistics and operational logistics. That translates into spare parts, documentation, training, and maintenance for our fleet of vehicles. Based on current customer needs, we believe that we have a substantial business opportunity to provide life cycle support services to our existing and future fleet of vehicles. In addition, as the fleet ages, we have the opportunity to offer upgrades and system improvements for our fleet that are designed to further enhance the ease of use as well as the longevity of the vehicles. We believe this will continue to provide us with an ongoing market to sustain and improve our fleet through contractor logistical support, remanufacturing, data reporting, and retrofitting. We expect that our vehicles will remain in service for an extended life cycle during which, we intend to ensure supportability of the fleet. As of December 31, 2008, we had delivered support, via a deployed base of approximately 245 field trainers and service representatives, to an aggregate of approximately 4,000 vehicles across all of our programs.

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*Armor Kit / ForceArmor* . We offer an external ballistic protection module ("EBPM"), identified as ForceArmor , that provides protection from EFPs. The EBPM package design has been tested and validated through the U.S. Army Aberdeen test center. The EBPM package can be readily installed and removed in the field allowing users to "scale" protection levels in response to likely enemy threats. As a result of its modularity, the EBPM package can also be retrofitted to our previously deployed vehicles as well as to wheeled vehicles manufactured by other companies. We provided ForceArmor kits for eight vehicles in 2008 and currently have orders for an additional 257 ForceArmor kits to be deployed on our 4x4 and 6x6 Cougar vehicles.

## Vehicle Deliveries and Backlog

The following tables set forth the number of vehicles delivered for the respective periods shown below and the total number of vehicles included in our backlog as of December 31, 2008, including vehicles manufactured or to be manufactured, as appropriate, by GDLS under the GDLS Subcontract. The backlog shown in the following table is "funded" backlog, meaning that it reflects vehicles for which we have received orders and for which funding has been appropriated and authorized for expenditure by the applicable agency. We cannot assure you that we will deliver or sell any of the vehicles included in our backlog. See Item 1A, *Risk Factors* in Part I of this Annual Report on Form 10-K for a discussion of the risk associated with backlog.

|                             | Vehicle Deliveries |                      |
|-----------------------------|--------------------|----------------------|
|                             | 2008               | 2007                 |
| Buffalo                     | 81                 | 85                   |
| Cougar MRAP (Competitive)*  | 1,724              | 1,165                |
| Cougar (all other variants) | 262                | 308 <sup>(a)</sup>   |
| TOTAL                       | 2,067              | 1,558 <sup>(a)</sup> |

|                            | Vehicle Funded<br>Backlog<br>As of December 31,<br>2008 |
|----------------------------|---------------------------------------------------------|
| Buffalo                    | 69                                                      |
| Cougar MRAP (Competitive)* | 5                                                       |
| Cougar Mastiff             | 24                                                      |
| Cougar Ridgback            | 83                                                      |
| Cougar (Canadian)          | 26                                                      |
| Cougar (other)             | 2                                                       |
| TOTAL                      | 209                                                     |

\*

Refers to Cougar vehicles manufactured pursuant to our arrangement with GDLS, whereby we and GDLS fulfill the MRAP Competitive Contract. See the discussion of our subcontract with GDLS under the heading *Major Contracts* for more information.

(a)

Excludes ILAV vehicles, for which we act as a subcontractor to primarily provide labor only for a portion of the production of the vehicles. As a result, we have also reduced the previously reported units sold for Cougar (all other variants) and total units sold by 99 units for the year ended December 31, 2007.

## Industry Overview and Force Protection Market Opportunity

*General.* We believe the world market for blast- and ballistic-protected military vehicles and other survivability solutions continues to grow. The global war on terrorism, especially in Iraq and Afghanistan, has confirmed that IEDs, roadside bombs and landmines pose a significant threat to military personnel and civilians. Landmines and IEDs have been used extensively by terrorists and insurgent groups in Iraq and other areas because of their highly effective nature and relatively low cost.



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As vehicles are fielded with a specific level of protection, insurgent forces attempt to find alternative ways to conduct attacks. This will further evolve as better vehicular protection is designed and leads to potentially new threats (e.g., anti-personnel weapons, hand held EFPs) which will generate the need for an ever expanding field of survivability solutions.

According to a Government Accountability Office ("GAO") report dated July 15, 2008, over 75% of the casualties suffered by U.S. forces in Operations Iraqi Freedom and Enduring Freedom in Afghanistan have been caused by IEDs. Vehicles that move troops or ordnance while providing significant protection against blast and ballistic threats, landmine hazards and IEDs, or that are capable of mine clearance operations, are critical in these situations. Missions for these vehicles range from troop transport in and around unexploded ordnance or mine threat areas to route clearance, convoy escort, reconnaissance, command and control, ambulance operations, EOD operations, general utility, and humanitarian de-mining.

In late 2004, the U.S. military began acquiring modern blast- and ballistic-resistant wheeled vehicles in order to counter the effect of IED attacks on friendly forces conducting missions in Iraq and Afghanistan. These missions have often involved the use of lightweight wheeled utility vehicles, including the HMMWV. The HMMWV, however, was not designed to sustain high powered explosive blasts and is vulnerable to enemy fire. In response to the increasing number of casualties from IEDs and other explosive devices sustained during Operation Enduring Freedom in Afghanistan and Operation Iraqi Freedom, the U.S. military sought to increase the armor and blast protection of many of its wheeled vehicles, including the HMMWV, by retrofitting them with heavy armor. However, retrofitting heavy armor onto the bodies of these normally lightly armored vehicles is costly, and the added weight both increases mechanical wear and reduces the payload of the vehicles. We developed and delivered Buffalos and Cougars in response to the U.S. military demand.

*MRAP Vehicle Program.* In 2006, the U.S. effort to acquire blast- and ballistic-protected vehicles evolved into the establishment of the MRAP Program. The DoD accelerated the pace of contract awards under this program in early 2007, and on May 2, 2007, the Secretary of Defense, Robert Gates, directed that the MRAP program be considered the highest priority DoD acquisition program. In June 2007, Secretary of Defense Gates provided the MRAP program with the highest priority access to components and materials among all defense acquisition programs and assigned the MRAP program a DX rating, which is the highest priority rating under the DoD Priorities and Allocation System. On June 9, 2008, a Congressional Research Service report on the MRAP program identified that the Joint Requirements Oversight Council ("JROC") in September 2007 had approved the procurement of a total of 15,374 MRAP vehicles. This same report noted, however, that the JROC "suggested that these numbers could change, based on assessment of commanders." According to a report dated July 15, 2008, from the GAO, the DoD had placed orders for 14,173 MRAP Category I and Category II vehicles with five suppliers, of which we received orders for 2,894 vehicles. As a result, we estimate that as of December 31, 2008, the U.S. military would have been permitted to order approximately 1,200 additional vehicles under the MRAP program. According to that same GAO report, the DoD has appropriated more than \$22 billion to acquire MRAP vehicles. As a result and based on expanded operations into the Afghanistan theater of operations, we believe there is potential for additional MRAP vehicles to be approved for procurement by the U.S. Military under the MRAP program. The U.S. Marine Corps has fielded over 3,000 Cougars under the MRAP program. This represents an opportunity to incorporate valued technology and capability updates while resetting the vehicle's service life. As a further extension of the MRAP program, on December 8, 2008, the U.S. government issued a full-and-open competition solicitation for an M-ATV calling for up to 10,000 vehicles providing MRAP levels of survivability and HMMWV levels of mobility (see the M-ATV program discussion below).

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The U.S. Marine Corps established a Joint Program Office in 2007 to manage the MRAP program for all branches of the U.S. military and, as part of that program, continues to procure wheeled vehicles that offer more effective blast protection for the military personnel of the U.S. armed forces. The MRAP program specifies three categories of vehicles, as outlined in the table below. The table also indicates which of our vehicles satisfy the criteria for each of these categories.

| Vehicle Type | Description                                                                                                                                | Force Protection Vehicle                                                  |
|--------------|--------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------|
| Category I   | Transports no less than six persons and must be suitable for urban operations                                                              | Cougar (4-wheeled variant)                                                |
| Category II  | Transports no less than ten persons and has multi-mission purposes including troop transport, command and control and route reconnaissance | Cougar Lightweight / Cougar Restricted Terrain Cougar (6-wheeled variant) |
| Category III | Transports no less than six persons and is designed to conduct EOD and route clearance missions                                            | Buffalo                                                                   |

We have received two contracts under the MRAP program. In November 2006, the U.S. Marine Corps awarded a sole-source contract to us for Category II Cougar 6x6 vehicles and Category III Buffalo vehicles, which as of December 31, 2008, were for an aggregate of 200 Cougars and 91 Buffalos. In January 2007, the U.S. Marine Corps awarded us a competitive contract for Category I and Category II vehicles. This contract allows the U.S. government to acquire up to 20,500 vehicles over a 5-year period. As of December 31, 2008, the U.S. Marine Corps, under this competitive contract placed with us 10 delivery orders for a total of 2,009 Category I vehicles and 885 Category II vehicles.

**M-ATV Program.** On December 8, 2008, the MRAP Joint Program Office issued a competitive Request for Proposal ("RFP"), named the M-ATV through which the U.S. government is seeking a vehicle solution that provides MRAP levels of survivability with HMMWV-style mobility. On January 12, 2009, Force Dynamics, LLC, our joint venture with GDLS, submitted a proposal to this RFP offering the Cheetah M-ATV as a solution. On February 23, 2009, in accordance with the terms of the solicitation, we delivered two production representative vehicles to Aberdeen Proving Grounds, Maryland, for the U.S. Army evaluation and testing under the M-ATV program. Subsequently, on March 11, 2009, we received a \$1 million contract award for the purchase of these two production representative vehicles signaling our continued consideration in the M-ATV program competition.

Our proposed M-ATV vehicle solution incorporates ForceArmor in response to requested EFP protection. Further, we believe that two M-ATV vehicle proposals by our competitors also incorporated ForceArmor in their response to the same requirement.

**Joint Light Tactical Vehicle Program.** Under the Joint Light Tactical Vehicle ("JLTV") program, the U.S. military is seeking a family of vehicles that fulfill mission role gaps identified from the current HMMWV program. The JLTV program specifies three categories of vehicles based on payload. The performance, protection and physical characteristics of these vehicle categories are tailored to fulfill the specified mission roles these vehicles will be required to execute. On July 9, 2008, a briefing by the Army staff on the U.S. Army and U.S. Marine Corps Tactical Wheeled Vehicle fleet strategy indicated that the demand for new light tactical vehicles is approximately 160,000 vehicles between the U.S. Army and the U.S. Marine Corps. The U.S. Army's 2007 light tactical wheeled vehicle budget states that following further development and testing, the DoD intends to replace portions of the HMMWV fleet with a new fleet of vehicles under the JLTV program. The JLTV program is expected to require vehicles to balance increased levels of protection and survivability with mobility and transportability requirements. This same briefing indicates that the U.S. Army will spend an estimated \$1 to \$6 billion

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per year on the JLTV program. On February 5, 2008, we entered into an exclusive teaming agreement with DRS Technologies, Inc. ("DRS"), whereby DRS will serve as prime contractor and we will serve as a subcontractor for awards under the JLTV program. On April 14, 2008, we submitted the Cheetah for consideration under the JLTV program as subcontractor to DRS. On August 14, 2008, we were informed that we were no longer in consideration for the JLTV program Milestone A (Technology Demonstration Phase). We will continue to pursue opportunities on the JLTV program by working with Milestone A vendors to determine whether there are potential fits for Force Protection technology (e.g., ForceArmor®). In addition, we will continue to monitor the JLTV program as it transitions from Milestone A to Milestone B (System Development Phase) in fiscal years 2010 to 2011 with a view to reentering the competition.

**GSTAMIDS Program.** The GSTAMIDS program is aimed at fielding newly established "Route Clearance Companies" for the purposes of conducting IED clearing operations to eliminate IED threats to friendly force mobility. With the Buffalo, we have been designated by the U.S. Army and U.S. Marine Corps as the sole-source supplier of vehicles for EOD, including EOD vehicles that satisfy the Category III requirements of the MRAP program, for the Joint Program Officer of MARSYSCOM, and the Route Clearance vehicles requirements under the GSTAMIDS for TACOM.

**FMS Program.** The DoD established the FMS program to manage government-to-government purchases of weapons and other defense articles, defense services, and military training. A foreign military buying weapons through the FMS program does not contract directly with the company that makes them. Instead, the DoD serves as an intermediary, usually handling procurement, logistics and delivery. In 2006, we entered into a subcontract with BAE Systems to provide Cougar ILAV vehicles for the Iraqi National Army. In 2007 and 2008, we entered into contracts with the DoD to provide Buffalo and Cougar vehicles to the Canadian Ministry of Defence through the FMS program. In 2008, we entered into contracts with the DoD to provide Buffalo and Cougar vehicles to the Italian Ministry of Defence, and Cougar Mastiff and Ridgbacks, as well as Buffalo vehicles, to the United Kingdom Ministry of Defence and French military through the FMS program. A May 2008 briefing by United Kingdom Ministry of Defence indicated that it is considering making its Cougar Mastiff and Cougar Ridgback fleets a long-term component in the United Kingdom Ministry of Defence. The original vision for the Cougar Mastiffs had been a stopgap program under which the vehicles were likely to be disposed of at the end of the combat deployments in Iraq and Afghanistan. As a result of the successful performance the United Kingdom experienced in combat, it decided to retain the vehicles and expand its fleet in order to maintain this capability within the United Kingdom Ministry of Defence for a longer term. It is our belief this decision will provide ongoing opportunities for sustainment and upgrade of the Cougar fleet in the United Kingdom.

**Other Opportunities.** Many countries have buried landmines as a result of their use as a defensive tactic in areas of enemy egress during the Cold War and in third-world civil- and international-warfare during the 1980's and 1990's. More recently, it is armed groups that place mines in more countries than government forces, and insurgent and rebel groups are using IEDs in increasing numbers. According to the 2008 Landmine Monitor Report, at least 70 countries and six areas not internationally recognized are believed to be landmine-affected. Additionally, in 2007 and 2008, clearance operations indicated that at least 25 states and three areas not internationally recognized have submunitions on their territory. As a result, humanitarian de-mining operations may become a potential market for our products in order to enable nations to safely clear their land of buried landmines.

### **Business Strengths**

**Survivability Performance.** Our Buffalo and Cougar blast- and ballistic-protected vehicles have been deployed with the U.S. and allied forces in Iraq and Afghanistan since 2004. We believe our vehicles are the most survivable and sustainable wheeled vehicles on the battlefield. According to our

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internal data, as of December 31, 2008, our vehicles have logged in excess of 600,000 days in combat operations and sustained in excess of 3,000 IED and landmine blasts during the course of their active duty. The advanced design and engineering incorporated into our vehicles increases the survivability rate of vehicle occupants in conflict with a hostile force. In addition, the structural integrity of the passenger compartment and our use of readily-available automotive parts help our vehicles to be quickly repaired and returned to duty after sustaining damage from an attack. As a result, our field data indicates over 99% of our vehicles delivered since 2004 are still in operation, and the U.S. military reports operational availability for those vehicles in excess of 90%.

*Scalable Manufacturing Capabilities.* We have developed a process-driven, scalable manufacturing operation that enables us to design and build vehicles with increased efficiency. Together with key partner and subcontractor relationships, we are able to rapidly expand our production capabilities to meet customer demands. This approach enables us to expand production capacity while reducing our capital investment requirements.

*Sustainability.* Our Buffalo and Cougar vehicles are designed to be sustainable. Ease of maintenance is a hallmark of the design such that the vehicle can endure a blast event and be repaired quickly to be ready to serve once again. Repairs are made using common tools with little need for any specialized tooling. On-board diagnostics aid the maintainer in making quick repairs. Storage and payload capacity for both the Buffalo and Cougar vehicles facilitate field repairs when needed. Our vehicles are constructed using common parts and off the shelf products to promote availability of spare parts. Additionally, the parts and material selected for these vehicles have a proven history of reliability and availability over the vehicle life cycle. Technical documentation is fully illustrated and easy to follow, which simplifies the operation and maintenance training. Thoughtful design of man-machine interfaces has minimized complexity for both the operator and the maintainer. We continuously refine our support services for our customers' training, field support, and parts distribution needs.

*Proprietary Technology and Commitment to Research and Development.* Our proprietary designs are derived from concepts that were initially developed outside the United States over 30 years ago to protect vehicle occupants against the threat of landmines and unexploded ordnance. We have continuously improved upon our proprietary designs through internally funded research, development and testing. For example, ForceArmor was developed in response to a need to counter EFP attacks experienced in Iraq and Afghanistan. We actively seek to protect our designs through our intellectual property rights. We believe our focus in these areas enables us to remain flexible in our design processes and improve our vehicle sustainability and performance.

*Demonstrated Ability to Anticipate Customer Requirements.* As one of the first U.S.-based manufacturers of the current generation of blast- and ballistic-protected vehicles, we believe we are a leader in technological innovation in this industry. Our expertise enables us to produce a range of vehicles that serve a variety of missions, and are capable of withstanding increasingly violent attacks from a constantly evolving threat. We believe we will continue to be able to proactively anticipate the needs of our customers and manufacture vehicles that exceed their operational requirements. For example, we initiated the design and testing of our Cheetah vehicle in 2005, two years prior to the official request by the U.S. military for a higher-mobility blast-resistant wheeled vehicle under the MRAP II solicitation in July 2007. In addition, we started the development of the ForceArmor /EFP program in 2006, two years prior to the official request by the U.S. Marine Corps for an exterior armor kit to be added to the MRAP vehicles.

*Strong Customer Relationships.* We have generated substantially all of our revenue from sales to the DoD. As a result, we have developed strong relationships with the U.S. Marine Corps, the United Kingdom Ministry of Defence, and other U.S. military branches and foreign military allies of the U.S. We believe that these relationships and the performance of our vehicles in the conflicts in Iraq and Afghanistan will provide us with a significant advantage as we compete for future government

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contracts. In addition, our Buffalo has been designated as a U.S. Army "Program of Record." In an effort to further enhance our customer relationships, we have located business development representatives near TACOM and the U.S. Marine Corps Systems Command facilities to service their requirements.

*Experienced Management Team.* Our success is due in large part to the broad experience and knowledge of our management team and key personnel. Our executive management team has expertise in automotive engineering, manufacturing and government contracting, and brings to the organization extensive knowledge of our customers. In order to keep pace with the growth of our business, we have recently strengthened our management team through the addition of several key personnel in the areas of finance, export compliance, engineering and total life cycle support and we will continue to add personnel in key positions based on our business needs.

**Business Strategy**

Our business strategy is built around three main imperatives: first, constant focus on innovation and the introduction of new survivability products and solutions; second, expand our customer base; and third, procure contracts for sustainment services of our fleet of vehicles across all customers. Specific components of the strategy include the following:

*Identify New Products and Markets to Meet Evolving Customer Requirements.* We plan to continue to maintain a strong emphasis on the development of new products and improved technology and believe that our ongoing commitment to research and development will better position us to anticipate the future needs of our customers.

*Capitalize on Demand for Blast- and Ballistic-Protected Vehicles and other Survivability Solutions.* The ongoing military operations in Iraq and Afghanistan against an innovative enemy have been the primary factor driving demand for our vehicles. Our marketing efforts focus on the sale of vehicles to the U.S. military and, with authorization from the U.S. government, to foreign allies of the United States. We also intend to expand our vehicle offerings by designing new variants and implementing model changes within the current fleet as we seek to anticipate evolving customer requirements.

*Expand Our Total Life Cycle Support Footprint.* We are experiencing an increase in the portion of our revenues generated by the sale of aftermarket and support services, such as spare parts, field service, technical documentation, and training, for our growing fleet of deployed vehicles. Due to the nature of their mission, we expect a significant number of our vehicles will need to be supported, serviced or repaired either in the field, at a depot, or upon return from combat operations. We intend to continue to increase our life cycle support footprint domestically and globally.

*Focus on Core Competencies.* We are making investments in mainstream and "newstream" innovation capabilities. Mainstream refers to our ability to maintain, improve and evolve our current vehicle platforms with a focus on survivability, sustainability and availability. Mainstream also refers to our ability to understand our current customer's evolving operational needs and to provide whole-system solutions beyond standard vehicle platforms to meet these requirements. "Newstream" refers to our ability to innovate new survivability solutions outside our core vehicle platform base. Our new ForceArmor EFP protection is an example of this effort.

*Leverage Key Relationships to Grow our Business.* We have developed strong relationships with the U.S. Marine Corps, the United Kingdom Ministry of Defence, domestic and certain other foreign military customers. We hired a full-time representative at TACOM to further improve upon our relationship with the U.S. Army. In addition, we placed a full-time representative at Marine Corps Base Quantico, Virginia to ensure we maintain our close relationship with the Marine Corps. We believe that these relationships and the performance of our vehicles in the conflicts in Iraq and Afghanistan will

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give us an advantage as we compete for future government contracts. In addition, we have established business relationships with several large companies in the defense industry, including GDLS, BAE Systems, Raytheon Technical Services Company, DRS, and Oshkosh Truck Corporation. We believe that these commercial relationships will provide us with an advantage by enabling us to pursue opportunities maximizing our core expertise and skills in a complementary fashion with our partners.

*Develop and Expand Strategic Partnerships.* We believe that combining our strengths and products with the strengths of other strategic partners will enable us to realize greater and manageable growth in our markets. We plan on developing new ventures and expanding existing partnerships to develop our vehicles. In addition, in furtherance of our relationship with GDLS, in December 2008, our Cheetah was submitted in response to the U.S. Army's M-ATV solicitation by Force Dynamics, LLC.

**Customer Activity**

Our primary customer is the DoD through which we directly and indirectly service U.S. military branches (primarily, the U.S. Army and the U.S. Marine Corps) and indirectly service foreign military allies of the U.S. through the DoD's FMS program. In 2008, our sales to the DoD's FMS program represented approximately 9.9% of all of our sales. We have field service representatives deployed in Iraq, Afghanistan and the United Kingdom to provide customer support of our direct and indirect DoD arrangements.

The following table sets forth the number of vehicles we sold in the respective periods shown below, including Cougar MRAP (Competitive) vehicles manufactured by GDLS under our GDLS Subcontract.

| <b>Vehicle</b>                                       | <b>2008</b>  | <b>2007</b>  | <b>2006</b> |
|------------------------------------------------------|--------------|--------------|-------------|
| Buffalo                                              | 81           | 85           | 28          |
| Cougar JERRV                                         |              | 25           | 169         |
| Cougar MRAP (Sole Source)                            |              | 200          |             |
| Cougar MRAP (Competitive)                            | 1,724        | 1,165        |             |
| Cougar Italy                                         | 6            |              |             |
| Cougar Mastiff (United Kingdom Ministry of Defence)  | 174          | 78           | 30          |
| Cougar (United Kingdom Ministry of Defence)          | 6            |              |             |
| Cougar Ridgback (United Kingdom Ministry of Defence) | 68           |              |             |
| Cougar Canada                                        | 8            | 5            |             |
| <b>Total</b>                                         | <b>2,067</b> | <b>1,558</b> | <b>227</b>  |

In addition, we sold 102 Cougar ILAVs in the year ended December 31, 2008, 99 Cougar ILAV's in the year ended December 31, 2007 and 58 Cougar ILAVs in the year ended December 31, 2006 pursuant to our subcontract with BAE Systems, for which we primarily provide only labor for a portion of the production of the vehicles.

**Competitive Positioning**

We are subject to significant competition from companies that market and manufacture armored vehicles, as well as other companies that supply spare parts for armored vehicles and sustainment. This competition could harm our ability to win business and increase the price pressure on our products. The companies we compete against include large, multinational vehicle, defense and aerospace firms such as BAE Systems Land & Armaments, L.P., Textron Inc., Navistar Defense (formerly known as International Military and Government) LLC, a subsidiary of Navistar International Corporation, Oshkosh Corporation, Mantech Services (UK) Ltd., Raytheon Company, NP Aerospace and GDLS. Most of our competitors have considerably greater financial, marketing and technological resources

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than we do, which may make it difficult for us to win new contracts, and we may not be able to compete successfully. Certain competitors operate fabrication facilities and have longer operating histories and presence in key markets, greater name recognition, larger customer bases and significantly greater financial, sales and marketing, manufacturing, distribution, technical and other resources. As a result, these competitors may be able to adapt more quickly to new or emerging technologies and changes in customer requirements. They may also be able to devote greater resources to the promotion, manufacturing and sale of their products.

We believe our competitive advantages include:

The level of blast- and ballistic-protection incorporated into our vehicles, which increases the survivability of the occupants and repairability of the vehicles;

The fact that our vehicles are currently deployed in Iraq and Afghanistan and have a well-established track record of performance since 2004;

Our ability to innovate survivability solutions to defeat new and emerging threats of attack;

Our ability to innovate lightweight, mobile blast- and ballistic-protected vehicles to anticipate and meet developing customer requirements;

The fact that our vehicles use many off-the-shelf automotive components that facilitate service or maintenance and repair; and

The prior testing and acceptance of our Buffalo, Cougar, and Cheetah vehicles, as well as our ForceArmor EFP kits by the U.S. military.

We believe our products are superior to many other wheeled vehicles currently in use by the U.S. military in terms of mine- and blast-protection because of its survivability and repairability. Existing U.S. wheeled military vehicles include HMMWV and other non-armored utility support vehicles. U.S. military tracked vehicles (meaning that they have treads instead of wheels) include heavyweight troop transport and offensive armor such as the Bradley Fighting Vehicle ("Bradley"), and the M1A1 Abrams Tank ("Abrams"). The lightly armored and un-armored HMMWV and other wheeled vehicles can be subject to attacks and efforts to "up-armor" these vehicles have not been completely successful due to the costs associated with retrofitting armor onto the bodies of the vehicles and the increased mechanical wear caused by the weight of the armor. Conventional tracked armored vehicles such as the Bradley and the Abrams offer protection from blast- and ballistic-threats, but are expensive, require substantial resources to maintain, are large and can be difficult to maneuver in urban environments and may not be well-suited to peace-keeping missions due to their intimidating offensive weapon systems.

### **Company History**

We were organized under the laws of the State of Colorado in November 1996 as Boulder Capital Opportunities III, Inc., a blank check corporation. In 1998, we acquired Sonic Jet Performance, LLC, a California limited liability company engaged in the business of producing and marketing recreational boats, jet boats, trailers, and related accessories. In November 1998, we changed our name to Sonic Jet Performance, Inc. In 2000 and 2001, we emphasized building recreational boats and, in 2002, we relocated our corporate headquarters, assembly, and prototyping facility to Stanton, California and shifted our focus to the design and production of fire and rescue boats.

In June 2002, we acquired a 90% interest in Technical Solutions Group, Inc., a development stage manufacturer of blast- and ballistic-protected vehicles based in Charleston, South Carolina. Technical Solutions Group, Inc. was originally formed in 1997 as a Nevada corporation. We subsequently increased our ownership interest in Technical Solutions Group, Inc. to 100%.



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The acquisition of Technical Solutions Group, Inc. shifted our principal focus from our then existing watercraft business to the production of mine clearing and armored vehicles. We sold the assets of our watercraft business in 2003, and we moved our corporate headquarters to South Carolina to utilize the office and manufacturing space previously used by Technical Solutions Group, Inc. on the grounds of the former Navy Shipyard in Charleston, South Carolina. On October 15, 2003, we moved our headquarters to our current location in Ladson, South Carolina. In September 2003, we changed our name to "Force Protection, Inc." to reflect our primary focus on producing and manufacturing protected and armored vehicles. In January 2005, we reincorporated from the State of Colorado to the State of Nevada. We became listed on the Nasdaq Capital Market in January 2007.

**Major Contracts**

Since January 1, 2006, we have secured over \$2.5 billion of orders in the global military market. The major military contracts that we have secured since January 1, 2006 include the following, which are further described below:

The U.S. Marine Corps awarded us a competitive contract under the MRAP program for our Cougar vehicles ("MRAP Competitive Contract").

The United Kingdom Ministry of Defence awarded us contracts under the DoD's FMS program for our Mastiff Protected Patrol Vehicles, a Cougar 6x6 variant, our Ridgback, a Cougar 4x4 vehicle and Buffalo vehicles ("FMS UK Contract").

We entered into a subcontract ("BAE Subcontract") with BAE Systems Land & Armaments L.P. for manufacture and provision of sustainment support (spare parts and training and field service support) for ILAV, a Cougar variant. This subcontract was pursuant to a prime contract awarded to BAE Systems by the U.S. Army under the DoD's FMS program.

We were awarded contracts by the U.S. Marine Corps for our ForceArmor kits ("ForceArmor Contract").

*MRAP Competitive Contract.* This is our largest contract for our Cougar vehicles which was competitively bid and awarded to us in January of 2007. It is an ID/IQ contract that allows the U.S. government to order up to a maximum of 4,100 MRAP vehicles per year over a five-year period. We fulfill this contract with GDLS through the GDLS Subcontract described below.

During 2007 and 2008, we delivered 1,165 and 1,724 vehicles, respectively, under the MRAP Competitive Contract. As of December 31, 2008, we had outstanding orders for five vehicles. The total awarded value of this contract from inception through December 31, 2008, is approximately \$1.9 billion (a portion of which is subject to price definitization (see the discussion under the heading *Government Contracts and Regulations* below for a further description of price definitization)) of which approximately \$957 million of the work has been or will be provided by GDLS under the terms of the Workshare Agreement described below.

On September 10, 2007, we entered into a subcontract with GDLS (the "GDLS Subcontract") pursuant to which GDLS performs approximately 50% of the work under the MRAP Competitive Contract for vehicle manufacturing and life cycle support based on revenues. We previously entered into a joint venture with GDLS on December 15, 2006 ("Workshare Agreement") pursuant to which we and GDLS would fulfill the obligations of the MRAP Competitive Contract. We formed a Delaware limited liability company, Force Dynamics, LLC ("Force Dynamics"), to govern the terms of the joint venture. However, the MRAP Competitive Contract was awarded to us and not to Force Dynamics or GDLS. We have attempted to transfer this contract to Force Dynamics, although the U.S. government has not yet agreed to the transfer.

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**FMS UK Contracts.** On February 21, 2008, we received an order from the United Kingdom Ministry of Defence for the purchase of 174 Cougar Explosive Ordnance Disposal Vehicles, known as Mastiff Protected Patrol Vehicles ("Cougar Mastiffs"), a Cougar 6x6 variant through the DoD's FMS program. During 2008, this order was further modified to add 24 more Cougar Mastiffs. On May 2, 2008, the order was modified to add the purchase of 151 Cougar 4x4 Ridgback variants through the DoD FMS program. On October 31, 2008, the order was further modified to add the purchase of 14 Buffalo vehicles under the United Kingdom Talisman project. All of the United Kingdom Ministry of Defence orders include associated spare parts, technical manuals and field service support.

During 2008, we delivered 174 Cougar Mastiffs, 68 Cougar Ridgbacks, six Cougar 4x4 variants and two Buffalos under the FMS UK Contract. As of December 31, 2008, we had outstanding orders for 119 vehicles. This contract is administered by the U.S. Marine Corps Systems Command and some of the 2008 orders are subject to price definitization. The total awarded value of this contract from inception to December 31, 2008, is approximately \$307 million.

**BAE Subcontract.** On May 30, 2006, TACOM awarded BAE Systems a delivery order in the amount of \$180.5 million as part of a fixed-price contract for the production and delivery of 378 ILAVs to the Iraqi National Army ("BAE Agreement"). On August 8, 2006, we entered into a subcontract with BAE pursuant to which we serve as BAE Systems' principal subcontractor to provide the manpower and other resources needed to produce 50% of the vehicles and 100% of the life cycle support.

On June 30, 2008, the BAE Subcontract was amended to allow for the purchase of up to 1,602 vehicles and life cycle support services through June 30, 2010. The total value of orders awarded to us by BAE Systems under this subcontract from inception to December 31, 2008, is approximately \$75.1 million.

**ForceArmor Contract.** In December 2008, the U.S. Marine Corps awarded us several orders for our EBPM products, also known as our ForceArmor . These undefinitized contract modifications have an aggregate value of approximately \$40.5 million, with a funding limitation and current expenditure authorization not to exceed approximately \$30.5 million.

### **Production**

The key components of our manufacturing process are the following:

We utilize proprietary technology to design and manufacture blast- and ballistic-protected vehicle passenger compartments, which we sometimes refer to as "capsules," that are designed to be capable of withstanding the explosive effects of most landmines, IEDs and other blast threats encountered in wars, insurgency and urban conflicts;

We use commercial American-made automotive drivetrains and certain other components that can be repaired and maintained by traditional truck mechanics, although certain of our components are manufactured abroad or are in limited supply;

Our workforce includes skilled welders and automotive mechanics;

We maintain a staff of engineers to provide in-house engineering support and utilize various manufacturing approaches to increase efficiency and product quality;

We utilize partners and subcontractors, including GDLS, to expand our capacity and capabilities to meet customer specifications, standards and delivery schedules at anticipated costs; and

We source steel and other raw material from various key vendors in the United States and overseas, and secure our automotive components from a variety of U.S. suppliers (including Caterpillar, Marmon-Herrington, Axle Tech International, and Allison Transmission) and in

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certain cases, from foreign suppliers. Whereas we have previously obtained all of the steel for Buffalo vehicles from foreign suppliers, our next generation Buffalos, currently in production, are constructed of domestic steel. All of our other vehicles are also constructed of domestic steel.

**Sales and Marketing**

Our employees, including senior management and our vice presidents of marketing and business development conduct our primary sales and marketing efforts. Apart from our senior management, our primary sales staff consists of employees or agents, who reside in South Carolina, Michigan, Virginia and Connecticut. We also have consultants and representatives in South Africa, United Kingdom, Turkey, Japan, Poland, Colombia, Hungary, the Kingdom of Saudi Arabia, Kuwait, the United Arab Emirates, Australia and Greece. These representatives facilitate our business development activities in their respective countries and serve as local subject matter experts in helping us to better understand local requirements and practices in our efforts to establish markets overseas.

We actively participate in trade shows involving countermine operations and technology, military vehicles, law enforcement technology and military force protection, including the Association of the U.S. Army Annual Meeting and Winter Symposium; Modern Marine Expo; and Tactical Wheeled Vehicle conferences. In addition we participate in overseas shows in France; the United Arab Emirates and England.

**Sales to the U.S. Government**

For each of 2008, 2007 and 2006, substantially all of our net sales were derived from work performed directly or indirectly under U.S. government contracts.

**Government Contracts and Regulation**

We are a DoD contractor that delivers products and services to the U.S. military. The U.S. government contracting process differs in many ways from commercial contracting, and involves a high degree of federal government regulation and oversight of the programs in which we participate. As a result, we are subject to extensive regulations and requirements of the U.S. government agencies and entities that govern these programs, including award, administration and performance of contracts. We are also subject to certain unique business risks associated with the U.S. government program funding and appropriations and government contracts.

U.S. government contracts generally are subject to the Federal Acquisition Regulation ("FAR"), which sets forth policies, procedures, and requirements for the acquisition of goods and services by the U.S. government; agency-specific regulations that implement or supplement the FAR, such as the DoD Federal Acquisition Regulation Supplement ("DFARS"); and other applicable laws and regulations. These statutes and regulations impose a broad range of requirements, many of which are unique to government contracting, including various procurement, import and export, security, contract pricing and cost, contract termination and adjustment, compliance, disclosure, and audit requirements. A contractor's failure to comply with these regulations and requirements could result in reductions of the value of contracts, contract modifications or termination, and the assessment of civil or criminal penalties and fines and could lead to suspension or debarment from government contracting or subcontracting for a period of time.

In addition, U.S. government contractors that perform military programs are also subject to audits and investigations by U.S. government agencies such as the Defense Contract Audit Agency ("DCAA"), the DoD Inspector General, and other government entities. U.S. government agencies review a contractor's performance under its contracts, cost structure and compliance with applicable laws, regulations and standards. These entities also review the adequacy of compliance with internal control

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systems and policies, including the contractor's purchasing, property, estimating, compensation and management information systems, as well as possible instances of fraud, waste, and abuse. Additionally, each fiscal year, we must submit final cost data to the federal government indicating our actual costs incurred for the prior year, exclusive of certain costs that are not recoverable by federal government contractors. Once audited, the U.S. government may adjust the amounts of reimbursable costs under certain contracts, based upon established guidance, which may affect recovery of our costs. These audits may also result in, among other things, price reductions, assessment of penalties, interest costs, or even potential debarment from participation in the federal procurement system. The DCAA recently audited our financial condition and capability and, in March 2009 advised us that we had an "acceptable rating." This rating means that the DCAA has determined that we currently, and for the near-term, have adequate financial resources to perform U.S. government contracts. Previously, the DCAA had expressed an opinion that Force Protection could not provide adequate financial data to determine whether we had adequate financial resources to perform on government contracts. See Item 1A, *Risk Factors* in Part I of this Annual Report on Form 10-K, for a discussion of certain additional risks associated with U.S. government contract regulations and requirements compliance.

Generally, Congress appropriates funds on a fiscal year basis even though a program may extend across several fiscal years. Consequently, programs are often only partially funded initially and additional funds are committed only as Congress makes further appropriations and agencies determine a continued need for the specific program. The contracts under a program generally are subject to termination or adjustment if appropriations for such programs are not available or change or the applicable agency's budgeting priorities change. Additionally, the U.S. government is required to equitably adjust a contract price for additions or reductions in scope or other changes directed by the applicable agency. See Item 1A, *Risk Factors* in Part I of this Annual Report on Form 10-K, for a discussion of additional risks associated with program funding and appropriations.

In most federal procurements, interested contractors submit information indicating their desire to provide the required goods. The agency then solicits competitive proposals or bids from qualified contractors by the publication of a formal request for proposal ("RFP"). The RFP typically describes the desired goods, terms and conditions, and evaluation criteria that the agency will use. Then, the interested contractors, called offerors, submit proposals in response to an RFP, and the agency evaluates the proposals and makes the award determination. The amount of time for a procurement to be completed (from notification of the RFP to award) can range from several months to a year or more.

The government contracts for which we compete typically have multiple year terms, including option years, and if we are unable to win a particular contract, we generally will be excluded from competing again for that contract until its expiration several years later. In addition, upon the expiration of a contract, if the customer requires further services of the type provided by the contract, there is frequently a competitive re-procurement process.

Many of our contracts are issued as orders on a sole-source basis and/or a not to exceed amount and then become fixed-price contracts. Under fixed-price contracts, the contractor agrees to perform a specific scope of work for a fixed price. As a result, the contractor benefits from any cost savings but suffers from any losses from any cost overruns. See Item 1A, *Risk Factors* in Part I of this Annual Report on Form 10-K for a discussion of certain risks associated with fixed-price contracts.

Many of our contracts are and have been subject to "definitization," meaning that the contract price is not agreed upon at contract inception. Instead, following award of the contract, we and the U.S. government seek to agree upon a contract price based upon our cost of performing the contract. During the definitization process, we are required to perform the contract work, make deliveries and receive payments from the U.S. military before the final contract price has been established. For this reason, as part of the original award, we agree to a not to exceed ("NTE") price to be used for

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invoicing and accounting purposes pending definitization. As a result, at the completion of the contract, we may have received overpayments during the course of the contract and will be required to return any overpayments to the U.S. military. See Item 1A, *Risk Factors* in Part I of this Annual Report on Form 10-K for a discussion of certain risks associated with contracts that are subject to price definitization.

Following an award of these orders, performance of the work commences while we and the government negotiate a final contract price for the scope of the work to be completed subject to the NTE amount. During this definitization process, we are obligated to perform up to the funding limitation for the order, make deliveries and receive payment before the final contract price has been established. Once the definitization is completed, we execute a modification to complete the order for a fixed price.

In addition, we also hold ID/IQ contracts. Essentially, the ID/IQ contracts are umbrella contracts setting forth the basic terms and conditions under which the agency may order goods from a contractor, and in some cases, multiple contractors. Contractors undergo a competitive preselection process to become eligible to receive orders under ID/IQ contracts. Many orders under these ID/IQ contracts are also subject to the definitization process. In addition, ID/IQ contracts do not obligate the federal government to purchase goods above the minimum levels set forth in the contract. See Item 1A, *Risk Factors* in Part I of this Annual Report on Form 10-K for a discussion of the risk associated with ID/IQ contracts.

U.S. government contracts generally permit the government to terminate the contract, in whole or in part, without prior notice, at the government's convenience, where the government no longer has a need for the service, or for default, usually based on deficiencies in performance. Generally, if a contract is terminated for convenience, the contractor is entitled to payments for some or all of its allowable costs incurred in performing the work that was terminated and may receive some allowance for profit on the work performed. If a contract is terminated for default, the contractor is generally entitled to payments for its work that has been accepted by the government. See Item 1A, *Risk Factors* in Part I of this Annual Report on Form 10-K for a discussion of certain additional risks associated with the U.S. government's right to terminate its contracts.

### **Certain Laws and Regulations Affecting Our Business**

There are certain federal laws that, while not specifically directed at us as a contractor, may affect our U.S. government contracts. The Anti-Deficiency Act is a collection of laws through which Congress exercises its constitutional control of the public purse. The central provision, codified at 13 U.S.C. §1341, prohibits making or authorizing an expenditure from, or creating or authorizing an obligation under, any appropriation or fund in excess of the amount available in the appropriation or fund unless authorized by law. The Anti-Deficiency Act also prohibits involving the government in any obligation to pay money before funds have been appropriated for that purpose, unless otherwise allowed by law. Generally, therefore, agencies cannot fund our contracts unless there has been a full appropriation of the necessary funds. Congress appropriates the majority of an agency's funds on a fiscal year basis, and the agencies, in turn, fund and award our projects. Agencies do not receive all funds for a given year at the outset of that year; rather they receive allocations and allotments in accordance with the Office of Management and Budget guidelines and internal agency policies. Therefore, the Anti-Deficiency Act indirectly regulates how the agency awards our contracts and pays our invoices.

There are also numerous provisions within the FAR that affect the procurement process and administration of our contracts. With respect to conducting a procurement, the FAR provides guidance on how the agency is to conduct the evaluation of an RFP. The FAR also provides a mechanism through which disappointed bidders and contractors excluded from competing for government contracts and task or delivery orders may submit an objection, called a "bid protest," in accordance with the

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relevant rules and regulations, to an agency contracting officer, the Government Accountability Office, or the U.S. Court of Federal Claims. Performance under a contract being protested may be suspended while the protest is pending, and in cases where the contract is found to have been improperly awarded, the contract may be terminated, or other corrective action may be taken.

Some contracts may be subject to the Truth in Negotiations Act ("TINA"), Cost Accounting Standards ("CAS") and Contract Cost Principles and Procedures ("Cost Principles"). Generally, TINA requires us to provide cost or pricing data and to certify that those data are current, accurate and complete, in connection with the negotiation of certain types of contracts, modifications or orders, but there are some exceptions to TINA, including contracts that are based on adequate price competition. As described under Item 1A, *Risk Factors* in Part I of this Annual Report on Form 10-K, we were previously categorized as a "small business" under federal procurement regulations, but due to our growth we no longer qualify as a "small business." As a result, CAS applies to contracts awarded to the Company after May 19, 2008. The Cost Principles set forth the rules regarding the allocability and allowability of costs incurred in connection with federal government contracts.

Another area covered by the FAR is an organizational conflict of interest ("OCI"). These regulations establish rules for avoiding, mitigating and neutralizing conflicts of interest in the issuance and performance of contracts by the federal government. Both contractors and contracting officers bear the burden of identifying and reporting OCIs. An OCI may arise because the nature of the work to be performed by a contractor has the potential, absent some restriction on future activities, to result in an unfair competitive advantage to the contractor or impair the contractor's objectivity in performing the contract or providing assistance or advice to the federal government. The government contracting officer is responsible for resolving any significant potential OCIs before a contract award is made or as soon as the OCI is identified.

Our conduct and performance is also subject to the False Claims Act and other anti-fraud statutes. The False Claims Act, 31 U.S.C. §3729, prohibits contractors from knowingly submitting false or fraudulent claims for money (*e.g.*, a false or fraudulent invoice) to the federal government. Any claim of violation of the False Claims Act may be a criminal and/or civil violation, which carries significant monetary penalties. Agencies may take administrative actions, such as suspension and debarment, in the event of a False Claims Act finding or conviction.

#### **Laws and Regulations Affecting International Activities**

Federal laws affect our ability to sell our products abroad and grant access to our technology to foreign nationals in the U.S. We are obligated to comply with a variety of federal, state and local regulations, both domestically and abroad, governing certain aspects of our international sales and support, including regulations promulgated by, among others, the U.S. Departments of Commerce, Defense, State and Justice and the Bureau of Alcohol, Tobacco, Firearms and Explosives.

For products and technology exported from the U.S. or otherwise subject to U.S. jurisdiction, we are subject to U.S. laws and regulations governing international trade and exports, including, but not limited to the International Traffic in Arms Regulations ("ITAR"), the Export Administration Regulations ("EAR"), the DoD's FMS program and trade sanctions against embargoed countries and destinations administered by the Office of Foreign Assets Control ("OFAC") of the U.S. Department of the Treasury. We are also obligated to fulfill requirements under the U.S. Munitions Import List for certain parts and components imported into the U.S. for our products. These laws and regulations impose compliance and licensing obligations to obtain U.S. government authorization for transfers outside the U.S. and to persons in the U.S. other than U.S. citizens and U.S. permanent residents.

The Foreign Corrupt Practices Act ("FCPA") and equivalent laws and regulations in foreign jurisdictions prohibit improper payments to foreign governments and their officials by U.S. and other business entities. The FCPA has two principal parts: anti-bribery and record keeping provisions. The

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U.S. Department of Justice enforces the anti-bribery provisions; the Securities and Exchange Commission ("SEC") also has jurisdiction over civil enforcement of the anti-bribery provisions. The record keeping requirement, applicable only to companies registered on U.S. stock exchanges, obligates companies to maintain accurate books and records and internal financial controls regarding all transactions. The SEC oversees enforcement of these provisions.

**Research and Development**

We continually seek to improve our technological leadership position through internal research, product development, licensing, and acquisitions of complementary technologies. We also seek to expand our research capability through partnerships with commercial, research, and educational institutions. For example, in August 2008, Force Protection and the Medical University of South Carolina jointly inaugurated the Force Protection Center for Brain Research at the Medical University of South Carolina. This program is anchored by a state of the art MRI research scanner operated by leading traumatic brain research physicians from the United States and the United Kingdom. Working in conjunction with the blast research capabilities of Force Protection, this team is well on the way to achieving a better understanding of the phenomenon of traumatic brain injury suffered by so many veterans of the Iraq and Afghanistan wars with the aim of introducing improved products and treatments. In addition, we regularly investigate new ways to manufacture our various products to reduce variation, improve manufacturing cycle times, and reduce overall manufacturing costs.

As of December 31, 2008, we had approximately 40 employees engaged in research and development. We continually work to enhance the survivability and reliability of our existing products and to develop and introduce innovative new products to satisfy the evolving needs of our customers domestically and internationally. To supplement our research activities, in 2007 we purchased a blast and ballistics range which gives us a technological advantage enabling rapid prototyping, confirmation testing, and analysis.

For the years ended December 31, 2008, 2007 and 2006, we spent \$14.3 million or 1.1% of net sales, \$14.1 million or 1.6% of net sales, and \$3.2 million or 1.6% of net sales, respectively, on research and development. None of our research and development costs were customer-sponsored.

We are committed to product development and expect to continue our investment in this area. We believe that the continual development or acquisition of innovative new products and service will be critical to our future success. Failure to develop, or introduce on a timely basis, new products, services or product enhancements that achieve market acceptance could have a material adverse effect on our business, operating results or financial condition. See Item 1A, *Risk Factors* in Part I of this Annual Report on Form 10-K for a discussion of the risk associated with product development.

**Engineering**

To effectively and efficiently develop reliable, high quality, manufacturable products and provide best value total life cycle costs, we are dependent upon our ability to manage, direct, and design advanced vehicle structures and systems utilizing internal and external engineering resources. We have established key engineering practices, procedures and tools along with a core design engineering team that utilizes appropriate standards and validation/verification methodologies to insure we meet our various customer requirements for both vehicle performance and survivability. We continue to explore ways to continuously improve engineering effectiveness through training, tools used for designing, testing, modeling and simulation along with establishing and leveraging strategic external resources that compliment our capabilities and are available during peak cyclical demand. These external resources have become increasingly important and during 2008 we undertook actions to better align our engineering organization and infrastructure to develop our capability to quickly integrate external engineering resources when required. During 2008, we leased a 10,000 square foot facility in Sterling

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Heights, Michigan, a suburb of Detroit, close to one of our key customer constituent TACOM and partner GDLS to establish an engineering technical center. We have hired both direct and contract technical center engineering resources to supplement our core engineering team located in Ladson, South Carolina. The new engineering facilities and the supporting management team, infrastructure, tools and engineering processes have created a strategic capability that can rapidly scale and integrate technical resources to meet customer needs.

**Raw Material and Supplies**

We depend on suppliers and subcontractors for raw material and supplies. The cost of our raw material and supplies may fluctuate substantially and some of our raw material and supplies may be in short supply, may be available from only one or a limited number of suppliers, or may only be available from foreign suppliers. Increased costs or difficulties in obtaining supplies and raw material in the requisite quantities, or at all, could have a material adverse effect on our results of operations. The credit crisis and rapidly escalating steel, fuel and other raw material costs in fiscal 2008 created additional risks for our supplier base. We believe that some suppliers may discontinue business due to tight credit conditions or the inability to either absorb cost increases or pass them on to their customers. In 2009, additional suppliers could face financial difficulties as a result of the global economic downturn. We actively monitor our suppliers' financial conditions, but to date have no knowledge of significant concerns with the financial stability of any of our major suppliers. See Item 1A, *Risk Factors* in Part I of this Annual Report on Form 10-K for a discussion of our raw materials.

We are highly dependent on the availability of essential materials, parts and sub-assemblies from our suppliers and subcontractors. The most important raw materials required for our products are armored steel, milled steel, major automotive components, and ballistic glass. Several major automotive components are procured or subcontracted on a sole-source, or limited source, basis with a number of domestic and non-U.S. companies. The most important raw material we purchase is steel, accounting for approximately 15.6% of our total vehicle material costs.

We are dependent upon the ability of our suppliers and subcontractors to meet our specifications, standards and delivery schedules at anticipated costs. While we maintain a qualification and performance surveillance system to control risk associated with such reliance on third parties, failure of suppliers or subcontractors to meet commitments could adversely affect production schedules and contract profitability, while jeopardizing our ability to fulfill commitments to our customers. See Item 1A, *Risk Factors* in Part I of this Annual Report on Form 10-K for a discussion of our suppliers.

No material portion of our business is considered to be seasonal. Various factors could affect the distribution of our sales between accounting periods, including the timing of government awards, the availability of government funding, product deliveries and customer acceptance.

**Intellectual Property**

Intellectual property rights, which apply to various Force Protection products and technologies, include patents, copyrights, trade secrets and trademarks. We seek to remain competitive in the market by placing emphasis on research and development and are committed to capturing, protecting and enforcing our intellectual property rights. We continue to review our practices and procedures to ensure the protection of our intellectual property.

We are a party to two long-term intellectual property agreements pursuant to which we have the right to use certain intellectual property technology relating to blast- and ballistic-protected vehicles. One agreement is with the CSIR Defencetek ("CSIR"), a division of the Council for Scientific and Industrial Research, a statutory council established in accordance with the Laws of the Republic of South Africa. The other is with Mechem, a division of Denel Pty Ltd, a company established under the Laws of the Republic of South Africa ("Mechem"). Under these agreements, we pay a per vehicle royalty fee in exchange for the exclusive transfer to us of certain technology.

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The agreement with CSIR provides for the provision, on an exclusive basis, by CSIR to us of certain technical, scientific and commercial intellectual property rights pertaining to the development of our Cougar and Buffalo vehicles. Under our agreement with CSIR, we pay CSIR a fee for each vehicle sold and/or manufactured by us using the licensed intellectual property during the term of the agreement, including vehicles manufactured by our subcontractors. We are not obligated to pay a fee in respect of our Cheetah vehicle, and the manufacture of the Cheetah vehicles is not dependent upon the technology granted to us under the agreement. The initial term of the agreement was March 8, 2002, through March 7, 2007, and the term of the renewed agreement is March 8, 2007, through March 7, 2012. We have no right to extend the agreement after March 2012, and if the agreement expires without renewal, after such date CSIR may grant a license to the licensed intellectual property to other parties. However, even upon expiration of the agreement we will have the ability to manufacture and deliver the Cougar and Buffalo vehicles.

The agreement with Mechem provides for the provision, on an exclusive basis, by Mechem to us of certain technical, scientific and commercial intellectual property rights pertaining to the development of our Cougar and Buffalo vehicles. Under our agreement with Mechem, we pay Mechem a fee for each vehicle sold and/or manufactured by us using the licensed intellectual property during the term of the agreement, including vehicles manufactured by our subcontractors. We are not obligated to pay a fee with respect to our Cheetah vehicle, and the manufacture of the Cheetah vehicle is not dependent upon the technology granted to us under the agreement with Mechem. Our original agreement with Mechem was effective October 15, 2001, and expired October 14, 2006. Our current agreement with Mechem, which we entered into on September 13, 2006, expires on September 12, 2011. We have no right to extend the agreement after September 2011 and, if the agreement expires without renewal, after such date Mechem may license the licensed intellectual property to other parties. However, even upon expiration of the agreement, we will have the ability to manufacture and deliver the Cougar and Buffalo vehicles.

In connection with our subcontract with BAE Systems, we entered into a production license agreement with BAE Systems, dated June 13, 2006, pursuant to which we license to BAE Systems the use of our Cougar vehicle as the basis for the ILAV vehicle design, and act as BAE Systems' principal subcontractor to provide the manpower and other resources needed to produce 50% of the vehicles in Ladson, South Carolina. Pursuant to the terms of the agreement, we receive a license fee for each ILAV vehicle manufactured by BAE Systems under the agreement. The production license agreement will remain in effect until the earlier of (i) completion of all the work under the BAE Agreement, (ii) termination of the agreement by us in the event of default by BAE Systems, or (iii) termination of the subcontract for convenience. We own all the intellectual property associated with the ILAV design, including improvements.

In connection with our Workshare Agreement with GDLS, we entered into a technology license agreement with Force Dynamics and GDLS, dated December 15, 2006. The agreement provides that we grant Force Dynamics and GDLS a non-exclusive license without the right to sublicense to manufacture the Cougar utilizing our background intellectual property for the MRAP Competitive Contract. Force Dynamics and GDLS pay us a fee per each vehicle manufactured by them using the licensed intellectual property, which fee we use to pay our license fees under the CSIR and Mechem agreements described above. The term of this technology license agreement is the later of completion or complete termination of the MRAP program or the Workshare Agreement.

We are a party to another license agreement with CSIR, pursuant to which we received two separate licenses. The first is a fully paid up internal license to perform research and development to verify, test and develop certain technology (the protection of wheeled and tracked vehicles against landmines and IEDs as disclosed in its patent) and assess the market for products through the parties written agreement of Proof of Concept (quantification and demonstration of the protection level and operation) in consideration of investing \$500,000 since January 1, 2005.

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By August 16, 2008, the Proof of Concept was obtained, and we are required to pay a \$200,000 exclusivity fee to CSIR that is deferred but paid through any sales of wheels and tracks for the second license. This second license also includes an exclusive, non-sublicensable license to exploit, including the manufacture, marketing, sale and use, the licensed technology in the United States, Canada, the United Kingdom, France, Israel, Germany and nonexclusively in South Africa. However, we must also pay CSIR a minimum royalty fee every year for each product that uses the technology or CSIR will have the right to rescind our exclusivity rights or terminate the agreement. The minimum royalty for the first year term, from August 16, 2008, to August 15, 2009, was \$150,000 and has been paid. All patent rights exist solely with CSIR, and CSIR will also have the right of first refusal to patent any improvements that are made by us to the licensed technology. In return, CSIR will grant to us a royalty free license to use the patented technology in the defined territory. We may cancel this agreement for any reason upon providing CSIR sixty (60) days notice.

**Personnel**

As of December 31, 2008, we had a total of approximately 1,170 employees, including approximately 250 field service representatives. Of our total employees, approximately 470 were hourly employees and approximately 700 were salaried employees. Sharp reductions in company and contract employees throughout 2008 are attributable to improvements in processes and productivity, as well as our successful fulfillment of major aspects of the MRAP contract. We are not a party to any collective bargaining agreement, although we are subject to the risk that labor unions may seek to unionize certain of our employees. We believe our relations with employees are good.

**Environmental Matters**

We are subject to federal, state and local laws and regulations regarding the protection of the environment, including air, water and soil. Our manufacturing business involves the use, handling, storage and contracting for the recycling or disposal of, hazardous or toxic substances or wastes, including environmentally sensitive materials, such as batteries, solvents, lubricants, degreasing agents, gasoline and resin. We must comply with certain requirements for the use, management, handling and disposal of these materials. We maintain limited pollution liability insurance for our Ladson, South Carolina facility, where we manufacture the Cougar and Buffalo vehicles, our Summerville, South Carolina facility, our Roxboro, North Carolina facility, and our Edgefield, South Carolina facility, where we conduct some of our blast range activities and some of our research and development activities. If we are found responsible for any hazardous contamination, we may have to pay expensive fines or penalties or perform costly clean-up. Even if we are charged, and later found not responsible for such contamination and clean-up, the costs of defending the charges could be high.

**Other Regulatory Matters**

In addition to the laws and regulations discussed above under " Government Contracts and Regulation " " Certain Laws and Regulations Affecting Our Business" and " Environmental Matters" above, our operations and products are subject to regulation, supervision, and licensing under various other federal, state, local and foreign laws and regulations. Certain governmental agencies such as the Occupational Safety and Health Administration ("OSHA") monitor our compliance with their regulations, require us to file periodic reports, inspect our facilities and products, and may impose substantial penalties for violations of the regulations. There can be no assurance we will be successful in complying with these laws and regulations, or that any failure to comply with these laws and regulations will not have a material adverse effect on our business, financial position, results of operations, and cash flows.

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### **Management**

The following table sets forth certain information about our directors and executive officers as of March 12, 2009.

| <b>Name</b>                 | <b>Age</b> | <b>Position</b>                                                 |
|-----------------------------|------------|-----------------------------------------------------------------|
| Michael Moody               | 62         | Chief Executive Officer, President, Chairman                    |
| Charles Mathis              | 49         | Chief Financial Officer                                         |
| Lenna Ruth Macdonald        | 46         | Chief Strategy Officer, General Counsel and Corporate Secretary |
| Daniel Busher               | 45         | Executive Vice President, Operations                            |
| Mark Edwards                | 47         | Executive Vice President, Development                           |
| Damon Walsh                 | 47         | Executive Vice President, M-ATV Program Director                |
| MGen. Jack A. Davis         | 62         | Director                                                        |
| LTG. Roger G. Thompson, Jr. | 64         | Director                                                        |
| John S. Day                 | 59         | Director                                                        |
| John W. Paxton, Sr.         | 72         | Director                                                        |

*Michael Moody.* Mr. Moody was appointed President of Force Protection, Inc. in September 2007, the Interim Chief Executive Officer on January 30, 2008 and the Chief Executive Officer on February 29, 2008. Mr. Moody has more than 30 years of senior management experience in operational management, reorganizations, acquisitions and business transformations. From 2005-2007 he provided business and financial advisory services to privately held businesses. Mr. Moody was the Chief Operating Officer at the London American General Agency and Senior Vice President of Corporate Development for Magna Carta Companies, a mutual insurance company, where he also served on the Board of Directors. Mr. Moody received the designation of Certified Practicing Accountant (Australia) and became an associate with the Australian Society of Accountants. Mr. Moody holds a Bachelor of Arts in Economics from Macquarie University in Sydney, Australia.

*Charles Mathis.* Mr. Mathis joined Force Protection, Inc. in June 2008 as Executive Vice President and was appointed Chief Financial Officer effective October 1, 2008. Mr. Mathis has over 20 years of experience in strategic finance and accounting for a number of manufacturing companies including two major defense contractors. Prior to joining Force Protection, Mr. Mathis was Chief Financial Officer of EFW, Inc. a U.S. segment of Elbit Systems Ltd., a public Israeli defense conglomerate. At Elbit, Mr. Mathis was responsible for all areas of finance, contract accounting, government compliance, Sarbanes Oxley compliance, tax and the development of joint venture agreements. Prior to Elbit, Mr. Mathis was Vice President, Finance and IT, with Fairbank Morse Engine, a supplier of medium speed diesel engines to the U.S. Navy and the engine segment of EnPro Industries. Mr. Mathis received his Master of Business Administration from the University of Chicago Graduate School of Business and completed his undergraduate studies at Wake Forest University. Mr. Mathis is a certified public accountant. He also served as a Lieutenant in the U.S. Marine Corps.

*Lenna Ruth Macdonald.* Ms. Macdonald joined Force Protection, Inc. in November 2007 with over 19 years legal experience as in-house counsel and in private practice. She was promoted to her current position from Co-General Counsel and Corporate Secretary in 2008. Ms. Macdonald has specialized experience in corporate governance, compliance, securities and transactional matters. Prior to joining the Company, she served as Vice President, General Counsel & Secretary of Commonwealth Industries, Inc. (a Nasdaq listed leading aluminum sheet manufacturer), as in-house counsel for Banc One Corporation and as Assistant General Counsel and Group Leader at BONHAM, a Banc One subsidiary. Ms. Macdonald was also an associate with the international law firm McDermott, Will & Emery based in its Boston, Massachusetts office. Ms. Macdonald holds a Juris Doctor from Emory University School of Law, attended the M.Sc. Program at the London School of Economics and Political Science, and received her A.B. from Brown University.

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*Daniel Busher.* Mr. Busher has been the Executive Vice President, Operations, of Force Protection, Inc. since March 2008. Bringing more than 20 years of international business experience in the automotive industry, Mr. Busher joined Force Protection, Inc. in October 2006. Previously, he was director of materials for North American Automotive Operations within Alcoa, maintaining responsibilities in the United States, Mexico and Honduras. In addition, he held numerous senior location Plant and Operations Management roles throughout Alcoa. Mr. Busher began his career as a member of the GM Saturn Corporation start-up team that implemented revolutionary new labor agreements and lean manufacturing methods from early concept to full production. Mr. Busher earned his Bachelor of Science degree in Mechanical Engineering from the University of Wisconsin. He also holds an Executive Master of Business Administration, Beta Gamma Sigma honors, from the Owen School at Vanderbilt University.

*Mark Edwards.* Mr. Edwards has been with Force Protection, Inc. since November 2004. Mr. Edwards has more than 18 years experience in both automotive and military transport equipment industries. Prior to joining Force Protection, Mr. Edwards was Vice President, Operations for Ducommun Aerostructures, where he was responsible for all aerostructure manufacturing for the Boeing C-17 and Chinook programs, as well as Sikorsky's BlackHawk/NavalHawk program. Mr. Edwards earned a Bachelor's degree in Mathematics and Chemistry from Wright State University, and a Masters of Business Administration from Pepperdine University.

*Damon Walsh.* Mr. Walsh joined Force Protection, Inc. in July 2005. Before joining Force Protection, Mr. Walsh was a career officer in the U.S. Army serving in a wide variety of staff and command positions including operational assignments as an airborne Infantry officer and Special Forces officer. Mr. Walsh also served for over a decade in the Army Acquisition Corps. This culminated in his assignment as the Commanding Officer of the Joint Systems Manufacturing Center at Lima, Ohio overseeing the manufacture of Abrams Main Battle Tanks, Stryker vehicles, and Marine Corps Expeditionary Fighting Vehicles. Retiring as a Lieutenant Colonel, Mr. Walsh is a Level III Certified Acquisition Professional as well as a Certified Professional Contracts Manager and has over 25 years experience in both the operational Army and the Acquisition community. Mr. Walsh holds a Master in Management from the U.S. Naval Postgraduate School and is a graduate of the Army Command & General Staff College. He is also a veteran of Operations Desert Shield/Desert Storm, Provide Comfort, Uphold Democracy, and Iraqi Freedom.

*Major General Jack A. Davis, USMC (RET.).* MGen. Davis has been a director of Force Protection, Inc. since March 2006 and has a diverse background of senior level management and leadership positions in business, law enforcement and the military. With over 40 years experience, he is highly regarded in each of these fields. MGen. Davis served in the U.S. Marine Corps, both active and reserve, from 1968 to 2005 where he held the rank of Major General. MGen. Davis' career included command at every level from platoon to division in addition to numerous staff assignments. MGen. Davis attended numerous high level schools both here and abroad. MGen. Davis' law enforcement career included both federal and state agencies where he retired in 1999 with 30 years of distinguished service. MGen. Davis is also the founder of J.A. Davis and Associates, a security and leadership training company. In addition to his service with Force Protection, MGen. Davis currently serves on the board of directors of one privately held company and the boards of advisors of three mutually held companies. MGen. Davis holds undergraduate and masters degrees from Indiana State University and a Master of Urban Administration from University of North Carolina, Charlotte.

*Lieutenant General Roger G. Thompson, Jr., USA (RET.).* LTG. Thompson has been a director of Force Protection, Inc. since December 2006. LTG. Thompson is Vice President of the Association of the United States Army where he is responsible for all operational events including symposia, the largest landpower exhibition and conference in North America and four exhibitions in four overseas trade shows. Additionally, he provides executive leadership of 124 AUSA Chapters worldwide and management of membership programs totaling over 5,300 major, midsize and small defense oriented

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companies. He currently serves on the Board of Advisors of a privately held company. A veteran with 34 years of experience on active duty, LTG. Thompson commanded at all levels of the Army, including field artillery and transportation units. While with the Department of Army Staff, LTG. Thompson served as Deputy Assistant Secretary of the Army, Financial Management and Comptroller (Director of the Army Budget). LTG. Thompson completed his military career as the Deputy Commander in Chief, United States Transportation Command. In this position he was responsible for the daily operations supporting all military and commercial transportation for the entire DoD. LTG. Thompson holds a Bachelor of Science from the United States Military Academy, a Master of Business Administration from Syracuse University, and a Master's degree in National Security and Strategic Studies from the Naval War College. He is a graduate of the Army's Command and General Staff College and the Naval War College.

*John S. Day.* Mr. Day has been a director of Force Protection, Inc. since September 2007. Mr. Day has over 30 years of experience in the accounting profession serving a broad range of publicly and privately owned clients. Mr. Day joined Arthur Andersen LLP in 1976 and was admitted as an audit partner in 1986. In 2002, he joined Deloitte & Touche LLP in Atlanta as a Director. Mr. Day retired from Deloitte in December 2005. Mr. Day was appointed to the board of Lenbrook Square Foundation, Inc., a non-profit organization, effective July 1, 2007 where he serves as chairman of the governance committee and a member of the finance committee. Mr. Day holds a Bachelor of Arts in Economics from the University of North Carolina and a Master of Business Administration from Harvard Graduate School of Business.

*John W. Paxton, Sr.* Mr. Paxton has been a director of Force Protection, Inc. since February 2008. He has over 30 years of experience in the aerospace, wireless voice and data, logistics and manufacturing industries. Currently, Mr. Paxton is the Chairman of Pro Mach, Inc., an integrated packaging solutions provider, and is Chairman of Intellicheck/Mobilisa, Inc., a publicly held provider of wireless internet solutions to the DoD. From 2002 until March 2008, Mr. Paxton has been the Chairman of IntelliCheck Mobilisa, Inc. From 1998 until 2002, Mr. Paxton was the Chairman and Chief Executive Officer of Telxon Corporation. Mr. Paxton served on the Board of Directors of TransDigm, Inc., a supplier of proprietary aerospace components used in commercial and military aircraft. Mr. Paxton holds a Bachelor of Science and Master of Science in business administration from LaSalle University, and is a registered professional engineer.

### **Our Board of Directors and Committees**

Our board of directors is divided into three classes, with each class of directors serving a staggered three-year term. Messrs. Day and Paxton are in the class of directors whose term expires in 2011; Mr. Moody and LTG. Thompson are in the class of directors whose term expires 2010; and MGen. Davis is in the class of directors whose term expires 2009.

We have an audit committee and a compensation committee, each of which is composed entirely of directors meeting the applicable independence standards of the Nasdaq Capital Market and the rules and regulations of the Securities Exchange Act of 1934 ("Exchange Act"). Generals Davis and Thompson and Messrs. Day and Paxton are the members of our audit committee. Our board of directors has determined that Mr. Day is an "audit committee financial expert" defined by applicable Securities and Exchange Commission rules. Our compensation committee is comprised of Mr. Paxton and Generals Davis and Thompson.

### **WHERE YOU CAN FIND ADDITIONAL INFORMATION**

Our principal executive offices are located at 9801 Highway 78, Building No. 1, Ladson, South Carolina 29456, and our telephone number is (843) 574-7000. We are subject to the information reporting requirements of the Exchange Act, and, in accordance with these requirements, we file annual, quarterly and other reports, proxy statements and other information with the SEC relating to

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our business, financial results and other matters. The reports, proxy statements and other information we file may be inspected and copied at prescribed rates at the SEC's Public Reference Room and via the SEC's website (see below for more information).

You may inspect a copy of the reports, proxy statements and other information we file with the SEC, without charge, at the SEC's Public Reference Room, 100 F Street, N.E., Room 1580, Washington, D.C. 20549, and you may obtain copies of the reports, proxy statements and other information we file with the SEC, from those offices for a fee. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. Our filings are available to the public at the SEC's website at <http://www.sec.gov>.

Our website address is [www.forceprotection.net](http://www.forceprotection.net). Through a link on the Investor Relations section of our website, we make available the following filings after they are electronically filed with or furnished to the SEC: our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13 or 15(d) of the Exchange Act. All such filings are available free of charge.

### **SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This Annual Report on Form 10-K, including the information incorporated by reference herein, contain both historical and forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended ("Securities Act"), and Section 21E of the Exchange Act. All statements other than statements of historical fact included in this Annual Report on Form 10-K and the documents incorporated by reference in this Annual Report on Form 10-K that address activities, events or developments that we expect, believe or anticipate will or may occur in the future are forward-looking statements including, in particular, the statements about our plans, objectives, strategies and prospects regarding, among other things, our financial position, results of operations, cash flows and business. We have identified some of these forward-looking statements with words like "believe," "may," "will," "should," "expect," "intend," "plan," "predict," "anticipate," "estimate" or "continue" and other words and terms of similar meaning. These forward-looking statements include, among other things:

Statements regarding the growth of the U.S. and world market for blast- and ballistic-protected vehicles and survivability solutions;

Statements regarding the U.S. military's plans or intentions to replace the HMMWV fleet with armored vehicles, including the possible timeframe of this replacement and the potential number of armored vehicles that might be required under this program or other programs;

Information regarding the number of various types of MRAP and other armored vehicles that may be purchased by the U.S. Marine Corps, the U.S. Army and other U.S. and foreign customers under various programs, including the M-ATV, MRAP, GSTAMIDS, JLTV and FMS programs, and the value of vehicles that may be acquired;

Statements with respect to our expectations regarding our ability to obtain materials, components and supplies necessary to manufacture our vehicles, our ability to improve cost efficiencies, including, without limitation, as a result of volume purchasing, improvements in our manufacturing process and possible future changes in the efficiencies in our operations;

Statements regarding any changes in our cost of sales, our general and administrative expenses or our research and development expenses as a percentage of net sales;

Statements regarding the revenues that may be derived from, and the quantities of vehicles that may be purchased or ordered pursuant to, existing or possible future contracts or orders by various customers, including statements regarding the estimated value of those orders and contracts and statements about the amount of vehicles in our backlog and the value of our backlog;



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Statements regarding the effects of rebalancing our workforce and manufacturing capacities;

Statements regarding the benefits that may be realized from our joint partnerships and any new ventures or business developed pursuant to those joint partnerships; and

Statements regarding our ability to utilize net operating loss carry-forwards for income tax purposes.

These forward-looking statements were based on expectations about future events at the time they were made and are subject to numerous uncertainties and factors, all of which are difficult to predict and many of which are beyond our control. Many factors mentioned in our discussion in this Annual Report on Form 10-K and the documents incorporated by or deemed to be incorporated by reference in this Annual Report on Form 10-K, including the risks outlined under Item 1A, *Risk Factors*, will be important in determining future results. We do not know whether the expectations reflected in these forward-looking statements will prove correct. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties, including those described under "Risk Factors" and those discussed in other documents we file with the SEC, which are incorporated or deemed to be incorporated by reference in this Annual Report on Form 10-K.

In addition, this Annual Report on Form 10-K and the documents incorporated by reference herein contain historical information, forecasts and estimates regarding defense expenditures by the U.S. government, actual and anticipated procurement of armored vehicles and similar matters. This historical data and these forecasts and estimates have been obtained from publicly available information, industry publications, trade associations and data compiled by independent market research firms. However, we have not independently verified this information and we cannot assure you that it is accurate or that these forecasts and estimates will prove correct.

When used in this Annual Report on Form 10-K, except as specifically noted otherwise, the term "Force Protection, Inc." refers to Force Protection, Inc. only, and the terms "Company," "we," "our," "ours" and "us" refer to Force Protection, Inc. and its consolidated subsidiaries.

**ITEM 1A. RISK FACTORS**

*The following risk factors and other information included in this Annual Report on Form 10-K should be carefully considered. Please also see "Special Note Regarding Forward-Looking Statements" on page 27.*

**If we are unable to obtain future orders for our vehicles, our financial position, results of operations, and cash flows would be adversely affected and our business may fail.**

Substantially all of our revenue comes from our U.S. government contracts either as a prime contractor or as a subcontractor to another prime contractor to the U.S. government. We received and fulfilled substantial vehicle orders from the U.S. military under the MRAP program, which accounted for substantially all of the increase in our net sales during the year ended December 31, 2008. These orders have resulted, in significant part, from the particular combat situations encountered by the U.S. military in Iraq and Afghanistan, especially the use of IEDs by enemy combatants. We cannot be certain, therefore, to what degree the U.S. military will continue placing orders, and these orders may decrease significantly or cease.

The main uncertainty about our future operations is whether we will continue to receive additional orders or contracts for our vehicles or our survivability solutions. We have no further substantial MRAP vehicle orders to fulfill at this time. Orders for our Cougar variant vehicles will allow us to continue production through the second quarter of 2009 and for our Buffalo vehicles to extend production until the fourth quarter of 2009. It is impossible to predict with certainty whether such future orders or contracts will be placed by existing or new customers. If we do not receive future orders or contracts for production beyond such dates, it is unlikely that our vehicle business will continue and our business

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will be materially affected. Even if we are successful in obtaining contracts, the length of the contract cycle, from testing, pre-production to the delivery of the order when revenue is recognized, may span several months to years. The longer the contract cycle, the greater the opportunity for the customer to cancel the order before we receive payment.

Our largest contract in 2008, in terms of value, was awarded to us by the United Kingdom Ministry of Defence under the FMS program. The FMS UK Contract is for 198 Cougar Mastiffs, a Cougar 6x6 variant, six 4x4 Cougars, and 151 Cougar Ridgbacks, a Cougar 4x4 variant. The FMS UK Contract is administered by the Marine Corps Systems Command and is subject to price definitization.

Our largest contract in 2007, in terms of value, was awarded to us in January 2007 by the U.S. Marine Corps under the MRAP program competitive bidding process. The MRAP Competitive Contract is an ID/IQ contract that allows the U.S. government to order a maximum of 4,100 Cougar vehicles per year for a five-year period. However, the U.S. government is not required to issue any vehicle orders under the MRAP Competitive Contract, and existing orders can be terminated at the convenience of the government before completion. We fulfill the MRAP Competitive Contract with GDLS through the GDLS Subcontract.

Our largest contract in 2006, in terms of value, was awarded to us on a sole source basis in November 2006 by the U.S. Marine Corps under the MRAP Program (the "MRAP Sole-Source Contract"). The MRAP Sole-Source Contract was for our Cougar and Buffalo vehicles and was substantially performed in 2007.

**We rely on sales to the U.S. government, and a failure to obtain new contracts or a reduction of sales under existing contracts with the U.S. government could adversely affect our operating performance and our ability to generate cash flow to fund our operations. The continuation and renewal of contracts with the U.S. government are contingent upon the availability of governmental funding, which may be unpredictable.**

Presently, we derive substantially all of our revenue from contracts and subcontracts with the U.S. government and its agencies, primarily the DoD. We expect that U.S. government contracts, particularly with the DoD, will continue to be our primary source of revenue for the foreseeable future. The continuation and renewal of our existing government contracts and new government contracts are, among other things, contingent upon the availability of adequate funding for various U.S. government agencies, including the DoD. Changes in U.S. government spending could directly affect our operating performance and lead to an unexpected loss of revenue. The loss or significant reduction in government funding of a large program in which we participate could also result in a material decrease to our future sales, earnings and cash flows. U.S. government contracts are also conditioned upon the continuing approval by Congress of the amount of necessary spending. Congress usually appropriates funds for a given program on a September 30 fiscal year basis, even though contract periods of performance may extend over many years. Consequently, at the beginning of a major program, the contract is usually partially funded, and additional monies are normally committed to the contract by the procuring agency only as appropriations are made by Congress for future fiscal years. Among the factors that could impact U.S. government spending and reduce our federal government contracting business include:

A significant decline in, or reapportioning of, spending by the U.S. government, in general, or by the DoD;

Recent constraints on the U.S. budget as a result of the macroeconomic crisis and the federal deficit;

Changes, delays or cancellations of U.S. government programs, requirements or policies;

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The adoption of new laws or regulations that affect companies that provide services to the U.S. government;

U.S. government shutdowns or other delays in the government appropriations process;

Curtailment of the U.S. government's outsourcing of services to private contractors;

Changes in the political climate, including with regard to the funding or operation of the services we provide; and

General economic conditions, including a slowdown in the economy or unstable economic conditions in the United States or in the countries in which we operate.

These or other factors could cause U.S. government agencies to reduce their purchases under our contracts, to exercise their right to terminate our contracts in whole or in part, to issue temporary stop-work orders, or decline to exercise options to renew, our contracts. The loss or significant curtailment of our material government contracts, or our failure to renew existing contracts or enter into new contracts could adversely affect our operating performance and lead to an unexpected loss of revenue.

**Our business may be adversely affected by the severe and rapid downturn in the economy.**

Recently, there has been a severe and rapid downturn in the economy due to a variety of financial conditions, including the sequential effects of the subprime lending crisis, general credit market crisis, collateral effects on the finance and banking industries, volatile energy costs, concerns about inflation, slower economic activity, decreased consumer confidence, reduced corporate profits and capital spending, adverse business conditions and liquidity concerns. These conditions could have an adverse impact on the automotive industry, particularly automotive suppliers and steel manufacturers. We cannot predict the timing or duration of the effects of these conditions on our business. These conditions make it difficult for our vendors and us to accurately forecast, plan and execute certain future business activities. If these conditions affect the ability of our vendors and subcontractors to perform, our business, financial condition, results of operations or cash flows may be materially adversely affected.

Additionally, due to the recent credit crisis and volatility of the U.S. dollar against other currencies in the second half of 2008, our products may become more expensive for customers whose purchases are denominated in U.S. dollars, which may further disadvantage us relative to our competitors or negatively impact our margins.

**We identified material weaknesses in our internal control over financial reporting, which have in the past and in the future could adversely affect our ability to report our financial condition and results of operations accurately or on a timely basis. We concluded that our internal control over financial reporting and our disclosure controls and procedures were not effective as of December 31, 2008 and 2007. As a result, current and potential shareholders could lose confidence in our financial reporting, which could harm our business and the trading price of our stock.**

As discussed in *Controls and Procedures* in Item 9A of this Annual Report on Form 10-K, in the years ended December 31, 2008, 2007 and 2006, we identified material weaknesses in our internal control over financial reporting. As a result, in part because of these material weaknesses, we also concluded that our disclosure controls and procedures were not effective as of December 31, 2008, December 31, 2007 and December 31, 2006.

Each of our material weaknesses results in more than a remote likelihood that a material misstatement of the annual or interim financial statements that we prepare will not be prevented or detected. As a result, we must perform extensive additional work to obtain reasonable assurance

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regarding the reliability of our financial statements. Even with this additional work, there is a risk of additional errors not being prevented or detected, which could result in additional restatements. Moreover, other material weaknesses may be identified.

Material weaknesses in our internal control over financial reporting could adversely impact our ability to provide timely and accurate financial information. If we are unsuccessful in implementing or following our remediation plan, or fail to update our internal control over financial reporting as our business evolves, we may be unable to report financial information timely and accurately or to maintain effective disclosure controls and procedures. Any such failure in the future could also adversely affect the results of periodic management evaluations and annual auditor attestation reports regarding the effectiveness of our internal control over financial reporting required under Section 404 of the Sarbanes-Oxley Act of 2002 and the rules promulgated thereunder and periodic management evaluation of our disclosure controls and procedures. If we are unable to report financial information in a timely and accurate manner or to maintain effective disclosure controls and procedures, we could be subject to, among other things, regulatory or enforcement actions by the SEC and Nasdaq, including a delisting from the Nasdaq Capital Market, securities litigation, and a general loss of investor confidence, any one of which could adversely affect our business prospects and the market value of our common stock.

We also have substantial work remaining to remedy the identified material weaknesses in our internal control over financial reporting and our disclosure controls and procedures and this work will continue during 2009. There can be no assurance as to when all of the material weaknesses will be remedied. Until our remedial efforts are completed, management will continue to devote significant time and attention to these efforts, and we will continue to incur expenses associated with the additional procedures and resources required to prepare our financial statements and to remediate these weaknesses. Certain of our remedial actions will be ongoing and will result in our incurring substantial additional costs even after our material weaknesses are remedied. In addition, there can be no assurance that, as a result of these remediation efforts or otherwise, we will not identify other inaccuracies in either our previous or future financial statements that will require amendments and restatements to those financial statements, which also could have a material adverse effect on us and on the price of our common stock.

Although we have taken steps to correct our material weaknesses, we may still be subject to risks. For a more detailed discussion of our material weaknesses, see Item 9A, *Controls and Procedures*, in this Annual Report on Form 10-K.

**We have started the manufacture and production of certain of our products for which we have no orders. If we do not receive orders for those products, we may incur losses.**

At times, if we believe that there is a probability of selling certain of our vehicles or products, we may commence the manufacture and production of such items without orders. Presently, we are in the process of procuring materials and fabricating approximately 50 Cheetah vehicles in our production facility and in subcontractors' facilities in anticipation of receiving future orders. In the event that we do not receive such orders, we may have excess inventory and incur losses, and, as a result, our business, financial condition, results of operations, or cash flows may be materially adversely affected.

Moreover, we are seeking to sell our Cheetah vehicles to the U.S. military and our future results of operations will depend to a large degree on our ability to sell significant quantities of Cheetah vehicles. Because we have commenced the manufacture and production of our Cheetah vehicles, we have incurred expenses for components, raw material, and other expenses without any orders from customers to purchase the vehicles we manufacture. We may experience difficulties, expenses and delays in starting up production, as we have no prior experience in manufacturing the Cheetah vehicle in commercial quantities and it may take a substantial period of time for us and our employees to achieve requisite efficiencies in producing the Cheetah. To the extent that we do not receive orders for

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the Cheetah in significant quantities, or if we incur delays or unforeseen expenses in connection with outfitting and equipping this facility, our business, prospects, results of operations and financial condition may be materially adversely affected. If these events occur, they could have a material adverse effect on our business, results of operations, financial position and cash flows. In addition, if we are not able to sell the Cheetah in significant quantities or at all, we may not be able to sustain the growth of our business, our net sales may decline and our business may be materially adversely affected.

**Many of the orders for our vehicles are subject to the competitive bidding process, which may cause us to incur substantial costs that we may not be able to recoup.**

We have received contract awards through the competitive bidding process, including the MRAP Competitive Contract, and may continue to do so in the future. The competitive bidding process presents a number of risks, including the following:

We may expend substantial funds, managerial time and effort to prepare bids and proposals for contracts that we may not win;

We may be unable to estimate accurately the resources and costs that will be required to service any contract we win, which could result in substantial cost overruns; and

We may encounter expenses and delays if our competitors protest or challenge awards of contracts to us in competitive bidding, and any such protest or challenge could result in a requirement to resubmit bids on modified specifications or in the termination, reduction or modification of any awarded contract.

**In 2008, we restated our condensed consolidated financial statements and other financial information for the periods ended March 31, 2007, June 30, 2007, and September 30, 2007 and filed separate amended Quarterly Reports on Form 10-Q to reflect the restated condensed consolidated financial statements for such periods. Continued amendments and restatements to our financial statements may result in potential and current shareholders losing confidence in our financial reporting, which could harm our business and the trading price of our stock.**

In addition to the restatement of our financial statements for the quarterly periods in 2007, we previously amended our consolidated financial statements and certain other financial information appearing in our Annual Report on Form 10-K for the year ended December 31, 2006, and restated our consolidated financial statements and certain other financial information appearing in our Annual Report on Form 10-K for the year ended December 31, 2005, and in our Quarterly Report on Form 10-Q for the quarter ended September 30, 2006.

Continued and repeated restatements and amendments to our consolidated financial statements and periodic reports may cause shareholders to lose confidence in our financial reporting, and such loss of confidence could cause the trading price of our stock to become volatile or to decrease.

**We are subject to and may continue to be subject to lawsuits alleging false or misleading public statements and/or omissions concerning our business, internal controls and financial results.**

We are aware that at least ten shareholder class action lawsuits have been initiated seeking damages to recompense those who purchased or otherwise acquired our securities between August 14, 2006, and February 29, 2008, because of a loss in the trading value of our stock. The allegations include, but are not limited to, allegations that certain former and current members of management and the board of directors violated the Exchange Act and made false or misleading public statements or omissions concerning our business, internal controls, and financial results. Shareholders have filed at least seven derivative lawsuits against former and current officers and board members seeking damages

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and other relief; and we have been the subject of other suits, described in more detail in Item 3, *Legal Proceedings*, stemming from weaknesses in our control over financial reporting or from our managerial and compliance processes. It is possible that other litigants may institute additional lawsuits against us as a result of these deficiencies seeking the payment of damages. These lawsuits are likely to be costly to defend and could involve the substantial diversion of management time and resources and have other adverse effects, and we may be required to make substantial payments to settle any such lawsuits or to satisfy any judgments that may be rendered against us.

Our rapid growth placed a great strain on the managerial and compliance processes in place at that time; that, along with the material weaknesses in our internal control over financial reporting, has subjected the Company to increased risk of regulatory enforcement proceedings and private litigation.

**Our business may be materially affected if we are unable to anticipate the demand for and develop acceptable next generation vehicles and other survivability solutions to meet the demands of our customers, or if we are unable to sell next generation vehicles or other survivability solutions in the quantities that we anticipate.**

The future of our business depends on our ability to anticipate threats to the survivability of friendly forces and to develop, test, and be able to produce solutions to counter these threats in a manner that satisfies the cost, performance, and schedule demands of our customers. To the extent that our customers seek additional survivability solutions, we expect to face substantial competition from other companies, many of which have significantly greater financial and other resources than we do, in competing for these orders. Accordingly, if we are unable to develop and design acceptable vehicles and solutions in time to meet the demands of our customers, our net sales may decline in the future. Additionally, if we are unable to sell the next generation of vehicles in the quantities that we anticipate, our inventory and prior capital investments may not be fully utilized and our business may be materially affected.

**Our configuration management process for our fielded fleet is still immature and may result in inadequate delivery of service and repair parts and may decrease our ability to generate life cycle revenue, which could negatively affect our business, financial condition, results of operations, and cash flows.**

As a result of the rapid deployment and demand required by the U.S. military in Iraq and Afghanistan, we have not been able to thoroughly establish our service parts documentation and configuration control; and at times this process is immature and weak. As a result, we may not be able to adequately handle some aftermarket part orders, such as spare parts, and training and field service support, and we could be late or delayed in accepting and delivering aftermarket orders. We are still implementing our service documentation processes and delivery methodologies which could result in increased service costs and a loss of service revenue.

**The DCAA has issued audit reports that have been highly critical of our accounting and price estimating systems, and have questioned our ability to track and report our government contract costs appropriately. As a result, the DCAA could question or disallow our proposed costs under some of our government contracts, and our profits may be adversely affected. In addition, other governmental agencies may audit or issue reports about the status of our contracts.**

U.S. government agencies, generally through the DCAA, routinely audit and investigate government contracts and government contractors' administrative processes and systems. The audits may review the costs we incur on our U.S. government contracts, including allocated indirect costs. The auditor may also review our compliance with applicable laws, government regulations, policies and standards as they relate to cost issues and the adequacy of our internal control systems and policies. An adverse finding under a DCAA audit could result in the disallowance of our costs under a U.S.

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government contract, termination of U.S. government contracts, forfeiture of profits, suspension of payments, fines and suspension or prohibition from doing business with the U.S. government. If any audit uncovers improper or illegal activities, we may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, suspension of payments, fines and suspension or prohibition from doing business with the U.S. government. In addition, responding to governmental audits may involve significant expense and divert management attention.

Moreover, if any of our administrative processes and systems are found not to comply with the applicable requirements, we may be subjected to increased government scrutiny or required to obtain additional governmental approvals that could delay or otherwise adversely affect our ability to compete for or perform contracts. Therefore, an unfavorable outcome to an audit by the DCAA or another government agency, could materially adversely affect our competitive position, effect our ability to obtain the maximum price for our products and services, and result in a substantial reduction of our revenues.

The DCAA issued at least 15 audit reports on our operations and contracts from May of 2004 through February 2009. Certain of these reports have generally been highly critical of the areas covered by the audits, including our job cost accounting and price estimating systems. As a result, the DCAA could question or disallow our proposed costs under some of our government contracts, and our profits may be adversely affected. In addition, other governmental agencies may audit or issue reports about the status of our contracts.

**Presently, all of our contracts are on a fixed-price basis, which could subject us to losses if there are cost overruns.**

Under a fixed-price contract, we receive only the amount indicated in the contract, regardless of the actual cost to produce the goods. While firm fixed-price contracts allow us to benefit from potential cost savings, they also expose us to the risk of cost overruns. If the initial estimates that we use to calculate the contract price and the cost to perform the work prove to be incorrect, we could incur losses. This risk is enhanced because of the deficiencies in our accounting systems described above. In addition, some of our contracts have specific provisions relating to cost, scheduling, and performance. If we fail to meet the terms specified in those contracts, then our cost to perform the work could increase or our price could be reduced, which would adversely affect our financial position and results of operations. We may incur losses on fixed-price contracts that we had expected to be profitable, or such contracts may be less profitable than expected, which could have a material adverse effect on our business, financial condition, results of operations, and cash flows.

**Our results of operations may be adversely affected by the "definitization" of our contracts if we are unable to reserve adequately for payments on these contracts and if we do not maintain accounting systems effective enough to capture all costs incurred under these contracts.**

Many of the contracts we have previously received from the U.S. military have been sole source with a "not to exceed" amount. This type of contract is subject to "definitization," meaning that the contract price is not agreed upon at contract inception. Instead, following award of the contract, we and the U.S. government seek to agree upon a contract price based upon our cost of performing the contract. During the definitization process, we are required to perform the contract work, make deliveries and receive payments from the U.S. military before the final contract price has been established. For this reason, as part of the original award, we provide a NTE price to be used for invoicing and accounting purposes pending definitization. As a result, at the completion of the contract, we may have received overpayments during the course of the contract and will be required to return any overpayments to the U.S. military.

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As result of the potential adjustments related to the definitization process, we maintain a separate account for payments received for contracts that may be subject to definitization. The definitization process can be time-consuming and completion can take extensive periods of time. Although we work diligently with our customers to proceed with significant work when we have a fully definitized task order, we cannot assure you that there will not be withholdings on future task orders.

Accordingly, there can be no assurance that the actual prices we receive under contracts subject to definitization will not be substantially less than our estimates, which would adversely affect our operating results and could result in losses. At the end of 2007, we had definitized all outstanding contracts. However, as of December 31, 2008, we had nine delivery orders that were still subject to the definitization process and may continue to be subject to the definitization process.

**We rely on subcontractors to manufacture or perform some of the assembly of our vehicles and the loss of any critical subcontractors could delay our manufacturing operations, which could affect our ability to meet our contract delivery requirements to our customers; in addition subcontractors may attempt to increase the amounts they charge us, adversely affecting our operating results.**

Some of the major work processes performed in our vehicle manufacturing are done by subcontractors. For example, a portion of the capsules of our Cougars are shipped to Spartan Chassis, Inc. ("Spartan") in Charlotte, Michigan, which supplies and installs the engine, transmission, transfer case, drive shafts, differentials, axle assemblies, tires, fuel tank, steering, and associated mechanical and electrical hardware. Additionally, under our GDLS Subcontract, GDLS and Spartan (as a subcontractor to GDLS) perform the final assembly of a portion of these vehicles (windows, doors, external appurtenances, hatches, seats, fenders, lights, paint, and other final assembly hardware). If these, or any other critical subcontractor, cease doing business with us (whether voluntarily or due to other events), we would be required to locate a substitute subcontractor or perform the work ourselves. Further, any inability of these subcontractors to perform these services in a timely manner may result in a delay in deliveries to our customers.

The amounts we pay to some of these subcontractors represent a very significant portion of the overall costs of our Cougar vehicles. However, certain of our subcontractors have not entered into subcontracts with us to provide these services, although in some cases we do have purchase orders covering basic terms such as price or quantities but other terms and conditions have yet to be agreed upon. This means that we may have issues regarding some terms and conditions, any of which could have a material adverse affect on our business and results of operations.

**Changes in the pace of operations in Iraq or Afghanistan or the duration of involvement by the U.S. military and foreign militaries in areas of conflict could have an impact on contracts for our spare parts and sustainment services.**

Any changes in the pace of operations in theater or the length of the duration of the U.S. military and foreign military involvement in areas of conflict will have a direct impact on the usage of our vehicles and products, and subsequently the support required to sustain these vehicles. Political pressure, the success of the current operations, changes in tactics of the insurgency, and other factors make it difficult to ascertain the required sustaining services our customers will require from Force Protection.

Additionally, the United States recently elected a new President and other government legislators. The economic, defense spending and taxing policies of the new government may have an adverse impact on our future business, prospects and results of operations. Until the new legislative agenda is finalized and enacted, it is not possible to determine the impact of such changes, if any.

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**We may require additional capital to provide for our working capital needs.**

We may require substantial additional capital to provide for our working capital and other cash needs. See Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources*, contained elsewhere herein. We may seek to obtain this additional capital through, among other things, borrowings or the issuance of debt or equity securities. There can be no assurance that we will be able to obtain any such additional capital on acceptable terms or at all. Presently, the credit markets and the financial services industry have been experiencing a period of unprecedented turmoil characterized by the bankruptcy, failure, collapse or sale of various financial institutions and an unprecedented level of intervention from the federal government. While the ultimate outcome of these events cannot be predicted, such events may have a material adverse effect on our ability to obtain additional capital. Any inability to obtain additional capital as and when required could have a material adverse effect on our business, prospects and results of operations.

We currently have a \$40 million credit facility with Wachovia Bank that expires on April 30, 2010, that provides us with the ability to obtain capital if cash available from other sources is insufficient to meet our needs. The current global financial crisis could adversely affect our ability to access the funds available under this credit facility.

In the event that we are not able to renew this credit facility or obtain another credit facility, we will not have the ability to make revolving credit borrowings to finance our business, which could have a material adverse effect on our financial position, results of operations, and cash flows. To date, we have not borrowed any funds under this credit facility.

Borrowings under our existing credit facility bear interest at variable rates, and borrowings we incur in the future may also bear interest at variable rates, which exposes us to the risk of increased interest rates. In addition, our existing credit facility is secured by an interest in all of our personal property and fixtures, and any debt instruments we enter into in the future may also be secured by our assets, which may make it more difficult for us to obtain additional debt financing.

**We may experience supply interruptions for certain components used in the manufacture and sustainment of our products, which could cause delays in production, product deliveries and the sustainment of our vehicles.**

In the event that we are unable to obtain required components from our existing suppliers, and if we are unable to mitigate the impact or find an alternate supplier in a timely manner, it could have a material adverse effect on our ability to produce our vehicles and provide sustainment. Significant interruptions in the supply of components may occur for a variety of reasons, including capacity constraints at our suppliers, competition for components with other manufacturers of vehicles, insolvency of a supplier, work stoppages at suppliers and transportation interruptions, which could involve significant additional costs and result in delays in production, product deliveries and sustainment and could have a material adverse effect on our results of operations. In addition, the unavailability or scarcity of certain components or raw material could result in increased costs, which could adversely affect our results of operations.

In addition, the economic distress of suppliers, particularly suppliers in the automotive industry, due to the current economic climate may in the future require us to provide financial support or take other measures to ensure our receipt of components or materials. We may experience commodity cost pressures and the effects of overcapacity in the automobile industry. These factors have also increased pressure on the industry's supply base, as suppliers cope with higher commodity costs, lower production volumes and other challenges. As a result, suppliers may be less able to absorb commodity cost increases or to achieve productivity improvements, and, therefore, less willing to reduce prices to us.

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**Our ability to operate effectively could be impaired if we were to lose the services of our key personnel, or if we are unable to recruit qualified managers and key personnel in the future. Moreover, a number of our officers and other key employees have joined our Company recently, and therefore have only limited experience with our business.**

Our success depends on the continued service of our management team and certain key personnel in our engineering department. If one or more of these individuals were unable to continue working due to health reasons, or were to resign or otherwise terminate their employment with us, we could experience a loss of sales, delays in new product development and diversion of management resources, and we may have difficulty replacing any of these individuals. We do not have key person insurance on any of our executive employees. Competition for qualified managers and key personnel is intense and we may not be able to recruit and retain such personnel. If we are unable to retain our existing managers and employees or hire and integrate new personnel, we may experience operating inefficiencies, production delays and reduced profitability or losses.

In addition, a number of our officers and key employees have joined our company recently, and therefore have limited experience with our business, personnel, and administrative systems. The ability of new management to articulate and implement their strategic vision, and to integrate effectively into our business, personnel, and administrative systems, is critical to our success.

**Our U.S. government contracts may be terminated or adversely modified prior to completion, which could adversely affect our business.**

Congress funds the vast majority of the federal budget on an annual basis, and Congress often does not provide agencies with all the money requested in their budget. Many of our contracts cover multiple years and, as such, are not fully funded at contract award. If Congress or one of our agency customers chooses to spend money on other programs, our contracts may be terminated. Federal laws, collectively called the Anti-Deficiency Act, prohibit involving the government in any obligation to pay money before funds have been appropriated for that purpose, unless otherwise allowed by law. Therefore, the Anti-Deficiency Act indirectly regulates how the agencies award our contracts and pays our invoices.

Federal government contracts generally contain provisions, and are subject to laws and regulations, that provide the federal government rights and remedies not typically found in commercial contracts, including provisions permitting the federal government to, among other provisions: terminate our existing contracts for convenience; unilaterally modify some of the terms and conditions in our existing contracts; subject the award to protest or challenge by competitors; suspend work under existing multiple year contracts and related delivery orders; and claim rights in technologies and systems invented, developed or produced by us.

The federal government may terminate a contract with us either "for convenience" (for instance, due to a change in its perceived needs) or if we default due to our failure or the failure of a workshare partner or subcontractor to perform under the contract. If the federal government terminates a contract with us for convenience, we generally would be entitled to recover only our incurred or committed costs, settlement expenses and profit on the work completed prior to termination. However, under certain circumstances, our recovery costs upon termination for convenience of such a contract may be limited. If the federal government terminates a contract with us based upon our default, we generally would be denied any recovery for undelivered work, and instead may be liable for excess costs incurred by the federal government in procuring undelivered items from an alternative source. As is common with government contractors, we have experienced and continue to experience occasional performance issues under some of our contracts. We have in the past received and may in the future receive show-cause or cure notices under contracts that, if not addressed to the federal government's

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satisfaction, could give the government the right to terminate those contracts for default or to cease procuring our services under those contracts.

U.S. government contracts and subcontracts typically involve long purchase and payment cycles, competitive bidding, qualification requirements, delays or changes in funding, extensive specification development, price negotiations and milestone requirements. In addition, the proposed transition in the United States to fund military and defense operations from emergency supplemental spending bills to the regular defense budget may have unknown consequences on military spending. Each U.S. government agency often also maintains its own rules and regulations with which we must comply and which can vary significantly among agencies.

**Our backlog is subject to uncertainties, and we may not sell or receive payment for all of the vehicles we have included in backlog, which would reduce our revenue in future periods.**

Our backlog reflects the number of vehicles for which we have received orders, but have not yet delivered, as of a specified date. Our backlog is subject to uncertainties, and there can be no assurance that we will deliver or receive payment for the vehicles we have included in our backlog. As a result, there is no certainty about our future revenues because the timing of any of these vehicles sales and revenues is subject to various contingencies, such as production difficulties, raw material shortages and quality acceptance. If we fail to sell vehicles included in our backlog, our revenues and operating results could be materially adversely affected.

**We must comply with numerous miscellaneous federal national security laws, regulations, and procedures, as well as the rules and regulations of foreign jurisdictions, and our failure to comply could adversely affect our business.**

We must observe laws and regulations relating to the formation, administration and performance of federal government contracts that affect how we do business with our clients and impose added costs on our business. For example, the FAR and the industrial security regulations of the DoD and related laws include provisions that:

Allow our federal government clients to terminate or not renew our contracts if we come under foreign ownership, control or influence;

Require us to prevent unauthorized access to classified information; and

Require us to comply with laws and regulations intended to promote various social or economic goals.

We are subject to industrial security regulations of the DoD and other federal agencies that are designed to safeguard against foreigners' access to classified information. As we expand our operations internationally, we will also become subject to the rules and regulations of foreign jurisdictions. If we were to come under foreign ownership, control or influence, we could lose our facility security clearances, which could result in our federal government customers terminating or deciding not to renew our contracts, and could impair our ability to obtain new contracts.

Our failure to comply with applicable laws, regulations or procedures, including federal regulations regarding the protection of classified information, could result in contract termination, loss of security clearances, suspension or prohibition from contracting with the federal government, civil fines and damages and criminal prosecution and penalties, any of which would materially adversely affect our business.

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**If we do not receive additional orders, we may have excess manufacturing capacity. If demand for our vehicles declines, we may have additional inefficient or under-utilized capacity, and our gross margins and cash flows may suffer and we may incur losses.**

In response to the increased demand for our blast- and ballistic-protected vehicles, we added significant manufacturing capacity during each of the past several years. Demand for our vehicles may not remain at levels sufficient to utilize our present manufacturing capacity. Much of our manufacturing facilities and production equipment are special purpose in nature and cannot be adapted easily to make other products. If the demand for mine-protected vehicles does not increase or declines substantially from current levels, we may have significant under-utilized capacity. Therefore, a substantial decline in demand for our blast- and ballistic-protected vehicles could result in significant additional excess manufacturing capacity, which would adversely affect our results of operations and could result in losses.

**We are currently under directives to improve our compliance policies and procedures concerning activity regulated by the International Traffic in Arms Regulations.**

In December 2007, we submitted a voluntary disclosure to the DDTC regarding the shipment of technical manuals, Cheetah spare parts, armored vest plates, parts not listed on our license and transfers of technical data to and by our vendors without proper authorization or identification of the appropriate exemption. In January, 2008, the DDTC requested additional information and documentation for each specific shipment of these items within sixty days. In addition, the DDTC directed us to undertake certain specific measures, including, but not limited to, that we hire a full time senior export control compliance officer, implement certain procedures, conduct comprehensive ITAR training, immediately conduct a comprehensive export compliance audit, and institute a plan to conduct periodic audits of the export compliance program. On February 11, 2008, we provided DDTC with the job description for the Director of Export Controls, draft Export Controls Manual, ITAR presentation provided in new orientation training and the attendance logs for annual ITAR training provided to executives and other employees having ITAR responsibilities. On March 11, 2008, we provided DDTC with our draft audit plan and on June 2, 2008, we provided the final audit report. On July 14, 2008, we provided DDTC with supplemental information to our previous voluntary disclosure and other information identified in the audit. We have developed and implemented an Export Control Policies and Procedures Manual and ITAR Product Classification Guide, established an Export Control Council, and revised our Technology Control Plan and Code of Conduct and Ethics. As a result of the export compliance audit, we have identified additional unauthorized transfers internally at our facility and in support of U.S. operations in Iraq and Afghanistan as well as issues associated with the execution of our licenses and agreements. We have reported these matters to DDTC. On October 27, 2008, we received a letter from the DDTC advising that, following our voluntary disclosure, this matter has been closed without taking any civil penalties, but reserving the right to reopen if circumstances warrant. We have also identified additional export compliance matters that may warrant disclosure to DDTC. Although we are in the process of addressing these measures, we cannot assure you that we will be able to correct the weakness in our compliance program.

Compliance with the directives of the DDTC may result in substantial expenses and diversion of management. Any failure to adequately address the directives of DDTC could result civil fines or suspension or loss of our export privileges, any of which could have a material adverse effect on our business or financial position, results of operations, or cash flows.

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**We are now a large business under applicable U.S. government regulations and may be precluded from being awarded new contracts with the U.S. government unless our accounting and estimating systems are improved sufficiently to meet government standards.**

In order to enter into certain contracts with the U.S. military, a contractor's accounting and estimating systems must generally meet the standards established by the FAR, and, with regard to certain types of contracts, CAS. Compliance is usually reviewed by the DCAA, an arm of the DoD. Contractors who do not meet these standards generally are not eligible to win certain new contracts from the U.S. government.

Because we previously were a small business within the meaning of applicable federal regulations, we were not required to comply with the accounting and estimating requirements in order to enter into contracts with the U.S. military. However, as a result of the growth of our business, as of November 14, 2007, we are no longer considered a small business and we therefore are required to meet these additional accounting and estimating standards to the extent that they apply to new contracts that we are awarded after November 14, 2007. We have been advised by the DCAA that our accounting and estimating systems do not meet these requirements and, although we have been seeking to improve these systems, we have extensive work remaining in order to meet these standards. There can be no assurance as to when we will be able to meet these standards and, until we are able to do so, we may not be eligible for new contract awards by the U.S. military. Accordingly, any failure to meet these standards will likely have a material adverse effect on our business. In that regard, we continue to enhance our accounting system; however, there is some uncertainty as to whether our system will be capable of generating the data necessary to comply with these standards. If our accounting system is inadequate for these purposes, we could incur substantial delays and additional expenses through efforts to remedy those deficiencies or acquire and implement a new accounting system.

CAS requires us to maintain detailed accounting records. Given the material weaknesses in our internal control over financial reporting and other deficiencies in our accounting system described below under Item 9A, *Controls and Procedures*, there can be no assurance that we will be successful in complying with CAS.

CAS is designed to achieve uniformity and consistency in the measurement, assignment, and allocation of costs to U.S. government contracts. CAS-covered contractors must complete a disclosure statement, which is a written description of the contractor's cost accounting practices and procedures. The purpose of the disclosure statement is to determine whether the contractor's cost accounting practices and procedures are consistently applied and whether they comply with CAS provisions. If the contractor fails to comply with CAS provisions, the U.S. government may withhold up to ten percent of each payment due until the necessary corrections are made. If a contractor fails to provide accurate information, under certain circumstances, the U.S. government can make unilateral adjustments. Additionally, DCAA may require more frequent updates if audits reveal non-compliant CAS submissions and accounting. We submitted a CAS disclosure statement to DCAA on May 19, 2008, with an effective date of June 1, 2008. On November 11, 2008, we received an audit report that stated that our submission did not adequately describe our accounting systems. We are in the process of updating our disclosure statement. To the extent that CAS requirements apply to future contracts awarded to us, we will be required to satisfy more difficult U.S. government accounting requirements than have previously applied, and a failure by us to comply with these new requirements may have consequences that would have a material adverse effect on our business.

**If we fail to comply with complex procurement laws and regulations, we could lose business and be liable for various penalties or sanctions.**

We must comply with laws and regulations relating to the formation, administration and performance of federal government contracts. These laws and regulations affect how we conduct

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business with our federal government contracts. In complying with these laws and regulations, we may incur additional costs, and non-compliance may also allow for the assignment of additional fines and penalties, including contractual damages. Among the more significant laws and regulations affecting our business are the following:

The Federal Acquisition Regulation, which comprehensively regulates the formation, administration and performance of federal government contracts;

The Truth in Negotiations Act, which requires certification and disclosure of all cost or pricing data in connection with certain negotiated contracts;

The Cost Accounting Standards and Cost Principles, which impose accounting requirements that govern our right to reimbursement under certain cost-based federal government contracts; and

Laws, regulations and executive orders restricting the use and dissemination of information classified for national security purposes and the export of certain products, services and technical data. We engage in international work falling under the jurisdiction of U.S. export control laws. Failure to comply with these control regimes can lead to severe penalties, both civil and criminal, and can include debarment from contracting with the U.S. government.

Our contracting agency customers periodically review our performance under and compliance with the terms of our federal government contracts, and we may be required to disclose certain types of alleged misconduct with regard to our federal government contracts. If a government review or investigation or Company disclosure results in a finding of improper or illegal activities, we may be subject to civil or criminal penalties or administrative sanctions, including

Termination of contracts;

Forfeiture of profits;

Cost associated with triggering of price reduction clauses;

Suspension of payments;

Fines; and

Suspension or debarment from doing business with federal government agencies.

Additionally, the civil False Claims Act provides for potentially substantial civil penalties where, for example, a contractor presents a false or fraudulent claim to the government for payment or approval. Actions under the civil False Claims Act may be brought by the government or by other persons on behalf of the government (who may then share a portion of any recovery).

If we fail to comply with these laws and regulations, we may also suffer harm to our reputation, which could impair our ability to win awards of contracts in the future or receive renewals of existing contracts. If we are subject to civil and criminal penalties and administrative sanctions or suffer harm to our reputation, our current business, future prospects, financial condition, or operating results could be materially harmed.

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The government may also revise its procurement practices or adopt new contracting rules and regulations, including cost accounting standards, at any time. Any new contracting methods could be costly to satisfy, administratively difficult for us to implement and could impair our ability to obtain new contracts.

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**We are presently subject to a number of legal proceedings and claims and we may become subject to additional legal proceedings and claims in the future.**

We have been named in several purported class actions brought by shareholders who purchased or otherwise acquired our securities between 2006 and 2008, alleging violations of the Exchange Act, and making false and misleading public statements and/or omissions. Other shareholders have named us and certain current and former officers and directors in derivative suits alleging breaches of fiduciary duties. We have also been subject to a variety of other lawsuits, including claims involving the use of our confidential information and trade secrets, Equal Employment Opportunity Commission claims, contractual claims, claims related to our common shares, OSHA claims and claims by the Department of State, Directorate of Defense Trade Controls ("DDTC"). Litigation and regulatory inquiries of these types are often expensive and time consuming and their outcome is uncertain.

Such claims and regulatory inquiries, whether successful or not, could require us to devote significant amounts of monetary or human resources to defend ourselves and could harm our reputation. We may need to spend significant amounts on our legal defense, senior management may be required to divert their attention from other portions of our business, new product launches may be deferred or canceled as a result of any proceedings, and we may be required to make changes to our present and planned products or services. If, as a result of any proceedings, a settlement is reached, a judgment is rendered or a decree is entered against us, it could materially and adversely affect our business, financial condition and results of operations and harm our reputation.

We are also a party to other litigation which we consider routine and incidental to our business. We may be involved from time to time in other litigation that could have a material effect on our operations or finances. Other than the litigation described above, we are not aware of any pending or threatened litigation against us that could have a material adverse effect on our business or financial position, results of operations, or cash flows.

See Item 3, *Legal Proceedings* in Part I of this Annual Report on Form 10-K.

**We may not be able to adequately safeguard our intellectual property rights and trade secrets from unauthorized use, and we may become subject to claims that we infringe on others' intellectual property rights.**

We rely on a combination of patents, trade secrets, trademarks, and other intellectual property laws, licensing agreements, nondisclosure agreements with employees and customers and other protective measures to preserve our proprietary rights to our products and production processes. Our pending patent applications may not be granted by the various patent offices examining them. Even if our patent applications are granted and issued as patents, these measures afford only limited protection and may not preclude competitors from developing products or processes similar or superior to ours. Moreover, the laws of certain foreign countries do not protect intellectual property rights to the same extent as the laws of the United States.

Although we implement protective measures and intend to defend our proprietary rights, these efforts may not be successful. From time to time, we may litigate within the United States or abroad to enforce our issued or licensed patents, to protect our trade secrets and know-how or to determine the enforceability, scope and validity of our proprietary rights and the proprietary rights of others. For example, we were recently engaged in a lawsuit in which we alleged misappropriation of our intellectual property. See Item 3, *Legal Proceedings*. Enforcing or defending our proprietary rights could be expensive, requires management's attention and might not bring us timely or effective relief.

We are party to two long-term intellectual property agreements pursuant to which we have the exclusive right to use certain intellectual property technology relating to blast- and ballistic-protected vehicles through 2011 and 2012, respectively. See Item 1, *Business Intellectual Property* for a further

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discussion of these agreements with CSIR and Mechem. In the event that the license agreements expire without renewal, CSIR and Mechem may permit other parties to use the licensed technology, including our competitors. The loss of these intellectual property rights may adversely affect our operations.

Furthermore, third parties may assert that our products or processes infringe their patent or other intellectual property rights. Our patents may be challenged, invalidated or circumvented. Infringement claims against us could result in substantial costs and diversion of our resources even if we ultimately prevail. A third party claiming infringement may also obtain an injunction or other equitable relief, which could effectively block the distribution or sale of allegedly infringing products. Although we may seek licenses from third parties covering intellectual property that we are allegedly infringing, we may not be able to obtain any such licenses on acceptable terms, if at all.

**Our products are subject to export limitations and we may be prevented from shipping our products to certain nations or buyers.**

We are subject to federal licensing requirements with respect to the sale and support in foreign countries of certain of our products and the importation of components for our products. In addition, we are obligated to comply with a variety of federal, state and local regulations, both domestically and abroad, governing certain aspects of our international sales and support, including regulations promulgated by, among others, the U.S. Departments of Commerce, Defense and State and the U.S. Department of Justice, Bureau of Alcohol, Tobacco, Firearms and Explosives.

Such licenses may be denied for reasons of U.S. national security or foreign policy. In the case of certain large orders for exports of defense equipment, the Department of State must notify Congress at least 15 to 30 days, depending on the size and location of the sale, prior to authorizing certain sales of defense equipment and services to foreign governments. During that time, Congress may take action to block the proposed sale. We can give no assurance that we will continue to be successful in obtaining the necessary licenses or authorizations or that Congress will not prevent or delay certain sales. Any significant impairment of our ability to sell products outside of the U.S. could negatively impact our results of operations and financial condition.

For products and technology exported from the U.S. or otherwise subject to U.S. jurisdiction, we are subject to U.S. laws and regulations governing international trade and exports, including, but not limited to ITAR, EAR, or FMS, program and trade sanctions against embargoed countries and destinations administered by OFAC, U.S. Department of the Treasury. We have discovered shortcomings in our export compliance procedures. We are currently analyzing product shipments and technology transfers, working with U.S. government officials to ensure compliance with applicable U.S. export laws and regulations, and enhancing our export compliance system. We have made voluntary disclosures to the Department of State and provided additional documentation to the U.S. Department of State regarding compliance issues. The State Department personnel visited our facilities in December 2007 as part of the State Department company visit program for a further review of our export control policies and procedures, as well as their implementation. The voluntary disclosures that have been finally adjudicated by the U.S. Department of State did not result in any monetary fines or restrictions on exports. The U.S. Department of State recommended enhancements to our compliance program, some of which we have implemented and others which we are implementing. We are currently reviewing additional compliance information and will file voluntary disclosures if warranted. A determination by the U.S. government that we have failed to comply with one or more of these export controls or trade sanctions, as a consequence of the results of the directed disclosure or any other violations that may be determined, could result in civil or criminal penalties, including the imposition of significant fines, denial of export privileges, loss of revenues from certain customers, and debarment from participation in U.S. government contracts. Any one or more of these sanctions could have a material adverse effect on our business, financial condition and results of operations.

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We are subject to the FCPA and other laws which prohibit improper payments to foreign governments and their officials by U.S. and other business entities. We operate in countries known to experience corruption. Our operations in such countries create the risk of an unauthorized payment by one of our employees or agents which would be in violation of various laws including the FCPA. Violations of the FCPA may result in severe criminal penalties which could have a material adverse effect on our business, financial condition and results of operations. In that regard, we do not have a formal FCPA compliance program.

Additionally, the failure to obtain applicable governmental approval and clearances could materially adversely affect our ability to continue to service the government contracts we maintain. Exports of some of our products to certain international destinations may require shipment authorization from U.S. export control authorities, including the U.S. Departments of Commerce and State, and authorizations may be conditioned on end-use restrictions. Failure to receive these authorizations may materially adversely affect our revenues and in turn our business, financial condition, results of operations, and cash flows.

Our international business may pose greater risks than our domestic business due to the greater potential for changes in foreign economic and political environments. Our international business is also highly sensitive to changes in foreign national priorities and government budgets. Sales of military products are affected by defense budgets (both in the U.S. and abroad) and U.S. foreign policy.

Sales of our products and services internationally are subject to U.S. and local government regulations and procurement policies and practices including regulations relating to import-export control.

**Risks Related to our Common Stock**

**Our articles of incorporation authorize the issuance of shares of blank check preferred stock.**

Under the terms of our articles of incorporation, our board of directors is authorized to issue from time to time, without any need for approval by our shareholders but subject to any limitations prescribed by law, shares of our preferred stock in one or more series. Each series shall consist of such number of shares and have the rights, preferences, powers and restrictions, such as dividend rights and preferences, conversion rights, voting rights, terms of redemption and liquidation rights and preferences, as our board of directors shall determine. Such shares of preferred stock could have preferences over our common stock with respect to dividends and liquidation rights. The board of directors may issue preferred stock with voting, conversion or other rights that may have the effect of delaying, deferring or preventing a change in control of the Company and that could adversely affect the market price of the common stock and the voting and other rights of the holders of common stock.

**Our stock price has been volatile, and the value of an investment in our common stock may decline.**

The market price and trading volume of our common stock has been subject to significant volatility, and this trend may continue. For example, in the last quarter of fiscal year 2008, the price of our common stock ranged from \$1.70 to \$6.03. The value of our common stock may decline regardless of our operating performance or prospects. Factors affecting our market price include, but are not limited to, our failure to meet expectations regarding new orders or sales of our vehicles; differences between our reported results and those expected by investors and securities analysts; announcements of new contracts or orders by us or our competitors; and market reaction to any future acquisitions, joint ventures or strategic investments announced by us or our competitors.

Recent events have caused stock prices for many companies, including ours, to fluctuate in ways unrelated or disproportionate to their operating performance. The general economic, political and stock market conditions that may affect the market price of our common stock are beyond our control. The

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continued credit crisis and related turmoil in the global financial markets has had and may continue to have an impact on our stock price. The market price of our common stock at any particular time may not remain the market price in the future. In the past, securities class action litigation has been instituted against companies following periods of volatility in the market price of their securities. Any such litigation, if instituted against us, could result in substantial costs and a diversion of management's attention and resources.

**Anti-takeover provisions in our articles of incorporation and by-laws, as well as Nevada Corporation Law, could make it difficult for our shareholders to replace or remove our current board of directors or have the effect of discouraging, delaying or preventing a merger or acquisition, which could adversely affect the market price of our common stock.**

As discussed above, our board of directors is empowered to issue preferred stock in one or more series without shareholder approval. Any issuance of this "blank check" preferred stock could materially limit the rights of holders of the common stock and render more difficult or discourage an attempt to obtain control of us by means of a tender offer, merger, proxy contest or otherwise. In addition, our articles of incorporation and by-laws contain a number of provisions that could impede a takeover or change in control of us, including our staggered board, limitation on the ability of our shareholders to act by written consent, advance notice provisions and the ability for the board of directors to fill a vacancy on our board of directors.

Certain provisions of the Nevada General Corporation Law could also discourage takeover attempts that have not been approved by our board of directors or shareholders. These provisions relate to, among other things, the acquisition of a controlling interest in a Nevada corporation meeting certain requirements or certain business combinations and other transactions between a Nevada corporation and certain "interested stockholders."

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2. PROPERTIES**

We have determined that our space is adequate for our current needs. We currently have excess manufacturing capacity. See Item 1A, *Risk Factors* for a discussion of our excess manufacturing capacity.

We currently have five leases for approximately 543,000 square feet of space in four buildings located on a single campus in Ladson, South Carolina, for our executive offices and to manufacture our Buffalo and Cougar vehicles, designated Building #1 (office), Building #1 (industrial), Building #2, Building #3 and Building #6. Each lease contains four five-year options that must be exercised six months prior to expiration. On December 22, 2008, we renewed all of these leases, with the exception of Building # 3, for an additional five year term. The leases for Building # 1 (office and industrial), Building # 2 and Building # 6 expire on June 30, 2014. The lease for Building # 3 was extended on March 5, 2009 for an additional six months and presently expires on December 31, 2009.

On March 9, 2007, we purchased a blast range of approximately 306 acres in Edgefield County, South Carolina, along with the purchase of selected assets, and acquired a lease of an office building with a lease term ending December 31, 2008. We are currently in the process of renewing this lease. We use these facilities for our own research and development activities and may also contract with selected governmental and commercial customers to use our facilities.

On March 22, 2007, we entered into an asset purchase agreement including an assignment and assumption of the lease for an approximately 60,000 square foot facility in Summerville, South

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Carolina, for the intended purpose of expanding research and development operations and to facilitate increased customer training requirements of products and applications. In 2007, we moved the research and development operations previously housed in Building #3 in Ladson, South Carolina, to this facility.

On July 12, 2007, we purchased an approximately 430,000 square foot facility in Roxboro, North Carolina, which we had intended to utilize to manufacture our Cheetah vehicle. We currently intend to use this facility for training purposes.

On November 11, 2008, we leased an approximately 9,700 square foot office in Sterling Heights, Michigan for offsite engineering with a three year term commencing on December 15, 2008 with two options to renew with a term of one year each.

On October 20, 2008, we leased an approximately 900 square foot office in the Washington, DC vicinity with a 12-month term.

On January 27, 2009, we leased an office and warehouse space of approximately 18,000 square feet in North Charleston, South Carolina for a two year term with three options to renew with a term of two years each.

### **ITEM 3. LEGAL PROCEEDINGS**

#### *Shareholder Class Action and Derivative Complaints*

On March 10, 2008, the first of ten related class action lawsuits was filed against us and certain of our former and current board members or officers in the United States District Court for the District of South Carolina Charleston Division on behalf of a proposed class of investors who purchased or otherwise acquired our securities during the period between August 14, 2006, and February 29, 2008. The complaints seek class certification, and the allegations include, but are not limited to, allegations that the defendants violated the Exchange Act and made false or misleading public statements and/or omissions concerning our business, internal controls, and financial results. The plaintiffs assert that as a result of the defendants' allegedly wrongful acts and omissions, members of the proposed class have suffered significant losses and damages. The individual class action lawsuits were consolidated on June 10, 2008, under the caption 'In Re Force Protection, Inc. Securities Litigation, Action No. 2:08-cv-845-CWH.' On June 20, 2008, a group of investors consisting of the Laborers' Annuity and Benefit System of Chicago, Gary Trautman, David J. Jager, Bhadra Shah, Panteli Poulikakos, George Poulikakos, and Niki Poulikakos were appointed lead plaintiff.

Between March 27, 2008, and May 28, 2008, various alleged shareholders filed derivative lawsuits against former and current officers or board members wherein the plaintiff shareholders are seeking damages for the Company. The Company has been named a nominal defendant in each derivative lawsuit. Four derivative lawsuits are pending in the United States District Court for the District of South Carolina Charleston Division; two derivative lawsuits are pending in Charleston, South Carolina Circuit Court; and one derivative lawsuit is pending in Clark County, Nevada District Court. The plaintiff shareholders' allegations include and are not limited to allegations of breach of fiduciary duties, abuse of control, gross mismanagement, waste of corporate assets, and unjust enrichment in connection with the Company's public statements regarding its operations and financial results, internal controls, compensation of certain defendants, and alleged insider stock sales by certain defendants. In August and September 2008, the defendants filed motions to dismiss the derivative lawsuits pending in the Charleston, South Carolina Circuit Court and the Clark County, Nevada District Court. The motions filed in the Clark County, Nevada District Court were denied on February 10, 2009. On February 10, 2009, the defendants' joint motion to dismiss the plaintiffs' derivative complaints filed in the Charleston, South Carolina Circuit court was denied as it relates to the Stevenson et al lawsuits and granted without prejudice as it relates to the Hughes et al lawsuit with leave granted to the Hughes et

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al plaintiffs to modify their complaint accordingly. Defendants' obligations to respond to the complaints in the derivative lawsuits pending in the United States District Court for the District of South Carolina have been suspended pending a ruling on motions filed by certain plaintiffs seeking consolidation of the lawsuits and appointment of a lead plaintiff.

*Other Disputes*

On August 21, 2007, we filed suit against Protected Vehicles, Inc. ("PVI") and three of PVI's employees (all of whom were former employees of Force Protection) in the United States District Court for the District of South Carolina. In the complaint, we alleged that the named defendants used our confidential information and trade secrets to create a competing business. We sought injunctive relief, unspecified damages, attorneys' fees and costs. The defendants answered our complaint and filed counterclaims against us. In their answers and counterclaims, the defendants alleged, among other things, that we and several of our current and former officers and directors engaged in: certain transactions (including transactions with Force Protection) in which such officers and directors maintained a financial interest; backdating and certain other improper acts in connection with certain stock issuances; allegedly wrongful acts with respect to a procurement contract with a foreign government; and other transactions involving alleged self-dealing and certain allegedly retaliatory acts in connection with defendants' prior attempts to bring such activities to the attention of the Company's personnel or governmental agencies. Defendants sought unspecified monetary damages, attorneys' fees and costs. On January 18, 2008, the district court entered an order staying the litigation in light of an involuntary bankruptcy petition filed on January 15, 2008, in the United States Bankruptcy Court for the District of South Carolina with respect to PVI. On February 5, 2008, PVI filed a voluntary Chapter 7 petition. On March 28, 2008, the Chapter 7 proceeding was converted to a Chapter 11 proceeding. On June 20, 2008, the Bankruptcy Court remanded the litigation back to the District Court, and on September 3, 2008, the bulk of PVI's assets, including certain rights and liabilities with respect to our suit against it, were sold to a third party. On July 31, 2008, we settled our claim against one of the employees, and we rehired him on October 13, 2008. As of February 2, 2009 Force Protection Industries, Inc. and Force Protection, Inc. entered into a settlement agreement with defendants, including the third-party purchaser, in which the defendants agreed to identify and return all our property and refrain from using it in the future, and agreed to dismiss all claims against us. The settlement agreement and release was approved by the United States Bankruptcy Court on February 19, 2009, and became effective on March 6, 2009.

From February 2007 through January 2009, we received a total of 70 complaints from current and former employees filed with the United States Equal Employment Opportunity Commission alleging, among other things, race and/or gender discrimination. We have responded to the complaints as such responses have become due, and are investigating the allegations.

On November 13, 2007, we were served with a lawsuit filed by former senior employee against Force Protection Inc., Force Protection Industries, Inc. and former Force Protection officers. The complaint, filed in the Charleston (South Carolina) County Court of Common Pleas, alleges, among other things, that former employee is owed warrants of approximately 83,000 shares of our common stock and certain back wages and sets forth claims for, *inter alia*, breach of contract, violation of the South Carolina Payment of Wages Act, retaliatory wrongful discharge, and defamation. We answered the complaint on January 25, 2008. We entered into a settlement agreement and general release with the former employee on March 13, 2009.

In early December 2007, we submitted a voluntary disclosure to DDTC regarding the shipment of technical manuals, Cheetah spare parts, armored vest plates, parts not listed on our license and transfers of technical data to and by our vendors without proper authorization or identification of the appropriate exemption. On January 22, 2008, the DDTC requested additional information and documentation for each specific shipment of these items within sixty days. In addition, the DDTC

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directed us to undertake certain specific measures, including, but not limited to, that we hire a full time senior export control compliance officer, implement certain procedures, conduct comprehensive ITAR training, immediately conduct a comprehensive export compliance audit, and institute a plan to conduct periodic audits of the export compliance program. On February 11, 2008, we provided DDTC with the job description for the Director of Export Controls, draft Export Controls Manual, ITAR presentation provided in new orientation training and the attendance logs for annual ITAR training provided to executives and other employees having ITAR responsibilities. On March 11, 2008, we provided DDTC with our draft audit plan and on June 2, 2008, we provided the final audit report. In response, we have hired an executive director of export controls. On July 14, 2008, we provided DDTC with supplemental information to our previous voluntary disclosure and other information identified in the audit. We have developed and implemented an Export Control Policies and Procedures Manual and ITAR Product Classification Guide, established an Export Control Council, and revised our Technology Control Plan and Code of Conduct and Ethics. As a result of the export compliance audit, we have identified additional unauthorized transfers internally at our facility and in support of U.S. operations in Iraq and Afghanistan as well as issues associated with the execution of our licenses and agreements. We have reported these matters to DDTC. On October 27, 2008, we received a letter from the DDTC advising that, following this voluntary disclosure, this matter has been closed without taking any civil penalties, but reserving the right to reopen if circumstances warrant.

On February 8, 2008, a temporary independent contractor whose services we had terminated filed a complaint with OSHA which alleges a violation under the employee protection provisions of Section 806 of the Corporate and Criminal Fraud Accountability Act of 2002, Title VIII of the Sarbanes-Oxley Act of 2002, 18 U.S.C. §1514A. The former independent contractor alleges that we terminated his engagement in retaliation for his allegation of certain corporate governance, government contracting, accounting and other irregularities. On April 18, 2008, we responded to the allegations. In August 2008 the claimant submitted a proposed amended complaint which sought to add additional claims and the current and former chief executive officers as defendants. On October 2, 2008, Force Protection and individuals submitted a further response. On November 20, 2008, the claimant exercised his rights under Section 806 to withdraw his claim from the Department of Labor, stating that he had decided instead to pursue his claims in a lawsuit in federal district court. As a result of the claimant's election, the Department of Labor terminated its processing of the matter at that time. However, to date we have not received any notice that the claimant has filed any lawsuit.

On August 15, 2008, we received a \$1.1 million notice of claim of lien for the balance of tooling supplied by a vendor to our prime contractor on the Roxboro Facility. We have demanded that the prime contractor resolve this matter with its vendor and indemnify us for this claim of lien.

On October 14, 2008, we settled a claim for \$583,000 by several investors in connection with the conversion of their shares of our preferred stock and alleged damages relating to warrants the investors allege were granted but never distributed to them.

Although we intend to defend ourselves in connection with the foregoing legal proceedings and claims, there can be no assurance that we will ultimately prevail in any of these matters. Moreover, the defense of these claims and proceedings may result in substantial legal expenses and diversion of our management, and any settlement or adverse judgment may require us to make substantial payments, any of which could have a material adverse effect on our business or financial position, results of operations, or cash flows.

In addition, compliance with the directives of the DDTC discussed above may result in substantial expenses and diversion of management. Any failure to adequately address the directives of DDTC could result in civil fines or suspension or loss of our export privileges, any of which could have a material adverse effect on our business or financial position, results of operations, or cash flows.

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We are also a party to other litigation which we consider routine and incidental to our business. We may be involved from time to time in other litigation that could have a material effect on our operations or finances. Other than the litigation described above, we are not aware of any pending or threatened litigation against us that could have a material adverse effect on our business or financial position, results of operations, or cash flows.

See Item 1A, *Risk Factors* in Part I of this Annual Report of Form 10-K.

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

We held our 2008 Annual Meeting of Shareholders on November 21, 2008. Our shareholders approved each of the following proposals by the votes specified below.

Proposal No. 1 The election of two nominees as Class III Directors to the Board of Directors for a term of three years.

| Nominee             | For        | Withheld  | Percentage |
|---------------------|------------|-----------|------------|
| John S. Day         | 56,067,795 | 2,832,020 | 95.1%      |
| John W. Paxton, Sr. | 56,048,443 | 2,851,372 | 95.1%      |

After the 2008 Annual Meeting of Shareholders, Major General Jack A. Davis, USMC (RET.) continued his term as a Class I Director serving until the 2009 Annual Meeting of Shareholders and Michael Moody and Lieutenant General Roger G. Thompson, Jr., USA (RET.) continued their terms as Class II Directors serving until the 2010 Annual Meeting of Shareholders.

Proposal No. 2 The approval of the proposed amendments to Force Protection, Inc.'s Amended Articles of Incorporation.

| For        | Against   | Abstain |
|------------|-----------|---------|
| 56,910,726 | 1,989,087 | 272,698 |

Proposal No. 3 The ratification of the Audit Committee's appointment of Grant Thornton LLP, as Force Protection, Inc.'s independent registered public accounting firm for the fiscal year ended December 31, 2007, and the fiscal year ending December 31, 2008.

| For        | Against | Abstain |
|------------|---------|---------|
| 58,436,468 | 310,687 | 152,660 |

Proposal No. 4 The approval of the Force Protection, Inc. 2008 Stock Plan.

| For        | Against   | Abstain |
|------------|-----------|---------|
| 30,403,919 | 5,966,515 | 175,267 |

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Our common stock has been listed on the Nasdaq Capital Market under the trading symbol "FRPT" since January 18, 2007. Prior to that time, our common stock was traded on the OTC Bulletin Board under the symbol "FRCP.OB" and subsequently changed to "FRPT.OB."

The following table reflects, for periods from and after January 18, 2007, the reported high and low sales prices of our common stock on the Nasdaq Capital Market and, for periods prior to that date, the reported high and low bid prices as reported on the OTC Bulletin Board. While listed on the OTC Bulletin Board, bid and ask quotations for our common shares were submitted by certain broker dealers who are members of the Financial Industry Regulatory Authority ("FINRA"), or its predecessor, the National Association of Securities Dealers, Inc. These quotations of our stock price while listed on the OTC Bulletin Board reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not represent actual transactions.

|                                             | <b>High</b> | <b>Low</b> |
|---------------------------------------------|-------------|------------|
| <b>2007</b>                                 |             |            |
| First Quarter (through January 17, 2007)    | \$ 24.30    | \$ 17.48   |
| First Quarter (commencing January 18, 2007) | \$ 22.95    | \$ 14.55   |
| Second Quarter                              | \$ 31.16    | \$ 18.40   |
| Third Quarter                               | \$ 24.50    | \$ 13.92   |
| Fourth Quarter                              | \$ 25.25    | \$ 3.89    |
| <b>2008</b>                                 |             |            |
| First Quarter                               | \$ 5.74     | \$ 1.03    |
| Second Quarter                              | \$ 4.80     | \$ 2.00    |
| Third Quarter                               | \$ 4.40     | \$ 2.22    |
| Fourth Quarter                              | \$ 6.03     | \$ 1.70    |

We estimate that there were 180 shareholders of record of our common stock as of March 20, 2009.

**Dividend Policy**

We have never paid nor declared any cash dividends on our common stock. We currently intend to retain earnings, if any, to finance the growth and development of our business, and we do not expect to pay any cash dividends on our common stock in the foreseeable future. Payment of future dividends, if any, will be at the discretion of the board of directors and will depend on our financial position, results of operations, capital requirements, restrictions contained in current or future financing instruments, and other factors the board considers relevant.

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**Performance Graph**

*Comparison of five-year cumulative return among Force Protection, Inc., the S&P 600 Small Cap and the S&P Small Cap Aerospace and Defense Indices, and the Peer Group*

The annual changes for the five-year period shown in the graph below are based on the assumption that \$100 had been invested in each of our common stock, the S&P 600 Small Cap Index, the S&P 600 Small Cap Aerospace and Defense Index and the Peer Group on December 31, 2003, and that all quarterly dividends were reinvested at the average of the closing stock prices at the beginning and end of the quarter. The total cumulative dollar returns shown on the graph represent the value that such investments would have had on December 31, 2008, assuming reinvestment of all dividends.

**Force Protection, Inc., S&P 600 Small Cap Index,  
S&P 600 Small Cap Aerospace and Defense Index and Peer Group<sup>(1)</sup>.**

| <b>Date</b>   | <b>Force<br/>Protection,<br/>Inc.</b> | <b>S&amp;P 600<br/>Small<br/>Cap</b> | <b>S&amp;P 600<br/>Small<br/>Cap<br/>Aerospace<br/>and Defense</b> | <b>Peer<br/>Group</b> |
|---------------|---------------------------------------|--------------------------------------|--------------------------------------------------------------------|-----------------------|
| December 2003 | \$ 100.00                             | \$100.00                             | \$ 100.00                                                          | \$ 100.00             |
| December 2004 | \$ 397.14                             | \$122.60                             | \$ 131.77                                                          | \$ 135.63             |
| December 2005 | \$ 92.86                              | \$132.00                             | \$ 133.21                                                          | \$ 143.91             |
| December 2006 | \$ 2072.62                            | \$151.93                             | \$ 155.34                                                          | \$ 176.86             |
| December 2007 | \$ 557.14                             | \$151.48                             | \$ 206.92                                                          | \$ 237.26             |
| December 2008 | \$ 711.90                             | \$104.42                             | \$ 133.33                                                          | \$ 147.59             |

(1) Total shareholder return assuming \$100 invested on December 31, 2003 and reinvestment of dividends on quarterly basis.



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**Peer Group**

The peer issuers included in the Peer Group are set forth below.

|                            |                              |                              |
|----------------------------|------------------------------|------------------------------|
| AAR Corp                   | DynCorp International        | Moog, Inc.                   |
| Ceradyne, Inc.             | Esterline Technologies Corp. | Orbital Sciences Corporation |
| Cubic Corporation          | GenCorp Inc.                 | Teledyne Technologies Inc.   |
| Curtiss-Wright Corporation | HEICO Corp.                  | TransDigm Group, Inc.        |
| Ducommun, Inc              | Hexcel Corp.                 | Triumph Group, Inc.          |
|                            | LMI Aerospace, Inc.          |                              |

We compared our stock performance with the S&P 600 Small Cap Index, the S&P 600 Small Cap Aerospace and Defense Index and the Peer Group. We believe these peer groups more closely reflect our business and, as a result, provide a more meaningful comparison of our stock performance. The comparison for each of the periods assumes that \$100 was invested on December 31, 2003, in our common stock, the stocks included in each of the indices and the peer group and that all dividends were reinvested. The stock performance shown on the graph above is not necessarily indicative of future price performance.

**Recent Sales of Unregistered Securities**

On each of January 11, 2008 and January 1, 2007, we issued an employee 50,000 shares of unregistered company stock pursuant to a Board resolution dated July 7, 2006.

With respect to the sales of our common stock described above, we relied on the Section 4(2) exemption from securities registration under the federal securities laws for transactions not involving any public offering. No advertising or general solicitation was employed in offering the shares. The shares were sold to accredited investors. The shares were offered for investment purposes only and not for the purpose of resale or distribution, and the transfer thereof was appropriately restricted by us.

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**ITEM 6. SELECTED FINANCIAL DATA**

We derived the selected historical consolidated financial data presented below from our audited consolidated financial statements and related notes included elsewhere in this Annual Report on Form 10-K. You should refer to Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, in Part II of this Annual Report on Form 10-K and the notes to our accompanying consolidated financial statements for additional information regarding the financial data presented below, including matters that might cause this data not to be indicative of our future financial condition or results of operations. In addition, you should note the following information regarding the selected historical consolidated financial data presented below.

The net income (loss) available to common shareholders for the years ended December 31, 2006, and 2005 was impacted by dividends and accretion for our Series D 6% convertible preferred stock. For additional information see Note 12, *Earnings Per Common Share*, to our accompanying consolidated financial statements.

As of December 31, 2006, we removed the valuation allowance from the deferred tax asset as we expect to be able to utilize our net operating loss carry-forwards for federal income tax purposes. For additional information see Note 11, *Income Taxes*, to our accompanying consolidated financial statements.

| As of and for the year ended December 31,          | 2008         | 2007       | 2006       | 2005       | 2004      |
|----------------------------------------------------|--------------|------------|------------|------------|-----------|
| (In thousands, except per share data)              |              |            |            |            |           |
| <b>Results of operations</b>                       |              |            |            |            |           |
| Net sales                                          | \$ 1,326,331 | \$ 890,672 | \$ 196,017 | \$ 49,713  | \$ 10,273 |
| Operating income (loss)                            | 68,452       | 5,773      | 6,636      | (15,630)   | (11,839)  |
| Income (loss) before income tax (expense) benefit  | 69,583       | 9,373      | 5,870      | (14,405)   | (11,954)  |
| Income tax (expense) benefit                       | (22,664)     | (1,721)    | 12,327     |            |           |
| Net income (loss)                                  | 46,919       | 7,652      | 18,197     | (14,405)   | (11,954)  |
| Net income (loss) available to common shareholders | 46,919       | 7,652      | 16,574     | (17,225)   | (11,954)  |
| Basic earnings (loss) per common share             | 0.69         | 0.11       | 0.37       | (0.51)     | (0.62)    |
| Diluted earnings (loss) per common share           | \$ 0.69      | \$ 0.11    | \$ 0.36    | \$ (0.51)  | \$ (0.62) |
| Weighted average common shares outstanding:        |              |            |            |            |           |
| Basic                                              | 68,314       | 68,054     | 44,786     | 33,927     | 19,358    |
| Diluted                                            | 68,393       | 68,404     | 50,428     | 33,927     | 19,358    |
| <b>Financial Position at Year-End</b>              |              |            |            |            |           |
| Property and equipment, net                        | \$ 61,429    | \$ 66,707  | \$ 8,964   | \$ 2,139   | \$ 1,037  |
| Total assets                                       | 418,024      | 474,670    | 280,414    | 39,777     | 13,627    |
| Current liabilities                                | 136,417      | 242,746    | 62,392     | 38,372     | 10,958    |
| Other long-term liabilities                        | 139          | 295        | 168        |            | 111       |
| Convertible preferred stock <sup>(a)</sup>         |              |            |            | 7,901      |           |
| Shareholders' equity (deficit)                     | \$ 278,327   | \$ 231,629 | \$ 217,854 | \$ (6,497) | \$ 2,558  |

(a) We recorded the Series D 6% convertible preferred stock as mezzanine equity on our consolidated balance sheet as of December 31, 2005.

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**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is designed to provide information that is supplemental to, and should be read together with, our consolidated financial statements and the accompanying notes contained in this Annual Report on Form 10-K. Information in this Item 7 is intended to assist the reader in obtaining an understanding of our consolidated financial statements, the changes in certain key items in those financial statements from year to year, the primary factors that accounted for those changes, and any known trends or uncertainties that we are aware of that may have a material effect on our future performance, as well as how certain accounting principles affect our consolidated financial statements. MD&A includes the following sections:

Highlights and Executive Summary

Overview

Our Business

Business Model and Key Concepts

Key Challenges

Strategy and Key Trends

Results of Operations an analysis of our consolidated results of operations, for the three years presented in our consolidated financial statements

Liquidity and Capital Resources an analysis of the effect of our operating, financing and investing activities on our liquidity and capital resources

Off-Balance Sheet Arrangements a discussion of such commitments and arrangements

Contractual Obligations a summary of our aggregate contractual obligations

Dividends our dividend history

Critical Accounting Policies and Estimates a discussion of accounting policies that require significant judgments and estimates

New Accounting Pronouncements a summary and discussion of our plans for the adoption of new accounting standards relevant to us

*The following discussion contains forward-looking statements that reflect our plans, estimates and beliefs. Our actual results could differ materially from those discussed in these forward-looking statements. Factors that could cause or contribute to these differences include, but are not limited to, those discussed below and elsewhere in this Annual Report on Form 10-K, particularly in "Special Note Regarding Forward-Looking Statements," "Market Data" and "Risk Factors."*

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References herein to the term "Force Protection, Inc." refers to Force Protection, Inc. only, and references to the "Company," "Force Protection," "we," "our" or "us" refer to Force Protection, Inc. and its subsidiaries unless the context specifically indicates otherwise.

### Highlights and Executive Summary

We are in the business of providing survivability solutions to support armed forces and security personnel in harm's way. We design, manufacture, test, deliver and support our blast- and ballistic-protected products to increase survivability of the users of our products. Our specialty vehicles, which we believe are at the forefront of blast- and ballistic-protected technology, are designed to protect their

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occupants from landmines, hostile fire, and improvised explosive devices ("IEDs"). In addition, we develop, manufacture, test, deliver and support products aimed at further enhancing the survivability of vehicles against additional threats. Our patented ForceArmor is designed to provide protection against explosively formed projectiles ("EFPs"). We are a key provider of the U.S. military's Mine Resistant Ambush Protected ("MRAP") vehicle program and have sold over 3,000 vehicles under this program. We also provide our Cougar Mastiff, Cougar Ridgback, Cougar Wolfhound, and Buffalo mine protected vehicles to the United Kingdom Ministry of Defence.

During the period January 1, 2008, through December 31, 2008, we received orders for 474 vehicles. During this same period we delivered 2,067 vehicles under the MRAP and other blast- and ballistic-protected vehicle programs, including vehicles manufactured pursuant to the terms of our arrangement with General Dynamics Land Systems Inc. ("GDLS") (described further in Item 1, *Business, Major Contracts* under "MRAP Competitive Contract.") During the period January 1, 2008 through December 31, 2008, we also delivered eight ForceArmor kits, as well as \$188 million in spare parts and \$56 million in mechanical field services. During the period January 1, 2007 through December 31, 2007, we delivered 1,558 vehicles under blast- and ballistic-protected vehicle programs.

Through an acquisition in 2002, we began shifting our principal focus from our then existing recreational watercraft production business to the production of mine clearing and armored vehicles. Our business began to grow exponentially when we were awarded contracts by the U.S. military in 2005 and each year after that. By 2008, substantially all of our net sales were derived from work performed directly or indirectly under U.S. government contracts. For the years ended December 31, 2008, 2007 and 2006, our net sales totaled \$1.3 billion, \$891 million, and \$196 million, respectively, and our net income totaled \$46.9 million, \$7.7 million, and \$18.2 million, respectively.

**Overview**

All of our products are aimed at offering improved protection to personnel operating in areas posing threats of blast- or ballistic- attack. Since the early stages of Operation Iraqi and Operation Enduring Freedom, the U.S. military has sought a wheeled vehicle approach that balances three potentially competing operational or mission dynamics: (i) protection, which refers to the level of crew survivability against blast- and ballistic- attack; (ii) payload, which refers to the load that the vehicles can carry on board the platform, measured in units, such as crew members and cargo; and (iii) performance, which refers to a vehicle's automotive mobility, its ability to provide technological solutions to mission requirements, and its suitability for transportation in existing military aircraft and ships.

We currently offer the following vehicle types aimed at fulfilling different operational or mission requirements:

The Buffalo platform;

The Cougar platform; and

The Cheetah platform.

We also currently offer ForceArmor as an external bolt-on solution, which provides state-of-the-art protection against attack by EFPs. ForceArmor is designed of commercially available materials that, when combined and packaged into a kit, offer lightweight bolt-on solutions that can be tailored to bolt on to the outside of any military vehicle platform. It is a modular solution that enables unit commanders to rapidly install or remove the kit depending on the threat they face. We also offer products and solutions which are aimed at enhancing the survivability of vehicles against further attacks, such as our Life Cycle Support and ForceArmor .

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We are headquartered, and have manufacturing facilities, in Ladson, South Carolina. In March 2007, we purchased a blast range in Edgefield, South Carolina, and leased a related office building. We use these facilities for our own research and development activities and may also contract with selected governmental and commercial customers to use our facilities. We also purchased, in March 2007, a facility in Summerville, South Carolina, for the intended purpose of expanding research and development operations and to facilitate our increased customer training requirements of products and applications. In July 2007, we purchased an additional facility in Roxboro, North Carolina. We intend to use this facility for training and sustainment purposes. In January 2008, we leased a small furnished office space in Sterling Heights, Michigan, for use as an offsite engineering office.

### **Our Business**

#### *Business Model and Key Concepts*

Our business is heavily influenced by the needs of the U.S. military for blast- and ballistic-protected wheeled vehicles. The DoD is our largest customer. For the past several years, substantially all of our net sales have been derived from the U.S. government. We align our workforce to satisfy our business requirements.

#### *Key Challenges*

Our rapid growth has come with numerous challenges. Coupled with our reliance on the U.S. military for substantially all of our business, we have identified the following key challenges to continued success:

Continuing to capture contract awards for our products and services in a volatile marketplace;

Competing for life cycle logistics support for our fielded fleet of vehicles;

Establishing long term programs to include upgrades, remanufacture, and sustainment for our fleet of vehicles;

Continuing the expansion of our customer base both domestically and internationally;

Continuing the development of new products to bring to market; and

Eliminating or reducing internal control weaknesses over financial reporting and disclosure.

As discussed in Item 1A, *Risk Factors*, the main uncertainty about our future operations is whether we will continue to receive additional orders or contracts for our vehicles or our survivability solutions. We have no further substantial MRAP vehicle orders to fulfill at this time. Orders for our Cougar variant vehicles will allow us to continue production through the second quarter of 2009 and for our Buffalo vehicles to extend production until the fourth quarter of 2009. It is impossible to predict with certainty whether such future orders or contracts will be placed by existing or new customers. If we do not receive future orders or contracts for production beyond such dates, it is unlikely that our vehicle business will continue and our business will be materially affected.

As discussed in Item 1A, *Risk Factors*, substantially all of our income comes from our U.S. government contracts either as a prime contractor or as a subcontractor to another prime contractor to the U.S. government. We received and fulfilled substantial vehicle orders from the U.S. military under the MRAP program, which accounted for substantially all of the increase in our net sales during the year ended December 31, 2008. These orders have resulted, in significant part, from the particular combat situations encountered by the U.S. military in Iraq and Afghanistan, especially the use of IEDs by enemy combatants. We cannot be certain, therefore, to what degree the U.S. military will continue placing orders, and these orders may decrease significantly or cease. The loss or significant reduction in

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government funding of a large program in which we participate could also result in a material decrease to our future sales, earnings and cash flows.

As discussed in Item 1A, *Risk Factors*, we have identified material weaknesses in our internal control over financial reporting and have concluded that our disclosure controls were not effective as of December 31, 2008, and although we have taken steps to correct our material weaknesses, we may still be subject to risks. If we are unsuccessful in implementing or following our remediation plan, or fail to update our internal control over financial reporting as our business evolves, we may be unable to report financial information timely and accurately or to maintain effective internal controls and procedures. There can be no assurance that, as a result of these remediation efforts or otherwise, we will not identify other inaccuracies in either our previous or future financial statements that will require amendments and restatements to those financial statements, which could have a material adverse effect on us and the price of our common stock.

During 2008, we sought to stabilize our business to match our contract delivery order requirements. We recognized that our business was changing, and in response, we are attempting to rebalance our workforce and manufacturing capacity. We may incur costs as a result of our efforts to recalibrate our business to meet the needs of our customers. In addition, in the past three years we had sought to rapidly expand and develop our operations and production capacity. We have incurred costs and are continuing to incur significant costs associated with our rapid expansion based on the expectation of future contract revenues. We are still experiencing and may continue to experience certain effects from this rapid growth, such as payments under severance arrangements and the costs associated with excess manufacturing capacity and inventory. This growth had placed significant demands on our management and our administrative, operating, manufacturing and financial resources. In addition, our accounting and financial systems need to be substantially improved in order to accommodate our current and projected production levels and to support our government compliance requirements now that we are classified as a large business under applicable federal contracting regulations. We continue to face challenges in improving our administrative, operating, managerial, accounting and financial systems to accommodate our current and projected production levels.

*Strategy and Key Trends*

Strategy

Our business strategy is built around three main imperatives: first, constant focus on innovation and the introduction of new survivability products and solutions; second, expand our customer base; and third, procure contracts for sustainment services of our fleet of vehicles across all customers. Specific components of the strategy, discussed in greater detail in Item 1, *Business*, include the following:

Identify new products and markets to meet evolving customer requirements;

Capitalize on demand for blast- and ballistic-protected vehicles and other survivability solutions;

Expand our total life cycle support footprint;

Focus on core competencies;

Leverage key relationships to grow our business; and

Develop and expand strategic partnerships.

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## Key Trends

For periods subsequent to 2008, certain factors are expected to affect our results of operations as compared to results reported herein for 2006 through 2008. Some of these factors are:

Likely reduction of combat forces using our vehicles in Iraq will reduce the operational tempo placed on our fleet;

An increase in forces deploying to Afghanistan will necessitate changes to the vehicles and increased sustainment/maintenance requirements;

Declining defense budgets may have an impact on planned future defense procurement needs; and

Our current customers establishing long term plans and visibility for their fleets of our vehicles.

## **Results of Operations**

The following discussion and analysis is based on our consolidated statements of operations, which reflect our results of operations for the years ended December 31, 2008, 2007 and 2006, as prepared in accordance with GAAP.

The following tables present our vehicle sales and our results of operations for the three years ended December 31, 2008, 2007 and 2006, as well as the percentage changes from year to year:

|                             | For the year ended<br>December 31, |                    |                    | Percentage<br>Change |                     |
|-----------------------------|------------------------------------|--------------------|--------------------|----------------------|---------------------|
|                             | 2008                               | 2007               | 2006               | 2008<br>vs.<br>2007  | 2007<br>vs.<br>2006 |
| <b>Units Sold</b>           |                                    |                    |                    |                      |                     |
| Buffalo                     | 81                                 | 85                 | 28                 | (5)%                 | 204%                |
| Cougar (MRAP Competitive)*  | 1,724                              | 1,165              |                    | 48%                  | n/m                 |
| Cougar (all other variants) | 262                                | 308 <sup>(a)</sup> | 199 <sup>(a)</sup> | (15)%                | 55%                 |
| <br>Total units sold        | <br>2,067                          | <br>1,558          | <br>227            | <br>33%              | <br>586%            |

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n/m not meaningful

\*

includes 905 and 461 vehicles produced by GDLS for the years ended December 31, 2008 and 2007, respectively.

(a)

Excludes ILAV vehicles, for which we act as a subcontractor to primarily provide labor only for a portion of the production of the vehicles. As a result, we have also reduced the previously reported units sold for Cougar (all other variants) and total units sold by 99 and 58 units for the years ended December 31, 2007 and 2006, respectively.

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| (in thousands)                                       | For the year ended December 31, |            |            | Percentage Change |               |
|------------------------------------------------------|---------------------------------|------------|------------|-------------------|---------------|
|                                                      | 2008                            | 2007       | 2006       | 2008 vs. 2007     | 2007 vs. 2006 |
| Net sales                                            | \$ 1,326,331                    | \$ 890,672 | \$ 196,017 | 49%               | 354%          |
| Cost of sales                                        | 1,149,670                       | 786,803    | 158,994    | 46%               | 395%          |
| Gross profit                                         | 176,661                         | 103,869    | 37,023     | 70%               | 181%          |
| General and administrative expenses                  | 93,950                          | 84,044     | 27,183     | 12%               | 209%          |
| Research and development expenses                    | 14,259                          | 14,052     | 3,204      | 1%                | 339%          |
| Operating income                                     | 68,452                          | 5,773      | 6,636      | 1,086%            | (13)%         |
| Other income, net                                    | 1,463                           | 4,209      | 963        | (65)%             | 337%          |
| Interest expense                                     | (332)                           | (609)      | (1,729)    | (45)%             | (65)%         |
| Income before income tax (expense) benefit           | 69,583                          | 9,373      | 5,870      | 642%              | 60%           |
| Income tax (expense) benefit                         | (22,664)                        | (1,721)    | 12,327     | 1,217%            | 114%          |
| Net income                                           | 46,919                          | 7,652      | 18,197     | 513%              | (58)%         |
| Accretion of Series D 6% convertible preferred stock |                                 |            | (1,297)    | n/a               | n/m           |
| Preferred stock dividend                             |                                 |            | (326)      | n/a               | n/m           |
| Net income available to common shareholders          | \$ 46,919                       | \$ 7,652   | \$ 16,574  | 513%              | (54)%         |

n/m not meaningful

### Results of Operations for the Year Ended December 31, 2008 Compared to the Year Ended December 31, 2007

#### Units sold

The increase in vehicles sold in 2008 compared to 2007 is primarily due to vehicles sold pursuant to the contracts awarded to us under the MRAP program. The vehicles sold pursuant to our MRAP Competitive Contract, which started shipping in the first quarter of 2007, represent 1,724 or 83% of the vehicles sold in 2008, compared to 1,165 or 75% of the vehicles sold in 2007.

#### Net sales

The increase in net sales for the year ended December 31, 2008 compared with the year ended December 31, 2007 is attributable to an increase in the volume of vehicle deliveries, spare parts, and logistics services (field service representatives, training, ILAV subcontractor revenues and technical publications). The mix of vehicles delivered and spare parts and logistics sales are set forth in the following table:

| (in thousands)                       | For the year ended December 31, |            | Percentage Change |
|--------------------------------------|---------------------------------|------------|-------------------|
|                                      | 2008                            | 2007       |                   |
| Buffalo                              | \$ 57,034                       | \$ 58,360  | (2)%              |
| Cougar (all variants) <sup>(a)</sup> | 1,015,619                       | 741,036    | 37%               |
| Spare parts and logistics            | 253,678                         | 91,276     | 178%              |
|                                      | \$ 1,326,331                    | \$ 890,672 | 49%               |

(a)

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Revenue for ILAV for which we act as a subcontractor to primarily provide labor only for a portion of the production of the vehicles is excluded from Cougar (all variants) revenue and included in spare parts, upgrades and services revenue. As a result, we have reclassified

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\$13.8 million from Cougar (all variants) to spare parts, upgrades and services revenue for the year ended December 31, 2007. Additionally, we have reclassified \$5.6 million and \$468,000 for the three months ended March 31, 2008 and June 30, 2008, respectively. The 2008 reclassifications are reflected in the amounts reported here for the year ended December 31, 2008.

### *Cost of sales and Gross profit*

| (in thousands)                            | For the year ended<br>December 31, |            |
|-------------------------------------------|------------------------------------|------------|
|                                           | 2008                               | 2007       |
| Cost of sales                             | \$ 1,149,670                       | \$ 786,803 |
| Gross profit                              | \$ 176,661                         | \$ 103,869 |
| Gross profit as a percentage of net sales | 13.3%                              | 11.7%      |

The gross profit as a percentage of net sales increased by 1.6 percentage points for the year ended December 31, 2008 compared with the year ended December 31, 2007. The increase was primarily a result of several factors:

- (1) cost savings resulting from increased material and labor efficiencies;
- (2) increased higher profit margin sales of spare parts and training services versus vehicle sales;
- (3) \$9.2 million lower write-down of our raw material and supplies to their net realizable values in 2008, net of items used in production of \$5.7 million of parts that had been previously written down; and
- (4) \$5.7 million lower losses on purchase commitments.

These increases were partially offset by increased GDLS Subcontract activity, whereby we recognized minimal gross profit in 2008 and no gross profit in 2007 on vehicles produced by GDLS. The revenue on vehicles produced by GDLS totaled \$479.5 million and \$228.1 million for the years ended December 31, 2008 and 2007, respectively.

### *General and administrative expenses*

| (in thousands)                      | For the year ended<br>December 31, |           |
|-------------------------------------|------------------------------------|-----------|
|                                     | 2008                               | 2007      |
| General and administrative expenses | \$ 93,950                          | \$ 84,044 |
| As a percentage of net sales        | 7.1%                               | 9.4%      |

General and administrative expenses increased by approximately \$9.9 million for the year ended December 31, 2008 compared with the year ended December 31, 2007. Demand for our blast- and ballistic-protected vehicles was substantially unchanged during 2008. We produced and shipped 1,162 vehicles (excluding those produced by GDLS) in 2008 versus 1,097 vehicles (excluding those produced by GDLS) in 2007, or an increase of 6%. The increase in general and administrative expense was primarily due to increased use of outside services in 2008 to restate each of the interim periods of 2007, related litigation and other litigation; costs related to excess capacity and impairment of certain Roxboro, North Carolina facility assets; the costs of right sizing of our workforce by over 600 full-time equivalent positions to more closely align with current and anticipated reduced future business levels; implementation of a short-term incentive compensation plan for executives; and a one-time contribution to the Medical University of South Carolina Foundation for brain trauma research. These increases were partially offset by the absence of a liquidated damage charge incurred during the year ended December 31, 2007 related to our December 2006 Private Investment in Public Entity ("PIPE")

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stock offering because the registration statement for the PIPE shares was not declared effective within the required time frame.

Significant year-over-year cost increases included: legal fees (\$6.2 million), impairment charges (\$4.9 million), consulting fees (\$4.3 million), audit fees (\$4.0 million), gain share and short-term incentive compensation (\$3.9 million), severance expenses (\$2.6 million), and charitable contributions (\$1.5 million). These increases were partially offset by the following year-over-year cost decreases: PIPE-related liquidated damage charges (\$7.2 million), litigation settlements and related expense (\$2.8 million), stock-based compensation (\$2.2 million) and all other net general and administrative expenses (\$5.3 million).

#### *Research and development expenses*

| (in thousands)                    | For the year ended<br>December 31, |           |
|-----------------------------------|------------------------------------|-----------|
|                                   | 2008                               | 2007      |
| Research and development expenses | \$ 14,259                          | \$ 14,052 |
| As a percentage of net sales      | 1.1%                               | 1.6%      |

Research and development expense increased by approximately \$0.2 million for the year ended December 31, 2008 compared with the year ended December 31, 2007. The increase was primarily due to an increase in prototype build activity. During 2008, we introduced Force Armor , developed and finished a prototype of the Tactical Support Vehicle and developed the Cheetah M-ATV.

#### *Other income*

Other income decreased approximately \$2.7 million for the year ended December 31, 2008 as compared with the year ended December 31, 2007 primarily due to decreased levels of average funds available for investing and lower rates of return. Management consciously concentrated funds in lower return, but lower risk, investment vehicles in the latter part of 2008 as a precaution against the impact of the nation's banking crisis.

#### *Interest expense*

Interest expense decreased \$0.3 million for the year ended December 31, 2008 as compared with the year ended December 31, 2007 primarily due to lower costs related to the refinancing of the company's line of credit.

#### *Income tax (expense) benefit*

We recorded income tax (expense) for the year ended December 31, 2008 as a result of the increase in our net sales and profitability compared to the year ended December 31, 2007. The effective income tax rates for the year ended December 31, 2008 and 2007 were (32.57)% and (18.36)%, respectively. See Note 11, *Income Taxes*, in the accompanying consolidated financial statements.

#### *Series D 6% convertible preferred stock dividends and accretion*

There are no preferred stock dividends or accretion of preferred stock in 2008 as all preferred stock was converted to common stock by year-end 2006.

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### *Net Income available to common shareholders*

|                            | <b>For the year ended<br/>December 31,</b> |             |
|----------------------------|--------------------------------------------|-------------|
|                            | <b>2008</b>                                | <b>2007</b> |
| Diluted earnings per share | \$0.69                                     | \$0.11      |

Net income available to common shareholders for the year ended December 31, 2008 increased over 2007 primarily due to increased gross margins, partially offset by higher income tax expenses.

### *Backlog*

The following table sets forth the number of vehicles included in our backlog as of December 31, 2008. The backlog shown in the following table is "funded" backlog, meaning that it reflects vehicles for which we have received orders and for which funding has been appropriated and authorized for expenditure by the applicable agency. We cannot assure you that we will deliver or sell all of the vehicles included in our backlog. See Item 1A, *Risk Factors* in Part I of this Annual Report on Form 10-K.

|                             | <b>Vehicle Funded<br/>Backlog<br/>As of December 31,<br/>2008</b> |
|-----------------------------|-------------------------------------------------------------------|
| Buffalo                     | 69                                                                |
| Cougar MRAP (Competitive)*  | 5                                                                 |
| Cougar Mastiff              | 24                                                                |
| Cougar Ridgback             | 83                                                                |
| Cougar (all other variants) | 28                                                                |
| <b>TOTAL</b>                | <b>209</b>                                                        |

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\*

Refers to Cougar vehicles manufactured under the GDLS Subcontract pursuant to which we and GDLS fulfill the MRAP Competitive Contract.

### *Results of Operations for the Year Ended December 31, 2007 Compared to the Year Ended December 31, 2006*

#### *Units sold*

The increase in vehicles sold in 2007 compared to 2006 is primarily due to vehicles sold pursuant to the contracts awarded to us under the MRAP program. The vehicles sold under such contracts, which started shipping in the first quarter of 2007, represent approximately 91% of the vehicles sold in 2007.

#### *Net sales*

The increase in net sales for the year ended December 31, 2007 compared with the year ended December 31, 2006 is attributable to an increase in volume of vehicle deliveries, spare parts, and

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logistics services (field service representatives and technical publications). The mix of vehicles delivered and spare parts and logistics sales are set forth in the following table:

| (in thousands)            | For the year ended December 31, |           |                   |
|---------------------------|---------------------------------|-----------|-------------------|
|                           | 2007                            | 2006      | Percentage Change |
| Buffalo                   | \$ 58,360                       | \$ 28,127 | 107%              |
| Cougar (all variants)     | 741,036                         | 132,872   | 458%              |
| Spare parts and logistics | 91,276                          | 35,018    | 161%              |
|                           | \$890,672                       | \$196,017 | 354%              |

## Cost of sales and Gross profit

| (in thousands)                            | For the year ended December 31, |           |
|-------------------------------------------|---------------------------------|-----------|
|                                           | 2007                            | 2006      |
| Cost of sales                             | \$786,803                       | \$158,994 |
| Gross profit                              | \$103,869                       | \$37,023  |
| Gross profit as a percentage of net sales | 11.7%                           | 18.9%     |

The gross profit decreased by 7.2 percentage points for the year ended December 31, 2007 compared with the year ended December 31, 2006. The gross profit was impacted by 4.1 percentage points as a result of GDLS Subcontract activity, whereby we recognized no gross profit on \$231.9 million of vehicles sold that were produced by GDLS. We also incurred a write-down of our raw material and supplies to their net realizable values in the amount of \$15.8 million, and we incurred a loss of \$5.9 million on firm commitments to acquire raw materials and supplies. See Note 3, *Inventories*, in the accompanying consolidated financial statements. The remainder of the decrease was primarily due to operational inefficiencies, and the use of contract labor in the production process. We define the gross profit percentage as net sales less cost of sales divided by net sales.

## General and administrative expenses

| (in thousands)                      | For the year ended December 31, |          |
|-------------------------------------|---------------------------------|----------|
|                                     | 2007                            | 2006     |
| General and administrative expenses | \$84,044                        | \$27,183 |
| As a percentage of net sales        | 9.4%                            | 13.9%    |

General and administrative expenses increased by approximately \$56.9 million for the year ended December 31, 2007 compared with the year ended December 31, 2006, or an increase of 209%. Demand for our blast- and ballistic-protected vehicles increased substantially during 2007, especially for the Mine Resistant Ambush Protected ("MRAP") vehicles, in response to the pervasive threat confronting our troops in Iraq and Afghanistan from land mines, hostile fire, and improvised explosive devices ("IEDs"). We expanded our operations such that we were able to produce and ship 1,558 vehicles in 2007 versus only 227 vehicles in 2006, or an increase of 586%. The increase in expense was primarily due to our increased general and administrative functions required to support the increased vehicle production activities associated with the MRAP program and the rapidly expanding customer base.

Prior to 2007, we did not have the operational or administrative infrastructure in place to accommodate this accelerated level of production volume. Establishing this infrastructure resulted in a sizeable increase in general and administrative costs, especially since it was accomplished in such a

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short timeframe in order to deliver the vehicles to the battlefield as quickly as possible. We experienced growth in accounting, program and contract management, human resources, information systems, business development, and other support functions. As a result, employees in our administrative functions increased from approximately 300 to approximately 675, as of December 31, 2006 and 2007, respectively. In addition, we had approximately 125 contractors filling newly created administrative positions as of December 31, 2007.

We also engaged outside consultants to function as our internal audit department and assist with our evaluation of internal controls over financial reporting as required by Section 404 of the Sarbanes-Oxley Act of 2002.

We incurred a liquidated damage charge of \$7.2 million during the year ended December 31, 2007 related to our December 2006 Private Investment in Public Entity ("PIPE") stock offering because the registration statement for the PIPE shares was not declared effective within the required time frame. See Note 6, *Other Current Liabilities*, in the accompanying consolidated financial statements.

Significant year-over-year cost increases included salaries, wages and fringe benefits, (\$15.5 million), consulting and temporary labor (\$14.8 million), liquidated damages (\$7.2 million), marketing, sales and other administrative costs (\$4.2 million), supplies (\$3.5 million), travel (\$2.9 million), depreciation (\$2.7 million), information technology (\$2.3 million), legal settlements and other charges (\$2.3 million), and other general and administrative expenses (\$1.5 million).

### *Research and development expenses*

| (in thousands)                    | For the year ended<br>December 31, |          |
|-----------------------------------|------------------------------------|----------|
|                                   | 2007                               | 2006     |
| Research and development expenses | \$ 14,052                          | \$ 3,204 |
| As a percentage of net sales      | 1.6%                               | 1.6%     |

Research and development expense increased by approximately \$10.8 million primarily due to increased expenditures related to the development of the Cheetah vehicle. We also increased research and development spending on upgrades and variants of the Buffalo and Cougar vehicles.

### *Other income*

Other income increased approximately \$3.2 million for the year ended December 31, 2007 as compared with the year ended December 31, 2006 primarily due to the interest income earned on investment of the funds received from our December 2006 private placement of common stock.

### *Interest expense*

Interest expense decreased \$1.1 million for the year ended December 31, 2007 primarily due to the repayment of a short-term loan in August 2006 and the termination of an accounts receivable factoring agreement in June 2006 facilitated by the sale of common stock through private placements, partially offset by the bank fees associated with the line of credit.

### *Income tax (expense) benefit*

We incurred income tax (expense) for the year ended December 31, 2007 as a result of the increase in our net sales and profitability compared to the year ended December 31, 2006. The effective income tax rate for the year ended December 31, 2007 was (18.4%). See Note 11, *Income Taxes*, in the accompanying consolidated financial statements. In addition, as of December 31, 2006, the valuation allowance for deferred tax assets of \$14.2 million was eliminated as we expect to realize future earnings sufficient to fully utilize the accumulated income tax benefit.

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### *Series D 6% convertible preferred stock dividends and accretion*

There are no preferred stock dividends or accretion of preferred stock in 2007 as all preferred stock was converted to common stock by year-end 2006.

### *Net Income available to common shareholders*

|                                   | <b>For the year ended<br/>December 31,</b> |               |
|-----------------------------------|--------------------------------------------|---------------|
|                                   | <b>2007</b>                                | <b>2006</b>   |
| <b>Diluted earnings per share</b> | <b>\$0.11</b>                              | <b>\$0.36</b> |

Net income available to common shareholders for the year ended December 31, 2007 decreased over the comparable period in 2006 primarily due to decreased gross margins and increased selling, administrative, development, research, and income tax expenses partially offset by increased interest income and decreased preferred stock dividends and accretion.

## **Liquidity and Capital Resources**

Our liquidity and available capital resources are impacted by operating, financing and investing activities. Our principal sources of liquidity are cash on hand and cash from operations, primarily from the U.S. government.

### *Sources and Uses of Cash*

Our primary sources of funding are cash flows from operations and from financing activities. Over the past three years, our funds were used primarily to fund working capital requirements and to make capital expenditures. The following chart shows the cash flows provided by or used in operating, investing, and financing activities for 2008, 2007, and 2006 (in thousands):

|                                                      | <b>For the year ended December 31,</b> |                |                |
|------------------------------------------------------|----------------------------------------|----------------|----------------|
|                                                      | <b>2008</b>                            | <b>2007</b>    | <b>2006</b>    |
| Net cash provided by (used in) operating activities  | \$ 37,031                              | \$ (9,075)     | \$ (25,920)    |
| Net cash used in investing activities                | (16,318)                               | (59,717)       | (7,537)        |
| Net cash (used in) provided by financing activities  | (709)                                  | 3,470          | 188,559        |
| <br>Increase (decrease) in cash and cash equivalents | <br>\$ 20,004                          | <br>\$(65,322) | <br>\$ 155,102 |

We ended 2008 with \$111.0 million of cash and cash equivalents, an increase from \$91.0 million at the end of 2007 and a decrease from \$156.3 million at the end of 2006.

### *Cash Flow from Operating Activities*

Cash provided by operating activities increased by \$46.1 million during the year ended December 31, 2008 compared to 2007. This change was primarily due to an increase in net income partially offset by an increase in working capital. Working capital excluding cash increased \$37.2 million over the prior year. Changes in working capital excluding cash in 2008 included:

- (1) an increase in accounts receivable of \$19.7 million resulting primarily from a change in sales mix (a higher portion of vehicles sold in the fourth quarter of 2008 did not have advance payments);

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- (2) a decrease in inventories of \$52.1 million resulting primarily from a reduction in the purchase of raw material and supplies related to the MRAP program as its production cycle nears its end, and the write-down of obsolete inventory;
- (3) a decrease in accounts payable of \$99.4 million, reflecting an increase in payments to suppliers and a reduction in inventory purchases;
- (4) a decrease in advance payment on contracts of \$27.0 million, offset by a decrease in advances to subcontractor of \$25.1 million, resulting from a reduction in the number of vehicles under contract for which we receive and make advance payments;
- (5) an increase in the amount due to the U.S. government of \$20.0 million, primarily due to an increased definitization reserve requirement for vehicles sold under the FMS contracts; and
- (6) a decrease of \$11.7 million in the other components of working capital.

The majority of our cash receipts are from the U.S. government and other foreign governments, and therefore the risk of default on payment of our accounts receivable as of December 31, 2008 is very low. However, the deepening global credit crisis and recession in the United States and western Europe may have an impact on the U.S. and other governments to continue to fund defense contracts and programs or delay payments to its contractors in the future.

Cash used in operating activities decreased by \$16.8 million during the year ended December 31, 2007 compared with 2006. This change was primarily due to an increase in advance payments on contracts partially offset by an increase in working capital and a decrease in deferred income taxes. Our advance payments on contracts increased due to the receipt of performance-based payments on the MRAP program. Working capital usage increased \$26.7 million (accounts receivable, inventories, and accounts payable) to support increased sale volumes. Deferred income taxes decreased due to the elimination of the valuation allowance for deferred tax assets of \$14.2 million as of December 31, 2006.

### *Cash Flow from Investing Activities*

Cash used in investing activities decreased by \$43.4 million during 2008 compared with 2007. During 2008, we expended approximately \$16.3 million primarily to complete the expansion of our manufacturing capability and capacity that we began in 2007 and to upgrade our information technology infrastructure. The majority of those expenditures were made in the first three months of 2008. We anticipate that capital expenditures for 2009 will total approximately \$10-\$15 million.

As our business grew, we made several significant acquisitions and expanded our manufacturing capacity and infrastructure. In March 2007, we purchased the research and developmental testing facility of NEWTEC Services Group, Inc., located near Edgefield, South Carolina, for \$5.5 million, \$5.1 million of which was in cash. In March 2007, we purchased real and personal property located in Summerville, South Carolina, for \$4.1 million in cash to use as a product development and logistic services training center. In July 2007, we purchased land and an approximately 430,000 square foot building in Roxboro, North Carolina, for \$3.5 million that we intend to use for training and sustainment purposes. Also, in July 2007, we completed construction on and placed into service a 90,000 square foot warehouse facility at our corporate headquarters in Ladson, South Carolina, at a cost of approximately \$3.5 million in cash. During 2007, we began to construct additional assembly lines. Construction in progress for the year ended December 31, 2007 totaled \$31.3 million. Additionally, we made leasehold improvements totaling \$10.2 million and purchased computer equipment and software totaling \$4.0 million.

During 2006, we acquired a paint booth, overhead cranes and welding equipment to expand our manufacturing capacity. We also acquired computers, furniture and a more robust accounting system to support our business growth.

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#### *Cash Flow from Financing Activities*

During the years ended December 31, 2008 and 2007, we did not issue common stock (except for exercised employee options and vested restricted stock) or debt to fund business activities. During the year ended December 31, 2006, we issued common stock for two private placements in public equity and exercised common stock warrants, totaling \$196.2 million to fund the expansion of the business and retired \$7.5 million of short-term debt. See Note 9, *Shareholders' Equity*, in the accompanying consolidated financial statements.

#### *Current Liquidity and Capital Resources*

Our cash and cash equivalents as of December 31, 2008 were held for working capital purposes and were invested primarily in short-term United States Treasury bills and money market funds. We do not enter into investments for trading or speculative purposes.

During 2008, we expended approximately \$16.3 million to complete the expansion of our manufacturing capability and capacity and to upgrade our information technology infrastructure. We do not expect any major capital expenditures in 2009.

The amount of capital that we will require depends on several factors, including without limitation, the extent and timing of sales of our products, performance based payments, inventory costs, costs of raw materials and components, labor costs, costs of improving our financial and accounting systems, the timing and costs associated with the expansion of our manufacturing, development, engineering and customer support capabilities, the timing and cost of our product development and enhancement activities and our operating results. We currently estimate that the cash flow we anticipate will be generated by our business will be sufficient to meet our presently budgeted capital expenditures and our other presently anticipated cash needs for the year ending December 31, 2009. In addition, we have available to us a \$40 million line of credit, which expires on April 30, 2010. After that time, we expect that we may need to obtain additional sources of capital, which may include borrowings or the issuance of debt or equity securities, including common stock, and there can be no assurance that such financing will be available to us when we need it or, if available, that the terms of any such financing will be satisfactory to us and not dilutive to our shareholders. Any failure to obtain necessary capital as and when required could have a material adverse effect on our business, prospects, financial position, results of operations and cash flows.

#### **Off-Balance Sheet Arrangements**

In accordance with the definition under SEC rules, the following qualify as off-balance sheet arrangements:

any obligation under certain guarantees or contracts;

a retained or contingent interest in assets transferred to an unconsolidated entity or similar entity or similar arrangement that serves as credit, liquidity, or market risk support to that entity for such assets;

any obligation under certain derivative instruments; and

any obligation under a material variable interest held by the registrant in an unconsolidated entity that provides financing, liquidity, market risk, or credit risk support to the registrant, or engages in leasing, hedging, or research and development services with the registrant.

The following discussion addresses each of the above items for the Company.

As of December 31, 2008, we do not have any obligation under certain guarantees or contracts as defined above.

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As of December 31, 2008, we do not have any retained or contingent interest in assets as defined above.

As of December 31, 2008, we do not hold derivative financial instruments, as defined by FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended.

As of December 31, 2008, we do not participate in transactions that generate relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities ("SPEs"), which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As of December 31, 2008 and 2007, we were not involved in any unconsolidated SPE transactions.

## Contractual Obligations

Achieving optimal returns on cash often involves making long-term commitments. SEC regulations require that we present our contractual obligations, and we have done so in the table that follows. However, our future cash flow prospects cannot reasonably be assessed based on such obligations, as the most significant factor affecting our future cash flows is our ability to earn and collect cash from our customers. Future cash outflows, whether they are contractual obligations or not, will vary based on our future needs. While some such outflows are completely fixed (for example, commitments to repay principal and interest on fixed-rate borrowings), most will depend on future events (for example, payments to subcontractors under long-term contracts). Further, normal operations involve significant expenditures that are not based on "commitments" (for example, amounts paid for income taxes or for payroll).

Our consolidated contractual obligations as of December 31, 2008, are as follows (in thousands):

|                                      | Total      | 2009       | 2010 - 2011 | 2012 - 2013 | 2014 and<br>Thereafter |
|--------------------------------------|------------|------------|-------------|-------------|------------------------|
| Operating lease obligations(a)(b)(d) | \$ 11,132  | \$ 2,525   | \$ 4,171    | \$ 3,523    | \$ 913                 |
| Purchase obligations(b)(c)(d)        | 117,533    | 117,533    |             |             |                        |
| Other long-term liabilities(d)(e)    | 300        | 150        | 150         |             |                        |
| Total                                | \$ 128,965 | \$ 120,208 | \$ 4,321    | \$ 3,523    | \$ 913                 |

- (a) We lease most of our facilities as well as other property and equipment under operating leases in the normal course of business. Some of our facility leases contain escalation clauses. The minimum lease payments do not include contingent rental expense. Some lease agreements provide us with the option to renew the lease or purchase the leased property. Our future operating lease obligations would change if we exercised these renewal options and if we entered into additional operating lease agreements. For more information, see Note 4, *Property and Equipment*, to our accompanying consolidated financial statements.
- (b) Future operating lease obligations and purchase obligations are not recognized in our consolidated balance sheet.
- (c) Purchase obligations include agreements to purchase goods or services that are enforceable and legally binding on Force Protection and that specify all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. Purchase obligations exclude agreements that are cancelable without penalty.
- (d) Because our future cash outflows are uncertain, the following liabilities are excluded from the table above: workers' compensation risks, deferred income taxes, warranty reserve, and our estimated

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liability for unsettled litigation. For more information, see Note 11, *Income Taxes*, and Note 14, *Contingencies and Other Commitments*, to our accompanying consolidated financial statements.

(e)

Includes accreted interest at 7.25% for the non-compete agreement portion.

**Dividends**

We have never paid or declared any cash dividends on our common stock. We currently intend to retain earnings, if any, to finance the growth and development of our business, and we do not expect to pay any cash dividends on our common stock in the foreseeable future. Payment of future dividends, if any, will be at the discretion of the board of directors and will depend on our financial condition, results of operations, capital requirements, restrictions contained in current or future financing instruments, and other factors the board deems relevant.

**Critical Accounting Policies and Estimates**

Our discussion and analysis of our results of operations and liquidity and capital resources are based on our consolidated financial statements, which have been prepared in accordance with GAAP. In connection with the preparation of our consolidated financial statements, we are required to make assumptions and estimates about future events, and apply judgments that affect the reported amounts of assets, liabilities, revenue, expenses, and the related disclosures. We base our assumptions, estimates and judgments on historical experience, current trends and other factors we believe to be relevant at the time we prepared our consolidated financial statements. On a regular basis, we review the accounting policies, assumptions, estimates and judgments to ensure that our consolidated financial statements are presented fairly and in accordance with GAAP. However, because future events and their effects cannot be determined with certainty, actual results could differ from our assumptions and estimates, and such differences could be material.

The preparation of our consolidated financial statements in conformity with GAAP requires us to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and the disclosures of contingent assets and liabilities as of the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Significant estimates and assumptions are used for, but are not limited to: (1) revenue recognition; (2) allowance for doubtful accounts; (3) definitization and advance payments on contracts; (4) inventory costs and reserves; (5) asset impairments (6) depreciable lives of assets; (7) economic lives and fair value of leased assets; (8) income tax reserves and valuation allowances; (9) fair value of stock options; (10) allocation of direct and indirect cost of sales; and (11) litigation reserves. Future events and their effects cannot be predicted with certainty, and accordingly, our accounting estimates require the exercise of judgment. The accounting estimates used in the preparation of our consolidated financial statements will change as new events occur, as more experience is acquired, as additional information is obtained and as our operating environment changes. We evaluate and update our assumptions and estimates on an ongoing basis and may employ outside experts to assist in our evaluations. Actual results could differ from the estimates we have used.

Our significant accounting policies are discussed in Note 1, *Summary of Significant Accounting Policies*, to our accompanying consolidated financial statements. We believe the following accounting policies are the most critical to aid in fully understanding and evaluating our reported financial results, as they require management to make difficult, subjective or complex judgments, and to make estimates about the effect of matters that are inherently uncertain. We have reviewed these critical accounting policies and related disclosures with the Audit Committee of our board of directors.

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| Description<br>Inventories                                                                                      | Judgments and Uncertainties                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          | Effect if Actual Results<br>Differ from Assumptions                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
|-----------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| We state our inventories at the lower of cost or market value and net of the cost of excess and obsolete items. | The determination of inventory valuation reserves requires management to make estimates and judgments on the future salability of inventories. Valuation reserves for excess, obsolete, and slow-moving inventory are estimated by comparing the inventory levels of individual parts to both future sales forecasts or production requirements and historical usage rates in order to identify inventory for which the resale value or replacement value is less than the inventoriable cost. Other factors that management considers in determining these reserves include whether individual inventory parts meet current specifications and can be substituted for a part currently being sold or used as a service part, overall market conditions, and other inventory management initiatives. | Our estimates of future product demand may prove to be inaccurate, in which case we may have understated or overstated the provision required for excess and obsolete inventories. In the future, if our inventories are determined to be overvalued, we would be required to recognize such costs in our cost of sales at the time of such determination. Likewise, if our inventories are determined to be undervalued, we may have over-reported our costs of sales in previous periods and would be required to recognize such additional operating income at the time of sale. |

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| Description                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  | Judgments and Uncertainties                                                                                                                                                                                                                                                                                                                                                                                                                                                                           | Effect if Actual Results Differ from Assumptions                                                                                                                                                                               |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p><b>Income taxes</b></p> <p>We account for income taxes using the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying values of existing assets and liabilities. They are also recorded with respect to net operating losses and other tax attribute carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the years in which temporary differences are expected to be recovered or settled. Valuation allowances are established when it is more likely than not that deferred tax assets will not be realized. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the income of the period that includes the enactment date.</p> <p>In addition, we establish reserves for tax contingencies in accordance with FASB Interpretation No. 48, <i>Accounting for Uncertainty in Income Taxes</i>.</p> | <p>A high degree of judgment is required to determine if, and the extent to which, valuation allowances should be recorded against deferred tax assets. Since December 31, 2006, we have not had a valuation allowance recorded against our deferred tax asset.</p> <p>Contingent tax liabilities are based on our assessment of the likelihood that we have incurred a liability. Such liabilities are reviewed based on recent changes in tax laws and regulations, including judicial rulings.</p> | <p>Although we believe that our approach to estimates and judgments as described herein is reasonable, actual results could differ and we may be exposed to increases or decreases in income taxes that could be material.</p> |

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| Description                                                                                                                                                       | Judgments and Uncertainties                                                                                                                                                                                                                                                                                                                                                                                                                     | Effect if Actual Results Differ from Assumptions                                                                                                                                                                         |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Assessment of Loss Contingencies</b>                                                                                                                           |                                                                                                                                                                                                                                                                                                                                                                                                                                                 |                                                                                                                                                                                                                          |
| We have legal and other contingencies, including product warranties, which could result in significant losses upon the ultimate resolution of such contingencies. | We have provided for losses in situations where we have concluded that it is probable that a loss has been or will be incurred and the amount of the loss is reasonably estimable. A significant amount of judgment is involved in determining whether a loss is probable and reasonably estimable due to the uncertainty involved in determining the likelihood of future events and estimating the financial statement impact of such events. | If further developments or resolution of a contingent matter are not consistent with our assumptions and judgments, we may need to recognize a significant charge in a future period related to an existing contingency. |

**Recent Accounting Pronouncements**

In May 2008, the FASB issued FASB Statement No. 162, *The Hierarchy of Generally Accepted Accounting Principles*. FASB Statement No. 162 defines the order in which accounting principles that are generally accepted should be followed. FASB Statement No. 162 became effective November 15, 2008. We follow the hierarchy and therefore expect that the adoption of FASB Statement No. 162 will not have a material impact on our consolidated financial position, results of operations, and cash flows.

In April 2008, the FASB issued Staff Position ("FSP") No. FAS 142-3, *Determination of Useful Life of Intangible Assets*, (FSP FAS 142-3). FSP FAS 142-3 amends the factors that should be considered in developing the renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, *Goodwill and Other Intangible Assets*. FSP FAS 142-3 also requires expanded disclosure related to the determination of intangible asset useful lives. FSP FAS 142-3 is effective for fiscal years beginning after December 15, 2008. Earlier adoption is prohibited. We expect that the adoption of FSP FAS 142-3 will not have a material impact on our consolidated financial position, results of operations, and cash flows.

In March 2008, the FASB issued FASB Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities*, an amendment of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. FASB Statement No. 161 changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (i) how and why an entity uses derivative instruments, (ii) how derivative instruments and related hedged items are accounted for under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and its related interpretations, and (iii) how derivative instruments and related hedged items affect an entity's financial position, results of operations, and cash flows. FASB Statement No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application permitted. FASB Statement No. 161 permits, but does not require, comparative disclosures for earlier periods at initial adoption. We do not have financial instruments subject to FASB Statement No. 133, and, as a result, the adoption of FASB Statement No. 161 will not have a material effect on our consolidated financial position, results of operations, cash flows or disclosures related to derivative instruments and hedging activities.

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In September 2006, FASB issued FASB Statement No. 157, *Fair Value Measurements*, which clarifies the definition of fair value whenever another standard requires or permits assets or liabilities to be measured at fair value. Specifically, the standard clarifies that fair value should be based on the assumptions market participants would use when pricing the asset or liability, and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. FASB Statement No. 157 does not expand the use of fair value to any new circumstances, and must be applied on a prospective basis except in certain cases. The standard also requires expanded financial statement disclosures about fair value measurements, including disclosure of the methods used and the effect on earnings.

In February 2008, FASB Staff Position ("FSP") FAS No. 157-2, *Effective Date of FASB Statement No. 157*, was issued. FSP No. 157-2 defers the effective date of FASB Statement No. 157 to fiscal years beginning after December 15, 2008, and interim periods within those fiscal years, for all nonfinancial assets and liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). Examples of items within the scope of FSP No. 157-2 are nonfinancial assets and nonfinancial liabilities initially measured at fair value in a business combination (but not measured at fair value in subsequent periods), and long-lived assets, such as property, plant and equipment and intangible assets measured at fair value for an impairment assessment under FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*.

The partial adoption of FASB Statement No. 157 on January 1, 2008, with respect to financial assets and financial liabilities recognized or disclosed at fair value in the consolidated financial statements on a recurring basis did not have a material impact on our consolidated financial statements. We are in the process of analyzing the potential impact of FASB Statement No. 157 relating to our January 1, 2009 adoption of the remainder of the standard.

On January 1, 2008, we adopted FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. FASB Statement No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value, which are not otherwise currently required to be measured at fair value. Under FASB Statement No. 159, the decision to measure items at fair value is made at specified election dates on an instrument-by-instrument basis and is irrevocable. Entities electing the fair value option are required to recognize changes in fair value in earnings and to expense upfront costs and fees associated with the item for which the fair value option is elected. The new standard did not impact our consolidated financial statements as we did not elect the fair value option for any instruments existing as of the adoption date. However, we currently plan to evaluate the fair value measurement election with respect to financial instruments we enter into in the future.

We have determined that all other recently issued accounting pronouncements will not have a material impact on our consolidated financial position, results of operations, and cash flows, or do not apply to our operations.

**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

**Commodity Prices**

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

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**Foreign Currency**

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

**Interest Rates**

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

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

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**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

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| <u>Report of Independent Registered Public Accounting Firm</u>                                               | <u>79</u>   |
| <u>Consolidated Balance Sheets as of December 31, 2008 and 2007</u>                                          | <u>80</u>   |
| <u>Consolidated Statements of Operations for the Years Ended December 31, 2008, 2007, and 2006</u>           | <u>81</u>   |
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**Management's Responsibility Report**

Force Protection's management is responsible for the preparation, integrity and fair presentation of the consolidated financial statements and other information used in this Annual Report. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and include, where appropriate, estimates based on the best judgment of management. Financial and operating data elsewhere in the Annual Report are consistent with that contained in the accompanying consolidated financial statements.

Force Protection's policy is to maintain systems of controls over financial reporting and disclosure controls and procedures. Such systems are designed to provide reasonable assurance that the financial information is accurate and reliable and Force Protection's assets are adequately accounted for and safeguarded. The Board of Directors oversees Force Protection's systems of controls over financial reporting and disclosure controls and procedures through its Audit Committee, which is comprised of directors who are not employees. The Audit Committee meets regularly with representatives of the Company's independent registered public accounting firm and management, including internal audit staff, to satisfy themselves that Force Protection's policy is being followed. The Audit Committee has engaged Grant Thornton LLP as the independent registered public accounting firm.

The financial statements have been reviewed by the Audit Committee and, together with the other required information in this Annual Report, approved by the Board of Directors. In addition, the 2008, 2007, and 2006 financial statements have been audited by Grant Thornton LLP whose reports are provided on the following pages.

/s/ MICHAEL MOODY  
**MICHAEL MOODY**  
*Chief Executive Officer*

/s/ CHARLES MATHIS  
**CHARLES MATHIS**  
*Chief Financial Officer*

March 26, 2009

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Shareholders of  
Force Protection, Inc.:

We have audited **Force Protection, Inc.** (a Nevada Corporation) and subsidiaries' (the Company) internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a deficiency, or combination of control deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of a company's annual or interim financial statements will not be prevented or detected on a timely basis. The following material weaknesses have been identified and included in management's assessment.

Accounting for revenue recognition

Inadequate monitoring of non-routine and non-systematic transactions

In our opinion, because of the effect of the material weaknesses described above on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Force Protection, Inc. and

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subsidiaries as of December 31, 2008 and December 31, 2007, and the related consolidated statements of operations, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2008. The material weaknesses identified above were considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2008 financial statements, and this report does not affect our report dated March 26, 2009 which expressed an unqualified opinion on those financial statements.

/s/ Grant Thornton LLP

Columbia, South Carolina  
March 26, 2009

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Shareholders of  
Force Protection, Inc.:

We have audited the accompanying consolidated balance sheets of **Force Protection, Inc.** (a Nevada corporation) and subsidiaries (the Company) as of December 31, 2008 and 2007, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2008. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Force Protection, Inc. and subsidiaries as of December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America.

As discussed in the notes to consolidated financial statements, effective January 1, 2007, the Company adopted the provision of Financial Accounting Standards Board (FASB) Interpretation No. 48, "Accounting for Uncertainty in Income Taxes-An Interpretation of FASB Statement No. 109."

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Force Protection, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 26, 2009, expressed an adverse opinion on the effectiveness of the Company's internal controls over financial reporting.

/s/ Grant Thornton LLP

Columbia, South Carolina  
March 26, 2009

Table of Contents**Force Protection, Inc. and Subsidiaries****Consolidated Balance Sheets**

|                                                                                                                                 | As of December 31, |           |
|---------------------------------------------------------------------------------------------------------------------------------|--------------------|-----------|
|                                                                                                                                 | 2008               | 2007      |
|                                                                                                                                 | (In Thousands,     |           |
|                                                                                                                                 | Except Share Data) |           |
| Assets                                                                                                                          |                    |           |
| Current assets:                                                                                                                 |                    |           |
| Cash and cash equivalents                                                                                                       | \$ 111,001         | \$ 90,997 |
| Accounts receivable, net of allowance for doubtful accounts of none in 2008 and \$323 in 2007                                   | 138,449            | 118,794   |
| Inventories                                                                                                                     | 88,502             | 140,639   |
| Advances to subcontractor                                                                                                       |                    | 25,106    |
| Deferred income tax assets                                                                                                      | 15,572             | 14,530    |
| Income taxes receivable                                                                                                         |                    | 6,565     |
| Other current assets                                                                                                            | 2,417              | 8,481     |
| Total current assets                                                                                                            | 355,941            | 405,112   |
| Property and equipment, net                                                                                                     | 61,429             | 66,707    |
| Intangible assets, net                                                                                                          | 654                | 1,355     |
| Deferred income tax assets                                                                                                      |                    | 1,496     |
| Total assets                                                                                                                    | \$418,024          | \$474,670 |
| Liabilities and Shareholders' Equity                                                                                            |                    |           |
| Current liabilities:                                                                                                            |                    |           |
| Accounts payable                                                                                                                | \$ 47,115          | \$146,515 |
| Due to United States government                                                                                                 | 39,015             | 18,969    |
| Other current liabilities                                                                                                       | 20,783             | 20,710    |
| Advance payments on contracts                                                                                                   | 29,504             | 56,552    |
| Total current liabilities                                                                                                       | 136,417            | 242,746   |
| Deferred income tax liabilities                                                                                                 | 3,141              |           |
| Other long-term liabilities                                                                                                     | 139                | 295       |
|                                                                                                                                 | 139,697            | 243,041   |
| Commitment and contingencies                                                                                                    |                    |           |
| Series D 6% convertible preferred stock, \$.001 par value; 20,000 shares authorized; none issued and outstanding                |                    |           |
| Shareholders' equity:                                                                                                           |                    |           |
| Series A preferred stock, \$.001 par value; 1,600 shares authorized; none issued and outstanding                                |                    |           |
| Series B preferred stock, \$.001 par value; 25 shares authorized; none issued and outstanding                                   |                    |           |
| Series C preferred stock, \$.001 par value; 150 shares authorized; none issued and outstanding                                  |                    |           |
| Common stock, \$.001 par value; 300,000,000 shares authorized; issued and outstanding 68,349,162 in 2008 and 68,247,648 in 2007 | 68                 | 68        |
| Additional paid-in capital                                                                                                      | 256,939            | 257,160   |
| Retained earnings (accumulated deficit)                                                                                         | 21,320             | (25,599)  |
| Total shareholders' equity                                                                                                      | 278,327            | 231,629   |

|                                                   |                  |                  |
|---------------------------------------------------|------------------|------------------|
| <b>Total liabilities and shareholders' equity</b> | <b>\$418,024</b> | <b>\$474,670</b> |
|---------------------------------------------------|------------------|------------------|

The accompanying notes to consolidated financial statements are an integral part of these balance sheets.

Table of Contents**Force Protection, Inc. and Subsidiaries****Consolidated Statements of Operations**

|                                                      | <b>For the year ended December 31,</b>       |             |             |
|------------------------------------------------------|----------------------------------------------|-------------|-------------|
|                                                      | <b>2008</b>                                  | <b>2007</b> | <b>2006</b> |
|                                                      | <b>(In Thousands, Except Per Share Data)</b> |             |             |
| Net sales                                            | \$ 1,326,331                                 | \$ 890,672  | \$ 196,017  |
| Cost of sales                                        | 1,149,670                                    | 786,803     | 158,994     |
| Gross profit                                         | 176,661                                      | 103,869     | 37,023      |
| General and administrative expenses                  | 93,950                                       | 84,044      | 27,183      |
| Research and development expenses                    | 14,259                                       | 14,052      | 3,204       |
| Operating income                                     | 68,452                                       | 5,773       | 6,636       |
| Other income, net                                    | 1,463                                        | 4,209       | 963         |
| Interest expense                                     | (332)                                        | (609)       | (1,729)     |
| Income before income tax (expense) benefit           | 69,583                                       | 9,373       | 5,870       |
| Income tax (expense) benefit                         | (22,664)                                     | (1,721)     | 12,327      |
| Net income                                           | 46,919                                       | 7,652       | 18,197      |
| Accretion of Series D 6% convertible preferred stock |                                              |             | (1,297)     |
| Preferred stock dividend                             |                                              |             | (326)       |
| Net income available to common shareholders          | \$ 46,919                                    | \$ 7,652    | \$ 16,574   |
| <b>Earnings per common share:</b>                    |                                              |             |             |
| Basic                                                | \$ 0.69                                      | \$ 0.11     | \$ 0.37     |
| Diluted                                              | \$ 0.69                                      | \$ 0.11     | \$ 0.36     |
| <b>Weighted average common shares outstanding:</b>   |                                              |             |             |
| Basic                                                | 68,314                                       | 68,054      | 44,786      |
| Diluted                                              | 68,393                                       | 68,404      | 50,428      |

The accompanying notes to consolidated financial statements are an integral part of these statements.

Table of Contents**Force Protection, Inc. and Subsidiaries****Consolidated Statements of Shareholders' Equity**

|                                                                       | For the year ended December 31,   |            |            |
|-----------------------------------------------------------------------|-----------------------------------|------------|------------|
|                                                                       | 2008                              | 2007       | 2006       |
|                                                                       | (In Thousands, Except Share Data) |            |            |
| NUMBER OF COMMON SHARES OUTSTANDING                                   |                                   |            |            |
| Balance at beginning of year                                          | 68,247,648                        | 66,762,565 | 36,114,216 |
| Issuance for:                                                         |                                   |            |            |
| Cash Private placement                                                |                                   | (27,700)   | 21,250,000 |
| Cash Warrants                                                         |                                   |            | 2,852,140  |
| Employee stock option exercises                                       | 31,000                            | 1,415,481  | 1,000      |
| Employee and board of director stock grants                           | 70,514                            | 97,302     | 313,644    |
| Third-party agreements                                                |                                   |            | 30,000     |
| Other                                                                 |                                   |            | 8,937      |
| Conversion of Series D 6% convertible preferred stock to common stock |                                   |            | 6,192,628  |
| Balance at end of year                                                | 68,349,162                        | 68,247,648 | 66,762,565 |
| COMMON STOCK                                                          |                                   |            |            |
| Balance at beginning of year                                          | \$ 68                             | \$ 67      | \$ 36      |
| Issuance for:                                                         |                                   |            |            |
| Cash Private placement                                                |                                   | Nil        | 21         |
| Cash Warrants                                                         |                                   |            | 3          |
| Employee stock option exercises                                       | Nil                               | 1          | Nil        |
| Employee and board of director stock grants                           | Nil                               | Nil        | 1          |
| Third-party agreements                                                |                                   | Nil        | Nil        |
| Other                                                                 |                                   |            | Nil        |
| Conversion of Series D 6% convertible preferred stock to common stock |                                   |            | 6          |
| Balance at end of year                                                | \$ 68                             | \$ 68      | \$ 67      |
| COMMON STOCK WARRANTS                                                 |                                   |            |            |
| Balance at beginning of year                                          | \$                                | \$         | \$ 5,781   |
| Issuance for common stock                                             |                                   |            | (5,781)    |
| Balance at end of year                                                | \$                                | \$         | \$         |
| ADDITIONAL PAID-IN CAPITAL                                            |                                   |            |            |
| Balance at beginning of year                                          | \$ 257,160                        | \$ 251,038 | \$ 38,808  |
| Issuance of common stock for:                                         |                                   |            |            |
| Cash Private placement                                                |                                   |            | 185,806    |
| Cash Warrants                                                         |                                   |            | 16,153     |
| Employee stock option exercises                                       | 46                                | 1,335      | 6          |
| Employee and board of director stock grants                           | Nil                               |            |            |
| Third-party agreements                                                |                                   |            | Nil        |
| Other                                                                 |                                   |            | 1,119      |
| Conversion of Series D 6% convertible preferred stock to common stock |                                   |            | 9,192      |
| Accretion of Series D 6% convertible preferred stock                  |                                   |            | (1,297)    |
| Stock-based compensation                                              | 270                               | 2,511      | 1,251      |
| Income tax effect realized from stock transactions                    | (537)                             | 2,276      |            |

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|                        |    |         |    |         |    |         |
|------------------------|----|---------|----|---------|----|---------|
| Balance at end of year | \$ | 256,939 | \$ | 257,160 | \$ | 251,038 |
|------------------------|----|---------|----|---------|----|---------|

## RETAINED EARNINGS (ACCUMULATED DEFICIT)

|                              |    |          |    |          |    |          |
|------------------------------|----|----------|----|----------|----|----------|
| Balance at beginning of year | \$ | (25,599) | \$ | (33,251) | \$ | (51,122) |
|------------------------------|----|----------|----|----------|----|----------|

|            |  |        |  |       |  |        |
|------------|--|--------|--|-------|--|--------|
| Net income |  | 46,919 |  | 7,652 |  | 18,197 |
|------------|--|--------|--|-------|--|--------|

Series D 6% convertible preferred stock dividends:

|      |  |  |  |  |  |       |
|------|--|--|--|--|--|-------|
| Cash |  |  |  |  |  | (277) |
|------|--|--|--|--|--|-------|

|              |  |  |  |  |  |      |
|--------------|--|--|--|--|--|------|
| Common stock |  |  |  |  |  | (49) |
|--------------|--|--|--|--|--|------|

|                        |    |        |    |          |    |          |
|------------------------|----|--------|----|----------|----|----------|
| Balance at end of year | \$ | 21,320 | \$ | (25,599) | \$ | (33,251) |
|------------------------|----|--------|----|----------|----|----------|

The accompanying notes to consolidated financial statements are an integral part of these statements.

Table of Contents**Force Protection, Inc. and Subsidiaries****Consolidated Statements of Cash Flows**

|                                                                                            | <b>For the year ended December 31,</b> |                 |                 |
|--------------------------------------------------------------------------------------------|----------------------------------------|-----------------|-----------------|
|                                                                                            | <b>2008</b>                            | <b>2007</b>     | <b>2006</b>     |
|                                                                                            | <b>(In Thousands)</b>                  |                 |                 |
| <b>Cash flows from operating activities:</b>                                               |                                        |                 |                 |
| Net income                                                                                 | \$ 46,919                              | \$ 7,652        | \$ 18,197       |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities |                                        |                 |                 |
| Depreciation and amortization                                                              | 12,761                                 | 5,810           | 769             |
| Deferred tax provision (benefit)                                                           | 3,058                                  | (3,699)         | (12,327)        |
| Income tax effect realized from stock transactions                                         | 537                                    | (2,276)         |                 |
| Stock-based compensation                                                                   | 270                                    | 2,511           | 1,251           |
| Common stock issued for services and other expenses                                        |                                        |                 | 1,071           |
| Provision for asset impairment                                                             | 4,947                                  |                 |                 |
| Allowance for doubtful accounts                                                            | (323)                                  | 278             | 45              |
| Provision for inventory obsolescence                                                       | 12,269                                 | 15,772          | 1,925           |
| Warranty reserve                                                                           | 1,546                                  | 1,844           | 164             |
| Reserve for loss on firm purchase commitments                                              | 148                                    | 5,871           |                 |
| Loss on disposal of property and equipment                                                 | 61                                     |                 |                 |
| (Increase) decrease in assets                                                              |                                        |                 |                 |
| Accounts receivable                                                                        | (19,332)                               | (77,037)        | (37,395)        |
| Inventories                                                                                | 39,868                                 | (96,015)        | (29,835)        |
| Advances to subcontractor                                                                  | 25,106                                 | (25,106)        |                 |
| Income taxes receivable                                                                    | 6,565                                  | (4,289)         |                 |
| Other current assets                                                                       | 6,064                                  | (8,108)         | (107)           |
| Increase (decrease) in liabilities                                                         |                                        |                 |                 |
| Accounts payable                                                                           | (94,872)                               | 103,060         | 23,965          |
| Due to United States government                                                            | 20,046                                 | 12,946          | 5,006           |
| Other current liabilities                                                                  | (1,559)                                | 7,983           | 1,126           |
| Advance payments on contracts                                                              | (27,048)                               | 43,728          | 225             |
| Total adjustments                                                                          | (9,888)                                | (16,727)        | (44,117)        |
| <b>Net cash provided by (used in) operating activities</b>                                 | <b>37,031</b>                          | <b>(9,075)</b>  | <b>(25,920)</b> |
| <b>Cash flows from investing activities:</b>                                               |                                        |                 |                 |
| Capital expenditures                                                                       | (16,318)                               | (59,717)        | (7,537)         |
| <b>Net cash used in investing activities</b>                                               | <b>(16,318)</b>                        | <b>(59,717)</b> | <b>(7,537)</b>  |
| <b>Cash flows from financing activities:</b>                                               |                                        |                 |                 |
| Proceeds from issuance of common stock:                                                    |                                        |                 |                 |
| Private placement                                                                          |                                        |                 | 185,828         |
| Warrants                                                                                   |                                        |                 | 10,375          |
| Other                                                                                      | 46                                     | 1,336           | 6               |
| Dividends on Series D 6% convertible preferred stock                                       |                                        |                 | (277)           |
| Payments on debt                                                                           |                                        |                 | (7,500)         |
| Income tax effect realized from stock transactions                                         | (537)                                  | 2,276           |                 |
| Net increase (decrease) in other long-term liabilities                                     | (218)                                  | (142)           | 127             |
| <b>Net cash provided by (used in) financing activities</b>                                 | <b>(709)</b>                           | <b>3,470</b>    | <b>188,559</b>  |

|                                                         |            |           |            |
|---------------------------------------------------------|------------|-----------|------------|
| <b>Increase (decrease) in cash and cash equivalents</b> | 20,004     | (65,322)  | 155,102    |
| <b>Cash and cash equivalents at beginning of year</b>   | 90,997     | 156,319   | 1,217      |
| <b>Cash and cash equivalents at end of year</b>         | \$ 111,001 | \$ 90,997 | \$ 156,319 |

**Supplemental cash flow information:**

|                                      |          |          |          |
|--------------------------------------|----------|----------|----------|
| Cash paid during the year for        |          |          |          |
| Interest, net of amounts capitalized | \$ 302   | \$ 616   | \$ 1,722 |
| Income taxes                         | \$ 8,861 | \$ 9,940 | \$       |

**Supplemental schedule of noncash investing and financing activities:**

|                                                                                  |        |          |    |
|----------------------------------------------------------------------------------|--------|----------|----|
| Property and equipment additions in accounts payable                             | \$ 273 | \$ 4,801 | \$ |
| Note payable, net of discount, issued as consideration for non-compete agreement | \$     | \$ 390   | \$ |

The accompanying notes to consolidated financial statements are an integral part of these statements.

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**Force Protection, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements**

**1. Summary of Significant Accounting Policies**

***Organization and Description of the Business***

Force Protection, Inc., reincorporated under the laws of Nevada in 2005, and its subsidiaries, is a provider of blast- and ballistic-protected products used to support armed forces and security personnel in harm's way. We design, manufacture, test, deliver and support our blast- and ballistic-protected products with the purpose to increase survivability of the users of the products. Our specialty vehicles, which we believe are at the forefront of blast- and ballistic-protected technology, are designed to protect their occupants from landmines, hostile fire, and improvised explosive devices ("IEDs"). Our primary customer is the United States Department of Defense ("DoD"). We are a key provider of the U.S. military's Mine Resistant Ambush Protected ("MRAP") vehicle program and have sold over 3,000 vehicles under this program. We also provide our Cougar Mastiff, Cougar Ridgback, Cougar Wolfhound, and Buffalo mine protected vehicles to the United Kingdom Ministry of Defence. In total, across all vehicle programs we have sold approximately 4,000 vehicles.

References herein to "Force Protection," the "Company," "we," "our," or "us" refer to Force Protection, Inc. and its subsidiaries unless otherwise stated or indicated by context.

***Basis of Presentation and Consolidation***

The accompanying consolidated financial statements of Force Protection and its subsidiaries were prepared in accordance with generally accepted accounting principles in the United States of America ("GAAP") and include the assets, liabilities, revenues, and expenses of our two wholly owned subsidiaries, Force Protection Industries, Inc. and Force Protection Technologies, Inc. We eliminate from our financial results all significant intercompany accounts and transactions.

***Use of Estimates***

The preparation of our consolidated financial statements in conformity with GAAP requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting periods. Significant estimates and assumptions are used for, but are not limited to: (1) revenue recognition; (2) allowance for doubtful accounts; (3) definitization and advance payments on contracts; (4) inventory costs and reserves; (5) asset impairments; (6) depreciable lives of assets; (7) economic lives and fair value of leased assets; (8) income tax reserves and valuation allowances; (9) fair value of stock options; (10) allocation of direct and indirect cost of sales; and (11) contingent liabilities, warranty, and litigation reserves. Future events and their effects cannot be predicted with certainty; accordingly, our accounting estimates require the exercise of judgment. The accounting estimates used in the preparation of our consolidated financial statements will change as new events occur, as more experience is acquired, as additional information is obtained and as our operating environment changes. We evaluate and update our assumptions and estimates on an ongoing basis and may employ outside experts to assist in our evaluation, as considered necessary. Actual results could differ from those estimates.

***Risks and Uncertainties***

We are exposed to a number of risks in the normal course of our operations that could potentially affect our financial position, results of operations, and cash flows.

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**Force Protection, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**1. Summary of Significant Accounting Policies (Continued)**

Customer Concentration

Substantially all of our revenue comes from our DoD contracts either as a prime contractor or as a subcontractor to another prime contractor to the U.S. government. Revenue from contracts for which we are the prime contractor approximated 96%, 94%, and 82%, of *Net sales* for the years ended December 31, 2008, 2007, and 2006, respectively. Our accounts receivable from the U.S. government as of December 31, 2008 and 2007 were 83% and 89% of our accounts receivable, respectively.

Law and Regulations

As a result of our DoD contracts, we are required to participate in the U.S. government contracting process, which involves extensive statutes, regulations and requirements of the U.S. government agencies and entities that govern these programs, including award, administration, funding, and performance of contracts. These statutes and regulations impose a broad range of requirements, many of which are unique to government contracting, including various procurement, import and export, federal national security, contract pricing and cost, funding, contract termination and adjustment, audit requirements, and protection of classified information requirements. Our failure to comply with these regulations and requirements could result in reductions of the value of contracts, contract modifications or termination, loss of security clearance, and the assessment of civil or criminal penalties and fines, inability to win new contracts, and lead to suspension or debarment from government contracting or subcontracting for a period of time, any of which could have a material adverse affect on our financial position, results of operations, and cash flows.

We are also subject to certain unique business risks associated with the defense market, including changes in budget appropriations, procurement policies, political developments both domestically and abroad, and other factors. Any material deterioration in the economic and environmental factors that impact the defense industry could have a material adverse effect on our financial position, results of operations, and cash flows.

There are certain federal laws that, while not specifically directed at us as a contractor, may affect our U.S. government contracts. The Anti-Deficiency Act is one of the major laws through which Congress exercises its constitutional control of the public purse. The Anti-Deficiency Act indirectly regulates how the agency awards our contracts and pays our invoices. Accounts receivable related to DoD contracts approximated 83% and 89% of our accounts receivable as of December 31, 2008 and 2007, respectively.

Our operations also are subject to a broad range of environmental, health and safety laws and regulations in the jurisdictions in which we operate. These laws and regulations impose increasingly stringent environmental, health and safety protection standards and permitting requirements regarding, among other things, air emissions, wastewater storage, treatment and discharges, the use and handling of hazardous or toxic materials, waste disposal practices, and the remediation of environmental contamination and working conditions for our employees. Some environmental laws, such as the U.S. Comprehensive Environmental Response, Compensation, and Liability Act, also known as CERCLA or Superfund, and comparable state laws, impose joint and several liability for the cost of environmental remediation, natural resource damages, third-party claims, and other expenses, without regard to the fault or the legality of the original conduct, on those persons who contributed to the release of a hazardous substance into the environment.

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**Force Protection, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**1. Summary of Significant Accounting Policies (Continued)**

The costs of complying with these laws and regulations, including participation in assessments and remediation of contaminated sites and installation of pollution control facilities could be significant. In addition, if we are found responsible for any hazardous contamination, we may have to pay expensive fines or penalties or perform costly clean-up. Even if we are charged, and later found not responsible for such contamination and clean-up, the costs of defending the charges could be significant.

*Sources and Supply of Materials*

Our products incorporate engines, transmissions, axles and a number of other components that are available only from the source or sources selected by the U.S. military. Identifying additional or replacement suppliers approved by the U.S. military for any of the numerous components used in our products may not be accomplished quickly or on commercially reasonable terms, if at all. In addition to suppliers specified by the U.S. military, we use other suppliers for certain components of our products, some of which are small businesses that are not well capitalized. In the event that we are unable to obtain required components from our existing suppliers, and if we are unable to mitigate the impact or find an alternate supplier in a timely manner, it could have a material adverse effect on our ability to produce our vehicles. Significant interruptions in the supply of components may occur for a variety of reasons, including capacity constraints at our suppliers, competition for components with other manufacturers of vehicles, insolvency of a supplier, work stoppages at suppliers and transportation interruptions, which could involve significant additional costs and result in delays in production and product deliveries and could have a material adverse effect on our results of operations. In addition, the unavailability or scarcity of certain components or raw material could result in increased costs, which could have a material adverse effect on our financial position, results of operations, and cash flows.

In addition, some of our product components are manufactured in and supplied from foreign countries. If import tariffs or taxes increase for any reason, our cost of goods would increase. Our financial performance could be adversely affected by changes in the political, social and economic environment in these foreign countries. The role of the central and local governments in the economies of these foreign countries may be significant. Policies toward economic liberalization, and laws and policies affecting foreign companies, foreign investment, currency exchange rates and other matters could change, resulting in greater restrictions on our ability to do business with suppliers based in other countries. A foreign government could impose surcharges, increase tax rates, or revoke, terminate or suspend operating licenses without compensating us. In addition, the U.S. government could impose charges and taxes and could take other actions that could make it more expensive or costly for us to obtain components from sources in foreign countries or could prevent us from acquiring those components. Also, other countries, from time to time, experience instances of civil unrest and hostilities and confrontations have occurred between the military, insurgent forces, and civilians. If for these or any other reason, we are unable to obtain required components from foreign sources as and when required, or at all, it could have a material adverse effect on our financial position, results of operations, and cash flows.

***Revenue Recognition***

Substantially all of our revenues from the U.S. government and certain of our revenues from others are earned pursuant to written contractual arrangements to design, develop, manufacture and/or modify blast- and ballistic-protected products and to provide related engineering and technical or other

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**Force Protection, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**1. Summary of Significant Accounting Policies (Continued)**

services according to the specifications of the buyers (customers). These contracts are generally fixed-price, cost-reimbursable, or time and material based. We recognize revenues and earnings on fixed-production contracts, whose units are produced and delivered in a continuous or sequential process, based upon the unit's contract selling price as we deliver it and the customer's *formal acceptance* of the unit. We charge the actual unit cost to *Cost of sales*.

We define *formal acceptance* under the U.S. government contract as taking place when a representative of the U.S. government signs the United States Form DD250 entitled "Material Inspection and Receiving Report." Under the Federal Acquisition Regulation ("FAR"), a signed Form DD250 signifies contractual inspection and acceptance by the United States of the work performed by Force Protection. A signed Form DD250 also is the event contractually obligating the U.S. government to pay us for the approved goods or services (subject to any "definitization" contractual adjustment(s), as discussed below).

In accordance with standard industry practice, there is a representative from the United States Defense Contract Management Agency ("DCMA") acting as a contractual representative of the U.S. government present at our facilities. This DCMA representative inspects each vehicle as it is delivered by us, and upon confirmation of the vehicle's conformity with the contractual specifications, the inspector or other contractually designated official signs the Form DD250 and formally accepts delivery of the vehicle. We only recognize revenues arising from our U.S. government contracts upon execution of the Form DD250 by the DCMA inspector.

Under some of our U.S. government contracts, we receive performance-based payments based on completion of specific milestones stipulated under the contract (for example, completion of manufacturing fabrication). We report these payments as *Advance payments on contracts* in our consolidated balance sheets until the final delivery of the products and formal acceptance by the U.S. government as evidenced by an executed Form DD250. As discussed above, upon acceptance of the products and the execution of the Form DD250, we recognize the full sale price of the product as revenue.

We recognize revenue from other items, such as foreign and domestic user training, field support (including vehicle repairs), performing vehicle modifications, and providing test support to the U.S. government for its vehicle testing, when we meet four basic criteria: (i) persuasive evidence that a customer arrangement exists; (ii) the price is fixed or determinable; (iii) collectibility is reasonably assured; and (iv) delivery of product has occurred or services have been rendered.

We negotiate contracts with our customers that may include revenue arrangements with multiple deliverables. We account for each deliverable under a contract separately. Historically, we negotiate and sign contracts with our customers that provide a contract amount and specific terms and conditions associated with each deliverable.

Shipping and handling costs are expensed as incurred and included in *Cost of sales*.

**Definitization / Due to United States Government**

Our contracts with the U.S. government are negotiated as either a "sole source" or "open competition" bid process. A sole source process is one in which we are the sole bidder for the contract. An open competition could involve various bidders. Once a bid is accepted, the U.S. government usually expects work to commence immediately. An open competition results in a final agreed-upon

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**Force Protection, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**1. Summary of Significant Accounting Policies (Continued)**

contract price to which the U.S. government has agreed. A sole source process results in an agreed-upon contract with the U.S. government, subject to an adjustment process at a later date, termed the "definitization process." The definitization process commences upon awarding of a contract, whereby the U.S. government undertakes a detailed review of our costs involved in the manufacturing and delivery process. We then work with the U.S. government to determine an adequate and fair final contract price. We have the right to submit proposed prices, but they are subject to final review and approval by the contracting officer, who may require that we use different prices. Although both parties make an effort to definitize the contract as quickly as possible, the process is time consuming and can take months to complete. In addition, if an agreement is not reached as to price by a specific date, the contracting officer may unilaterally determine a price. During definitization, we are usually required to perform the contract work and make deliveries before the final contract price has been established. For this reason, as part of the original award, we bill the U.S. government at a predetermined price that is used for invoicing and accounting purposes pending final definitization.

As a result of the adjustments related to the definitization process, we recognize a liability, *Due to United States government*, and reduce gross sales to arrive at net sales. As of December 31, 2008, our liability for contracts subject to the definitization process has been determined based upon our estimate of final contract prices or subsequently negotiated settlements. As of December 31, 2007, our liability for contracts subject to the definitization process have been determined based upon subsequent settlement with the United States government.

*Sales Returns and Allowance for Doubtful Accounts*

Historically, we have not encountered sales returns or significant uncollectible accounts receivable and we do not anticipate them in the near future. The majority of our accounts receivable are with the U.S. government and we do not maintain an allowance for doubtful accounts for those accounts due to the credit-worthiness of the U.S. government. When necessary, we maintain an allowance for doubtful accounts, which is based upon specific identification, for our non-governmental customers.

***Cash and Cash Equivalents***

*Cash and cash equivalents* includes investments that are highly liquid and have maturities of three months or less when purchased. The carrying values of cash and cash equivalents approximate their fair value due to the short-term nature of these instruments.

We maintain amounts on deposit with various financial institutions, which may at times exceed federally insured limits. However, management periodically evaluates the credit-worthiness of those institutions, and we have not experienced any losses on such deposits.

***Inventories***

We carry our inventories at the lower of their cost or market value, reduced by reserves for excess and obsolete items. Cost is determined using the first-in, first-out ("FIFO") method. Market is determined based on net realizable value. Appropriate consideration is given to obsolescence, excess quantities, and other factors in evaluating net realizable value.

Table of Contents**Force Protection, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****1. Summary of Significant Accounting Policies (Continued)**

Where there is evidence that the utility of goods, in their disposal in the ordinary course of business, will be less than cost, whether due to physical obsolescence, changes in price levels, or other causes, we recognize the difference as a loss in the current period. A write-down of inventory to the lower of cost or market creates a new cost basis that subsequently is not marked up based on changes in underlying facts and circumstances.

***Property and Equipment***

We report land, buildings, leasehold improvements, and machinery and equipment, including tooling and pattern equipment, at cost, net of depreciation and asset impairments, if applicable. We report assets under capital lease obligations at the lower of their fair value or the present value of the aggregate future minimum lease payments as of the beginning of the lease term. We depreciate our assets using the straight-line method over the shorter of the lease term or the estimated useful lives of the assets.

The ranges of estimated useful lives of our property and equipment are as follows:

|                                                      | <b>Years</b> |
|------------------------------------------------------|--------------|
| Buildings and building improvements                  | 5-29         |
| Leasehold improvements                               | 2-5          |
| Machinery and equipment, including tooling and molds | 5-7          |
| Computer equipment and software                      | 3-7          |
| Furniture and fixtures                               | 3            |
| Demonstration vehicles                               | 5            |
| Manuals                                              | 5            |
| Vehicles                                             | 5            |

The carrying amounts of all long-lived assets are evaluated periodically to determine if adjustment to the depreciation and amortization period or to the remaining balance is warranted. Such evaluation is based principally on the expected utilization of the long-lived assets.

Maintenance and repairs of property and equipment are expensed as incurred. We capitalize replacements and improvements that increase the estimated useful life of an asset and we capitalize interest on major construction and development projects while in progress.

We retain fully depreciated assets in property and accumulated depreciation accounts until we remove them from service. In the case of sale, retirement, or disposal, the asset cost and related accumulated depreciation balance is removed from the respective account, and the resulting net amount, less any proceeds, is included as a component of income from operations in the consolidated statements of operations.

We recognize escalated rents, including any rent holidays, on a straight-line basis over the term of the lease for those lease agreements where we receive the right to control the use of the entire leased property at the beginning of the lease term.

We test for impairment of long-lived assets, including intangible assets, whenever events or changes in circumstances indicate that the carrying value of an asset or asset group (hereinafter referred to as "asset group") may not be recoverable by comparing the sum of the estimated undiscounted future

Table of Contents**Force Protection, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****1. Summary of Significant Accounting Policies (Continued)**

cash flows expected to result from use of the asset group and its eventual disposition to the carrying value. If the sum of the estimated undiscounted future cash flows is less than the carrying value, an impairment determination is required. The amount of impairment is calculated by subtracting the fair value of the asset group from the carrying value of the asset group. An impairment charge, if any, is recognized within *Operating income*.

***Intangible Assets***

We amortize the cost of intangible assets over their respective estimated useful lives on a straight-line basis. The amortization periods are as follows:

|                               | <b>Years</b> |
|-------------------------------|--------------|
| Licenses                      | 3            |
| Non-compete agreement         | 4            |
| Customer base                 | 2            |
| Special expertise             | 2            |
| Weighted-average useful lives | 3            |

***Investments in and Advances to Non-consolidated Affiliates***

Equity method investments are recorded at original cost and adjusted periodically to recognize (i) our proportionate share of the investees' net income or losses after the date of investment; (ii) additional contributions made and dividends or distributions received; and (iii) impairment losses resulting from adjustments to net realizable value. However, for contracts not yet novated to an equity method investee, we continue to recognize the revenues and expenses from those contracts in our consolidated financial statements.

We assess the potential impairment of our equity method investments. We determine fair value based on valuation methodologies, as appropriate, including the present value of estimated future cash flows, estimates of sales proceeds, and external appraisals. If an investment is determined to be impaired and the decline in value is other than temporary, we record a write-down.

**Force Dynamics LLC**

On September 10, 2007, we entered into a subcontract with General Dynamics Land Systems, Inc. ("GDLS") (the "GDLS Subcontract") pursuant to which GDLS performs approximately 50% percent of the work under the MRAP Competitive Contract for vehicle manufacturing and life cycle support based on revenues. We previously entered into a joint venture with GDLS on December 15, 2006 ("Workshare Agreement") pursuant to which we and GDLS would fulfill the obligations of the MRAP Competitive Contract. We formed a Delaware limited liability company, Force Dynamics, LLC ("Force Dynamics"), to govern the terms of the joint venture. However, the MRAP Competitive Contract was awarded to us and not to Force Dynamics or GDLS. We have attempted to transfer this contract to Force Dynamics, although the U.S. government has not yet agreed to the transfer. Revenue related to the Workshare Agreement was \$574.7 million, \$231.8 million and \$zero for the years ended December 31, 2008, 2007 and 2006, respectively.

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**Force Protection, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**1. Summary of Significant Accounting Policies (Continued)**

*Advances to subcontractor* consist of amounts paid to a subcontractor based upon the achievement of contractual performance milestones. These advances are a pass-through pursuant to our contract with the U.S. government.

In connection with our joint venture arrangement with GDLS, we entered into a technology license agreement with Force Dynamics and GDLS. The agreement provides that we grant Force Dynamics and GDLS a non-exclusive license without the right to sublicense. Force Dynamics and GDLS will pay us a vehicle fee for each MRAP vehicle produced. The term of this technology agreement is the later of completion or complete termination of the MRAP program or the Workshare Agreement.

***Stock-Based Compensation***

As of December 31, 2008, Force Protection had one formal stock-based compensation plan, the Force Protection, Inc. 2008 Stock Incentive Plan ("2008 Stock Incentive Plan"), which was approved by shareholders in 2008. The purpose of the 2008 Stock Incentive Plan is to attract, retain and motivate officers, directors and key employees (including prospective employees), consultants and others who may perform services for Force Protection, to compensate them for their contributions to the long-term growth and profits of Force Protection and to encourage them to acquire a proprietary interest in our success.

Awards may be made under the 2008 Stock Incentive Plan in the form of any of the following, in each case in respect of common stock: (a) stock options, (b) stock appreciation rights, (c) restricted shares, (d) restricted stock units, (e) dividend equivalent rights and (f) other equity-based or equity-related awards, such as the grant or offer for sale of unrestricted shares of common stock and performance share awards and performance units settled in cash in such amounts and subject to such terms and conditions as the Compensation Committee may determine. Such awards may entail the transfer of actual shares of common stock to award recipients and may include awards designed to comply with or take advantage of the applicable local laws of jurisdictions other than the United States that the Compensation Committee determines to be consistent with the purposes of the 2008 Stock Incentive Plan and the interests of Force Protection.

As approved by shareholders, the total number of shares of common stock that may be granted under the 2008 Stock Incentive Plan is 5,200,000.

Stock options granted under the 2008 Stock Incentive Plan will have contractual terms not to exceed 10 years (or 5 years for 10% shareholders) and generally vest ratably over three years. Restricted Stock granted under the 2008 Stock Incentive Plan will generally vest ratably over three years.

Prior to 2008, Force Protection did not have a formal stock option plan. However, we provided stock-based compensation to some of our employees in the form of stock options and shares of our common stock.

***Warranty***

Our sales contracts generally include a warranty that our products are free from defects in design, material, and workmanship for a period of one year from the acceptance date. The warranty does not apply to any damage or failure to perform caused by the misuse or abuse of the vehicle, combat damage, fair wear-and-tear items (brake shoes, wiper blades, etc.), or by the customer's failure to

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**Force Protection, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**1. Summary of Significant Accounting Policies (Continued)**

perform proper maintenance or service on the supplies. We base our warranty accruals on estimates of the expected warranty costs that incorporate historical information and forward assumptions about the nature, frequency, and average cost of warranty claims. Warranty costs are included in *Cost of sales*.

***Litigation Reserve***

We accrue for loss contingencies associated with outstanding litigation, claims and assessments for which management has determined it is probable that a loss contingency exists and the amount of loss can be reasonably estimated. We expense professional fees associated with litigation claims and assessments as incurred.

***Research and Development***

We incur costs in connection with research and development programs that are expected to contribute to future earnings, and charge such costs against income as incurred. Research and development costs consist primarily of payroll and personnel related costs, contractor fees, infrastructure costs, materials to assemble prototype vehicles, and administrative expenses directly related to research and development support.

***Advertising Costs***

We expense costs of print and other advertisements as incurred. Advertising expenses, included in *General and administrative expenses* within the accompanying consolidated statements of operations, approximated \$0.6 million in 2008, \$0.8 million in 2007, and \$0.3 million in 2006.

***Income Taxes***

We provide for income taxes using the asset and liability method. This approach recognizes the amount of federal, state, and local taxes payable or refundable for the current year, as well as deferred tax assets and liabilities for the future tax consequence of events recognized in the consolidated financial statements and income tax returns. Deferred income tax assets and liabilities are adjusted to recognize the effects of changes in tax laws or enacted tax rates. In addition, we establish reserves for tax contingencies in accordance with FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*. We include interest and penalties related to federal and state income taxes, if any, as a component of *Income tax expense*.

A valuation allowance is required when it is more likely than not that some portion of the deferred tax assets will not be realized. Realization is dependent on generating sufficient future taxable income.

Force Protection and its subsidiaries file a consolidated federal income tax return. State income tax returns are filed on a separate, combined, or consolidated basis in accordance with relevant state laws and regulations.

***Earnings per Common Share***

The calculation of basic earnings per common share is based on the weighted-average number of our common shares outstanding during the applicable period. The calculation for diluted earnings per

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**Force Protection, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**1. Summary of Significant Accounting Policies (Continued)**

common share recognizes the effect of all potential dilutive common shares that were outstanding during the respective periods, unless their impact would be anti-dilutive.

***Fair Value of Financial Instruments***

FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, requires disclosures of the fair value of financial instruments. Our financial instruments include cash and cash equivalents, accounts receivable, advances to subcontractor, accounts payable, and amounts due to United States government. The carrying amounts of cash and cash equivalents, accounts receivable, advances to subcontractors, accounts payable and amounts due to the U.S. government, approximate their fair value because of the short-term maturity and highly liquid nature of these instruments. The carrying values of our financial instruments approximate their fair value as of December 31, 2008 and 2007.

***Recent Accounting Pronouncements***

In May 2008, the FASB issued FASB Statement No. 162, *The Hierarchy of Generally Accepted Accounting Principles*. FASB Statement No. 162 defines the order in which accounting principles that are generally accepted should be followed. FASB Statement No. 162 became effective November 15, 2008. We follow the hierarchy and therefore expect that the adoption of FASB Statement No. 162 will not have a material impact on our consolidated financial position, results of operations, and cash flows.

In April 2008, the FASB issued Staff Position ("FSP") No. FAS 142-3, *Determination of Useful Life of Intangible Assets*, (FSP FAS 142-3). FSP FAS 142-3 amends the factors that should be considered in developing the renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, *Goodwill and Other Intangible Assets*. FSP FAS 142-3 also requires expanded disclosure related to the determination of intangible asset useful lives. FSP FAS 142-3 is effective for fiscal years beginning after December 15, 2008. Earlier adoption is prohibited. We expect that the adoption of FSP FAS 142-3 will not have a material impact on our consolidated financial position, results of operations, and cash flows.

In March 2008, the FASB issued FASB Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities*, an amendment of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. FASB Statement No. 161 changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (i) how and why an entity uses derivative instruments, (ii) how derivative instruments and related hedged items are accounted for under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and its related interpretations, and (iii) how derivative instruments and related hedged items affect an entity's financial position, results of operations, and cash flows. FASB Statement No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application permitted. FASB Statement No. 161 permits, but does not require, comparative disclosures for earlier periods at initial adoption. We do not have financial instruments subject to FASB Statement No. 133, and, as a result, the adoption of FASB Statement No. 161 will not have a material effect on our consolidated financial position, results of operations, cash flows or disclosures related to derivative instruments and hedging activities.

In September 2006, FASB issued FASB Statement No. 157, *Fair Value Measurements*, which clarifies the definition of fair value whenever another standard requires or permits assets or liabilities to be measured at fair value. Specifically, the standard clarifies that fair value should be based on the

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**Force Protection, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**1. Summary of Significant Accounting Policies (Continued)**

assumptions market participants would use when pricing the asset or liability, and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. FASB Statement No. 157 does not expand the use of fair value to any new circumstances, and must be applied on a prospective basis except in certain cases. The standard also requires expanded financial statement disclosures about fair value measurements, including disclosure of the methods used and the effect on earnings.

In February 2008, FASB Staff Position ("FSP") FAS No. 157-2, *Effective Date of FASB Statement No. 157*, was issued. FSP No. 157-2 defers the effective date of FASB Statement No. 157 to fiscal years beginning after December 15, 2008, and interim periods within those fiscal years, for all nonfinancial assets and liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). Examples of items within the scope of FSP No. 157-2 are nonfinancial assets and nonfinancial liabilities initially measured at fair value in a business combination (but not measured at fair value in subsequent periods), and long-lived assets, such as property, plant and equipment and intangible assets measured at fair value for an impairment assessment under FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*.

The partial adoption of FASB Statement No. 157 on January 1, 2008, with respect to financial assets and financial liabilities recognized or disclosed at fair value in the consolidated financial statements on a recurring basis did not have a material impact on our consolidated financial statements. We are in the process of analyzing the potential impact of FASB Statement No. 157 relating to our January 1, 2009 adoption of the remainder of the standard.

On January 1, 2008, we adopted FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. FASB Statement No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value, which are not otherwise currently required to be measured at fair value. Under FASB Statement No. 159, the decision to measure items at fair value is made at specified election dates on an instrument-by-instrument basis and is irrevocable. Entities electing the fair value option are required to recognize changes in fair value in earnings and to expense upfront costs and fees associated with the item for which the fair value option is elected. The new standard did not impact our consolidated financial statements as we did not elect the fair value option for any instruments existing as of the adoption date. However, we currently plan to evaluate the fair value measurement election with respect to financial instruments we enter into in the future.

We have determined that all other recently issued accounting pronouncements will not have a material impact on our consolidated financial position, results of operations, and cash flows, or do not apply to our operations.

Table of Contents**Force Protection, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****2. Accounts Receivable**

Accounts receivable consists of the following (in thousands):

|                                       | <b>As of December 31,</b> |             |
|---------------------------------------|---------------------------|-------------|
|                                       | <b>2008</b>               | <b>2007</b> |
| U.S. government                       | \$ 114,230                | \$ 106,021  |
| Other accounts receivable             | 24,219                    | 13,096      |
|                                       | 138,449                   | 119,117     |
| Less: Allowance for doubtful accounts |                           | (323)       |
| Accounts receivable, net              | \$ 138,449                | \$ 118,794  |

Other accounts receivable includes amounts that relate to non-government entities and the sale of excess raw materials to suppliers. Any gain or loss on the sale of excess raw materials is included in *Other income, net* in the accompanying consolidated statements of operations. As of December 31, 2008 and 2007, our accounts receivable from the U.S. government included \$8.6 million and \$8.2 million, respectively, of earned and unbilled accounts receivable.

The following is the activity related to our allowance for doubtful accounts (in thousands):

| <b>For the year ended December 31,</b> | <b>Balance at Beginning of Period</b> | <b>Additions and Charges to Expense</b> | <b>Deductions and Accounts Written Off</b> | <b>Balance at End of Period</b> |
|----------------------------------------|---------------------------------------|-----------------------------------------|--------------------------------------------|---------------------------------|
| 2008                                   | \$ 323                                | \$                                      | \$ (323)                                   | \$                              |
| 2007                                   | \$ 45                                 | \$ 278                                  | \$                                         | \$ 323                          |
| 2006                                   | \$                                    | \$ 45                                   | \$                                         | \$ 45                           |

On June 22, 2006, we terminated our Factoring Agreement with GC Financial, Inc. and we have no further obligation under that agreement as of December 31, 2006. We incurred factoring expenses of \$0.8 million for the year ended December 31, 2006. These amounts are included in *General and administrative expenses* in the accompanying consolidated statements of operations.

**3. Inventories**

Inventories consist of the following (in thousands):

|                           | <b>As of December 31,</b> |             |
|---------------------------|---------------------------|-------------|
|                           | <b>2008</b>               | <b>2007</b> |
| Raw material and supplies | \$64,857                  | \$105,313   |
| Work in process           | 23,645                    | 35,035      |
| Finished goods            |                           | 291         |
| Inventories               | \$ 88,502                 | \$ 140,639  |

Due to excess and obsolete inventory and to account for our inventory at the lower of cost or market, we reduced the cost basis of our raw material and supplies and charged to *Cost of Sales* \$12.3 million, \$15.8 million and \$1.9 million during the years ended December 31, 2008,

2007 and 2006,

Table of Contents**Force Protection, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****3. Inventories (Continued)**

respectively. We also incurred a loss of \$0.1 million and \$5.9 million on firm purchase commitments to acquire raw material during 2008 and 2007, respectively.

**4. Property and Equipment**

Property and equipment consist of the following (in thousands):

|                                                      | <b>As of December 31,</b> |             |
|------------------------------------------------------|---------------------------|-------------|
|                                                      | <b>2008</b>               | <b>2007</b> |
| Land                                                 | \$ 4,419                  | \$ 4,419    |
| Buildings and building improvements                  | 12,669                    | 5,221       |
| Leasehold improvements                               | 13,988                    | 11,775      |
| Machinery and equipment; including tooling and molds | 32,421                    | 6,698       |
| Computer equipment and software                      | 9,062                     | 6,750       |
| Furniture and fixtures                               | 3,580                     | 4,454       |
| Demonstration vehicles                               | 1,863                     | 1,531       |
| Manuals                                              | 705                       | 705         |
| Vehicles                                             | 676                       | 576         |
|                                                      | 79,383                    | 42,129      |
| Less: Accumulated depreciation                       | (18,683)                  | (6,714)     |
|                                                      | 60,700                    | 35,415      |
| Construction in progress                             | \$ 729                    | 31,292      |
| Property and equipment, net                          | \$ 61,429                 | \$ 66,707   |

The amount of fully depreciated assets, depreciation expense, and rent expense under operating leases is as follows (in thousands):

|                            | <b>As of and for the year ended<br/>December 31,</b> |             |             |
|----------------------------|------------------------------------------------------|-------------|-------------|
|                            | <b>2008</b>                                          | <b>2007</b> | <b>2006</b> |
| Fully depreciated assets   | \$ 344                                               | \$ 134      | \$ 57       |
| Depreciation expense       | \$ 12,060                                            | \$ 5,225    | \$ 769      |
| Rent expense:              |                                                      |             |             |
| Minimum rent payments      | \$ 2,564                                             | \$ 1,966    | \$ 1,027    |
| Contingent and other rents | 875                                                  | 846         | 708         |
| Total rent expense         | \$ 3,439                                             | \$ 2,812    | \$ 1,735    |

**Significant Asset Acquisitions**

In January 2008, we placed into service a new automotive integrated assembly line for use in producing our Cougar vehicles at a total cost of \$19.2 million.

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In March 2007, we purchased the research and developmental testing facility of NEWTEC Services Group, Inc., located near Edgefield, South Carolina, for \$5.5 million (\$5,050,000 in cash and \$450,000

Table of Contents**Force Protection, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****4. Property and Equipment (Continued)**

note payable, which was discounted using an implied interest rate of 7.25%). We use this facility for expanded research and development activities and to support the verification and quality control validation of our armored vehicles used to protect military personnel against explosive threats. The purchase price was allocated as follows (in thousands):

|                                                           | <b>Amount</b>   |
|-----------------------------------------------------------|-----------------|
| Land                                                      | \$ 2,100        |
| Furniture and fixtures                                    | 800             |
| Manuals                                                   | 600             |
| Intangible assets (See Note 5, <i>Intangible Assets</i> ) | 1,940           |
| <b>Total</b>                                              | <b>\$ 5,440</b> |

In March 2007, we purchased real and personal property located in Summerville, South Carolina, for \$4.1 million in cash. We use this facility as a product development and logistic services training center. In June 2009, we plan to move our logistic services training to our Roxboro facility. The purchase price was allocated as follows (in thousands):

|                        | <b>Amount</b>   |
|------------------------|-----------------|
| Land                   | \$ 1,320        |
| Building               | 2,502           |
| Furniture and fixtures | 278             |
| <b>Total</b>           | <b>\$ 4,100</b> |

In July 2007, we purchased land and an approximately 430,000 square foot building in Roxboro, North Carolina for \$3.5 million in cash, which we originally planned to use as a manufacturing plant. We now plan to use the Roxboro facility for training purposes beginning in June 2009 (see *Asset Impairment* discussion below). We allocated approximately \$0.8 million to land and \$2.7 million to the building. In 2008, we completed the renovation of the Roxboro facility and capitalized costs as building improvements of approximately \$5.8 million.

Also, in July 2007, we completed construction on and placed into service a 90,000 square foot warehouse facility at our corporate headquarters in Ladson, South Carolina at a cost of approximately \$4.4 million, which is included in leasehold improvements.

***Leases***

We lease buildings located on a single campus in Ladson, South Carolina under non-cancelable operating leases expiring on June 30, 2009; with five separate five-year renewal options which must be exercised six months prior to the expiration of the lease term. On December 22, 2008, we renewed four of the five leases for an additional five-year term; they now expire on June 30, 2014. On March 5, 2009, we extended the lease that was not renewed for six months and it now expires on December 31, 2009. Leases for other office and warehouse space have terms ranging from one to three years.

Our other operating leases generally have 3- to 5-year terms, with one or more renewal options, with terms to be negotiated at the time of renewal. Contingent rents are included in rent expense in the year incurred. The excess of cumulative rent expense (recognized on the straight-line basis) over

Table of Contents**Force Protection, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****4. Property and Equipment (Continued)**

cumulative rent payments made on leases with fixed escalation terms is recognized as straight-line rental accrual and is included in *Other current liabilities* in the accompanying consolidated balance sheets, as follows (in thousands):

|                              | <b>As of<br/>December 31,</b> |             |
|------------------------------|-------------------------------|-------------|
|                              | <b>2008</b>                   | <b>2007</b> |
| Straight-line rental accrual | \$ 174                        | \$ 200      |

Future minimum lease payments at December 31, 2008, for those leases having an initial or remaining non-cancelable lease term in excess of one year are as follows (in thousands):

| <b>For the year ending December 31,</b> | <b>Amount</b>    |
|-----------------------------------------|------------------|
| 2009                                    | \$ 2,525         |
| 2010                                    | 2,274            |
| 2011                                    | 1,897            |
| 2012                                    | 1,734            |
| 2013                                    | 1,789            |
| 2014 and thereafter                     | 913              |
| <b>Total</b>                            | <b>\$ 11,132</b> |

***Construction in Progress***

Amounts in construction in progress as of December 31, 2008 related primarily to information technology upgrades and leasehold improvements at our new Sterling Heights, Michigan office. Amounts in construction in progress as of December 31, 2007 related primarily to the construction of an assembly line at our Ladson, South Carolina manufacturing plant that was completed in 2008, and the construction of an assembly line at our Roxboro, North Carolina manufacturing plant (see *Asset Impairment* discussion below).

***Asset Impairment***

In March 2008, we decided to suspend the construction of the assembly line at our Roxboro facility and we have now redeployed that facility for training purposes. As a result, we charged \$4.9 million to operations in 2008, comprised of \$2.1 million in deposits on services to be provided and \$2.8 million in design costs.

Table of Contents**Force Protection, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****5. Intangible Assets**

Intangible assets consist of the following (in thousands):

|                       | December 31, 2008           |                             |              | December 31, 2007           |                             |                |
|-----------------------|-----------------------------|-----------------------------|--------------|-----------------------------|-----------------------------|----------------|
|                       | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net          | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net            |
| Licenses              | \$ 800                      | \$ 489                      | \$311        | \$ 800                      | \$ 222                      | \$ 578         |
| Non-compete agreement | 540                         | 248                         | 292          | 540                         | 113                         | 427            |
| Customer base         | 200                         | 183                         | 17           | 200                         | 83                          | 117            |
| Special expertise     | 400                         | 366                         | 34           | 400                         | 167                         | 233            |
| <b>Total</b>          | <b>\$1,940</b>              | <b>\$ 1,286</b>             | <b>\$654</b> | <b>\$1,940</b>              | <b>\$ 585</b>               | <b>\$1,355</b> |

As discussed in Note 4, *Property and Equipment*, we acquired the above intangible assets in March 2007 in connection with the purchase of a research and development testing facility located in Edgefield, South Carolina.

Amortization expense for intangible assets was \$701,000 and \$585,000 for the years ended December 31, 2008 and 2007, respectively. Future amortization expense is as follows (in thousands):

| For the year ending December 31, | Amount        |
|----------------------------------|---------------|
| 2009                             | 452           |
| 2010                             | 179           |
| 2011                             | 23            |
| <b>Total</b>                     | <b>\$ 654</b> |

**6. Other Current Liabilities**

Other current liabilities consist of the following (in thousands):

|                                                                         | As of December 31, |                 |
|-------------------------------------------------------------------------|--------------------|-----------------|
|                                                                         | 2008               | 2007            |
| Current portion of other long-term liabilities                          | \$ 128             | \$ 193          |
| Current income taxes payable                                            | 4,207              |                 |
| Compensation and benefits                                               | 7,686              | 2,721           |
| Warranty reserves                                                       | 5,240              | 3,694           |
| Vehicle fee payable                                                     | 2,334              | 4,626           |
| Litigation reserve (See Note 14, <i>Commitments and Contingencies</i> ) | 500                | 3,147           |
| Property tax accrual                                                    | 325                |                 |
| Straight-line rent accrual                                              | 174                | 200             |
| Loss on firm purchase commitments                                       | 148                | 5,871           |
| Liquidated damages settlement                                           | 19                 | 258             |
| Other                                                                   | 22                 |                 |
| <b>Other current liabilities</b>                                        | <b>\$20,783</b>    | <b>\$20,710</b> |

Table of Contents**Force Protection, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****6. Other Current Liabilities (Continued)*****Warranty Reserves***

Warranty reserves consist of the following (in thousands):

|                                 | As of December 31, |          |          |
|---------------------------------|--------------------|----------|----------|
|                                 | 2008               | 2007     | 2006     |
| Balance at beginning of year    | \$ 3,694           | \$ 1,850 | \$ 1,686 |
| Charges to expense              | 4,394              | 4,779    | 164      |
| Costs paid or otherwise settled | (2,848)            | (2,935)  |          |
| Balance at end of year          | \$ 5,240           | \$ 3,694 | \$ 1,850 |

***Vehicle Fee Payable***

Intellectual property rights, which apply to various Force Protection products and technologies, include patents, copyrights, trade secrets and trademarks. We seek to remain competitive in the market place by placing emphasis on research and development and are committed to capturing, protecting and enforcing our intellectual property rights. We continue to review our practices and procedures to ensure the protection of all intellectual property.

We are party to two long-term intellectual property agreements pursuant to which we have the right to use certain intellectual property technology relating to blast- and ballistic-protected vehicles. One agreement is with the CSIR Defencetek ("CSIR"), a division of the Council for Scientific and Industrial Research, a statutory council established in accordance with the Laws of the Republic of South Africa. The other is with Mechem, a division of Denel Pty Ltd., a company established under the Laws of the Republic of South Africa. Under these agreements, we pay a per-vehicle royalty fee in exchange for the exclusive transfer to us of certain technology.

The agreement with CSIR provides for the license, on an exclusive basis, by CSIR to us of certain technical, scientific and commercial intellectual property rights pertaining to the development of our Cougar and Buffalo vehicles. Under our agreement with CSIR, we pay CSIR a fee for each vehicle sold and/or manufactured by us using the licensed intellectual property during the term of the agreement, including vehicles manufactured by our subcontractors. We are not obligated to pay a fee in respect of our Cheetah vehicle, and the manufacture of the Cheetah vehicles is not dependent upon the technology granted to us under the agreement. The initial term of the agreement was March 8, 2002 through March 7, 2007, and the term of the renewed agreement is March 8, 2007 through March 7, 2012. We have no right to extend the agreement after March 2012 and, if the agreement expires without renewal, after such date CSIR may grant a license to the licensed intellectual property to other parties. However, even upon expiration of the agreement we will have the ability to manufacture and deliver the Cougar and Buffalo vehicles.

The agreement with Mechem provides for the provision, on an exclusive basis, by Mechem to us of certain technical, scientific and commercial intellectual property rights pertaining to the development of our Cougar and Buffalo vehicles. Under our agreement with Mechem, we pay Mechem a fee for each vehicle sold and/or manufactured by us using the licensed intellectual property during the term of the agreement, including vehicles manufactured by our subcontractors. We are not obligated to pay a fee with respect to our Cheetah vehicle, and the manufacture of the Cheetah vehicle is not dependent upon the technology granted to us under the agreement with Mechem. Our original agreement with

Table of Contents**Force Protection, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****6. Other Current Liabilities (Continued)**

Mechem was effective October 15, 2001 and expired October 15, 2006. Our current agreement with Mechem, which we entered into on September 13, 2006, expires on September 12, 2011. We have no right to extend the agreement after September 2011 and, if the agreement expires without renewal, after such date Mechem may license the licensed intellectual property to other parties. However, even upon expiration of the agreement, we will have the ability to manufacture and deliver the Cougar and Buffalo vehicles.

***Liquidated Damages Settlement***

On December 20, 2006, we completed a private placement of 13 million shares of our common stock to institutional investors at \$11.75 per share, resulting in gross proceeds of \$152.8 million. The proceeds, net of commissions, were \$146.6 million. Per the Securities Purchase Agreement, we agreed to file a registration statement to register all 13 million shares of common stock for resale and distribution under the Securities Act of 1933, as amended, within 30 calendar days thereafter (January 19, 2007) and cause the registration statement to be declared effective by the SEC no later than 120 calendar days thereafter (April 19, 2007). If the registration statement registering these shares was not declared effective on or before the applicable date, then we were required to deliver to each purchaser, as liquidated damages, an amount equal to one and one third percent (1 $\frac{1}{3}$ %) for each 30 days (or such lesser pro-rata amount for any period of less than 30 days) of the total purchase price of the securities purchased and still held by such purchaser pursuant to the Securities Purchase Agreement on the first day of each 30 day or shorter period for which liquidated damages were calculable. The registration statement for the shares issued became effective July 26, 2007. On October 15, 2007, we filed a prospectus supplement with respect to the registration statement. Liquidated damage expense for the years ended December 31, 2008 and 2007 was \$31,000 and \$7.2 million, respectively, and is included in *General and administrative expenses* in the accompanying consolidated statements of operations.

**7. Advance Payments on Contracts**

Advance payments on contracts consist of the following (in thousands):

|                                                  | <b>As of December 31,</b> |             |
|--------------------------------------------------|---------------------------|-------------|
|                                                  | <b>2008</b>               | <b>2007</b> |
| Mine Resistant Ambush Protected ("MRAP") program | \$29,504                  | \$53,767    |
| Iraqi Light Armored Vehicles ("ILAV")            |                           | 2,785       |
| Advance payments on contracts                    | \$29,504                  | \$56,552    |

Table of Contents**Force Protection, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****8. Other Long-term Liabilities**

Other long-term liabilities consist of the follow items.

|                                                                       | As of<br>December 31, |        |
|-----------------------------------------------------------------------|-----------------------|--------|
|                                                                       | 2008                  | 2007   |
| Non-compete agreement note payable                                    | \$ 267                | \$ 417 |
| Equipment note payable                                                |                       | 71     |
|                                                                       | 267                   | 488    |
| Less: Current portion (included in <i>Other current liabilities</i> ) | (128)                 | (193)  |
| Other long-term liabilities                                           | \$ 139                | \$ 295 |

As discussed above in Note 4, *Property and Equipment*, we purchased the research and developmental testing facility of NEWTEC Services Group, Inc., located near Edgefield, South Carolina, for \$5,500,000 (\$5,050,000 in cash and \$450,000 note payable). We discounted the note using an implied interest rate of 7.25%. The note is payable in annual installments of \$150,000 on January 1, 2008, 2009, and 2010.

**9. Shareholders' Equity***Authorization of Shares*

We have the authority to issue 310 million shares, in aggregate, consisting of 300 million shares of common stock and 10 million shares of preferred stock, of which 1,600 have been designated "Series A," 25 of which have been designated as "Series B," 150 of which have been designated as "Series C" and 20,000 of which have been designated as "Series D." By shareholder resolution effective January 1, 2005, all classes of stock were declared to have a par value of \$0.001 per share. As of December 31, 2008 and 2007, we had no shares of preferred stock outstanding.

*Preferred Stock*

Our preferred stock has the following characteristics:

Dividends

Each holder of preferred stock shall be entitled to receive dividends in cash, stock or otherwise, if, when and as declared by our board of directors, with the exception of the preferred stock designated as Series A, which shall not be entitled to receive dividends. However, we will not declare or pay a dividend to common shareholders without first declaring and paying a dividend to the preferred shareholders. Each share of Series D 6% convertible preferred stock is specifically entitled to 6% cumulative dividends, payable semi-annually in cash or common stock.

Liquidation

In the event of any voluntary or involuntary liquidation, dissolution or winding-up of the Company, the assets of the Company available for distribution to its shareholders shall be distributed as follows:

Series A preferred stock shall rank senior to Series B preferred stock, Series C preferred stock, Series D 6% convertible preferred stock and common stock;



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**Force Protection, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**9. Shareholders' Equity (Continued)**

Series B preferred stock shall rank junior to Series A preferred stock, senior to Series C preferred stock, Series D 6% convertible preferred stock and common stock;

Series C preferred stock shall rank junior to Series A preferred stock and Series B preferred stock and senior to Series D 6% convertible preferred stock and common stock;

Series D 6% convertible preferred stock shall rank junior to Series A preferred stock, Series B preferred stock, Series C preferred stock and senior to common stock; and

Common stock shall rank junior to Series A preferred stock, Series B preferred stock, Series C preferred stock, and Series D 6% convertible preferred stock.

Additionally, upon a liquidation event, holders of Series A preferred stock will receive \$1,000 per share of Series A preferred stock. Holders of Series B preferred stock will receive the greater of \$2,500 per share of Series B preferred stock or the pro-rata share of the Company's remaining net assets to be distributed, after rank considerations. Holders of Series C preferred stock will receive a 150% return on the face value of the share of Series C preferred stock, or \$1,500 per share of Series C preferred stock, after rank considerations. In any event whereby the preceding distributions are unable to be met, the rank considerations outlined above shall be considered and the distribution of our net assets shall be determined according to rank and on a pro-rata basis.

Conversion

Series A preferred stock shall convert into common stock at a rate of \$4.00 per share, as adjusted accordingly. Each share of Series B preferred stock shall convert into 759,167 shares of common stock. Each share of Series C preferred stock shall convert into 75,917 shares of common stock. Each share of Series D 6% convertible preferred stock shall convert into common stock at \$2.10 per share.

All shares of Series B and Series C preferred stock were converted into common stock effective January 19, 2005. All outstanding shares of the Series D 6% convertible preferred stock were converted in full in 2006, and no shares of the Series D 6% convertible preferred stock were outstanding as of December 31, 2008 and 2007. We had classified our Series D 6% convertible preferred stock as mezzanine equity.

***Preferred Stock Transactions***

During the year ended December 31, 2006, 13,004 shares of Series D 6% convertible preferred stock were voluntarily converted to 6,192,628 shares of common stock. The fully accreted conversion value of these shares of common stock at the time converted was \$9.2 million.

During the year ended December 31, 2006, 8,937 shares of common stock were issued in lieu of cash dividends for the holders of Series D 6% convertible preferred stock. The shares issued were valued at \$48,825, which was 85% of the average of the lowest market value for three of the prior 10 trading days.

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**Force Protection, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**9. Shareholders' Equity (Continued)**

***Common Stock Transactions***

For the year ended December 31, 2008

During 2008, employees exercised stock options to purchase 31,000 shares of our common stock valued at \$47,000.

On May 1, 2008, we issued 20,513 shares of common stock as a result of the vesting of an award of restricted stock made to a former executive.

On January 2, 2008, we issued 50,000 shares of common stock granted in June 2006 to an employee that vested on January 2, 2008.

For the year ended December 31, 2007

During 2007, employees exercised stock options to purchase 1,411,133 shares of our common stock valued at \$1.4 million. We also issued 4,348 shares of our common stock related to 2006 employee stock option exercises that were identified as shares to be issued in shareholders' equity as of December 31, 2006.

During 2007, it was discovered that, during 2006, that we inadvertently issued an additional 27,700 purchased shares relating to the December 2006 Private Investment in Public Equity ("PIPE") offering. Upon discovery of this error, we cancelled those shares in 2007.

We issued 26,789 shares of common stock to members of the board of directors as 2006 compensation, which were indentified as shares to be issued in shareholders' equity as of December 31, 2006.

On January 1, 2007, we issued 50,000 shares of common stock granted in June 2006 to an employee that vested on January 1, 2007.

On June 1, 2007, we issued 20,513 shares of common stock as a result of the vesting of an award of restricted stock made to a former executive.

For the year ended December 31, 2006

During 2006, employees exercised stock options to purchase 5,348 shares of the Company's common stock valued at \$6,001. A total of 4,348 shares of our common stock were indentified as shares to be issued in the shareholders' equity as of December 31, 2006 related to employee exercised stock options.

On December 20, 2006, we closed a private placement sale and issued 13,000,000 shares of common stock to investors for gross proceeds of \$152.8 million. Net proceeds received after expenses were \$146.6 million.

On July 24, 2006, we closed a private placement sale and issued 8,250,000 shares of common stock to investors for gross proceeds of \$41.3 million. Net proceeds received after expenses were \$39.2 million.

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**Force Protection, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**9. Shareholders' Equity (Continued)**

The following issuances of our common stock during 2006 were valued by us using our closing bid price of our common stock as quoted on the OTC Bulletin Board market as of the date of the associated contract or the issuance date if no contract existed:

On August 8, 2006, we agreed to issue 30,000 shares of common stock under a settlement agreement with Atlantis Partners, Inc. The shares issued were valued at \$187,500.

On June 2, 2006, we granted and issued 12,500 shares of our unregistered common stock to a member of our board of directors, valued at \$40,500 as compensation due under a previous employment contract with us. During 2006, we granted and issued 165,202 shares of our unregistered common stock valued at \$405,786 under various employment agreements. Included within these issuances were common stock issuances related to certain employee agreements which were modified during 2006. A total of 233,418 shares of common stock were rescinded as a result of the modifications to employee agreements. These transactions resulted in a reduction of the total stock-based compensation for 2006 of \$224,688.

On April 21, 2006, the board of directors adopted a resolution approving payment of annual compensation to each member of our board of directors. Each member was to receive annual cash compensation of \$24,000. In addition, each member received a guarantee of an annual grant of 15,353 shares of our unregistered common stock. The shares of our unregistered common stock are required to be held until the individual's service as a member of our board of directors is complete. We awarded 96,149 and issued 69,360 shares of our common stock to the members of our board of directors in 2006. A total of 26,789 shares of our common stock were included in shares to be issued in the shareholders' equity as of December 31, 2006 relating to this award. The value for the 96,149 shares of common stock awarded to the members of the board of directors was recorded as stock based compensation of \$445,990.

Effective January 1, 2006, our board of directors granted our then chief executive officer 300,000 shares of our unregistered common stock valued at \$216,000. The shares were fully vested upon issuance.

During 2006, warrants associated with Series D 6% convertible preferred stock were exercised and we issued 2,633,333 shares of common stock for gross proceeds of \$9.9 million. In addition, various warrants were exercised and we issued 218,807 shares of common stock for gross proceeds of \$499,573.

As of December 31, 2006, all warrants were exercised or expired. No warrants remained outstanding as of December 31, 2006.

**10. Stock-Based Compensation**

*Stock Options*

In 2008, 61 employees were granted options to purchase an aggregate of 715,000 shares of our common stock. Stock options are granted at an exercise price equal to the closing market price at the date of grant. Options vest ratably over three years. Options granted expire no later than 10 years after the grant date. Twenty-five (25) employees and non-employee directors received grants of restricted stock totaling 880,600 shares. Stock grants generally vest ratably over three years. Shares available for future option and stock grants at December 31, 2008 totaled 3,604,400 shares.

Table of Contents**Force Protection, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****10. Stock-Based Compensation (Continued)**

Options granted prior to 2008 were not granted under a formal stock option plan and generally had vesting ranging from immediate to 14 months with contractual terms of four to five years.

All equity awards are settled by issuing new shares of common stock.

We used the Black-Scholes valuation model to determine the fair value options granted during the years ended December 31, 2008 and December 31, 2006. No awards were granted in 2007. The Black-Scholes option-pricing model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option-pricing models require the input of highly subjective assumptions, including the expected stock price volatility. Because our trading history is shorter than the expected life of the options, we used historical stock price volatility data from comparable companies to supplement our own historical volatility to determine expected volatility assumptions. We calculated volatility using weekly closing prices as of grant date for a period commensurate with the expected term. We do not pay a dividend, and therefore assume a zero percent dividend yield in our pricing model. Risk-free interest rates are based on U.S. Treasury STRIP yields, converted to continuously compounded rates, with terms to maturity consistent with the expected lives of the options. Because we do not have a sufficient history of option exercise or cancellation, we estimated the expected life of the options by using the short-cut approach described and permitted in Staff Accounting Bulletin ("SAB") No. 107, *Share-Based Payment*, and SAB No. 110, *Share-Based Payment*, for grants made in 2008. Prior to 2008, also due to insufficient history of option exercise and cancellations, the expected life of the options was estimated to be two years, which for a majority of the options was generally the midway point through the contractual term. Under the Black-Scholes option-pricing model, the weighted-average fair value per share of employee stock options granted during the years ended December 31, 2008 and December 31, 2006 was \$1.83, and \$1.20, respectively. For Restricted Stock, the fair value recognized is equal to the closing price of our stock on the date of grant.

The fair value of our options was estimated using the following assumptions:

|                                  | For the year ended December 31, |        |               |
|----------------------------------|---------------------------------|--------|---------------|
|                                  | 2008                            | 2007   | 2006          |
| Expected volatility              | 58.60%                          | 45.82% | 70.31%        |
| Risk-free interest rate          | 2.28%                           | 4.40%  | 4.97%         |
| Expected forfeiture rate         | 10.00%                          |        | 5%            |
| Dividend yield                   | 0.00%                           |        | %             |
| Stock price on date of grants    | \$ 3.28                         |        | \$0.77 \$7.48 |
| Expected option terms (in years) | 6.00                            |        | 2.00          |
| Contractual Term (in years)      | 10.00                           |        | 4 and 5       |
| Option vesting term (in years)   | 3.00                            | 1-day  | 1.17 years    |

*Stock Option Activity*

Table of Contents**Force Protection, Inc. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****10. Stock-Based Compensation (Continued)**

The following table summarizes stock option activity for the Stock Plans during 2008:

|                                                                                 | <b>Number<br/>of<br/>Options</b> | <b>Weighted-<br/>Average<br/>Exercise<br/>Price<br/>(per<br/>share)</b> | <b>Weighted-<br/>Average<br/>Remaining<br/>Contractual<br/>Term<br/>(in years)</b> | <b>Aggregate<br/>Intrinsic<br/>Value<br/>(in<br/>thousands)</b> |
|---------------------------------------------------------------------------------|----------------------------------|-------------------------------------------------------------------------|------------------------------------------------------------------------------------|-----------------------------------------------------------------|
| Options outstanding December 31, 2007                                           | 548,532                          | \$ 6.96                                                                 |                                                                                    |                                                                 |
| Granted                                                                         | 715,000                          | \$ 3.28                                                                 |                                                                                    |                                                                 |
| Exercised                                                                       | (31,000)                         | \$ 1.50                                                                 |                                                                                    |                                                                 |
| Forfeited                                                                       | (15,000)                         | \$ 3.28                                                                 |                                                                                    |                                                                 |
| Cancelled/expired                                                               | (500,033)                        | \$ 7.48                                                                 |                                                                                    |                                                                 |
| Options outstanding December 31, 2008                                           | 717,499                          | \$ 3.25                                                                 |                                                                                    |                                                                 |
| Vested and expected to vest (net of estimated forfeitures) December 31, 2008(a) | 660,999                          | \$ 3.25                                                                 | 9.67                                                                               | \$ 1,809                                                        |
| Exercisable December 31, 2008                                                   | 17,499                           | \$ 2.19                                                                 | 1.54                                                                               | \$ 71                                                           |

The following table summarizes stock option activity for the Stock Plans the year ended December 31, 2007:

|                                                                                 | <b>Number of<br/>Options</b> | <b>Weighted-<br/>Average<br/>Exercise<br/>Price<br/>(per<br/>share)</b> | <b>Weighted-<br/>Average<br/>Remaining<br/>Contractual<br/>Term<br/>(in years)</b> | <b>Aggregate<br/>Intrinsic<br/>Value<br/>(in<br/>thousands)</b> |
|---------------------------------------------------------------------------------|------------------------------|-------------------------------------------------------------------------|------------------------------------------------------------------------------------|-----------------------------------------------------------------|
| Options outstanding December 31, 2006                                           | 1,959,665                    | \$ 2.63                                                                 |                                                                                    |                                                                 |
| Granted                                                                         |                              |                                                                         |                                                                                    |                                                                 |
| Exercised                                                                       | (1,411,133)                  | \$ 0.95                                                                 |                                                                                    |                                                                 |
| Forfeited                                                                       |                              |                                                                         |                                                                                    |                                                                 |
| Cancelled/expired                                                               |                              |                                                                         |                                                                                    |                                                                 |
| Options outstanding December 31, 2007                                           | 548,532                      | \$ 6.96                                                                 |                                                                                    |                                                                 |
| Vested and expected to vest (net of estimated forfeitures) December 31, 2007(a) | 548,532                      | \$ 6.96                                                                 | 2.89                                                                               | \$ 147                                                          |
| Exercisable December 31, 2007(a)                                                | 548,532                      | \$ 6.96                                                                 | 2.89                                                                               | \$ 147                                                          |

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**Force Protection, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements (Continued)**

**10. Stock-Based Compensation (Continued)**

The following table summarizes stock option activity for the Stock Plans during the year ended December 31, 2006:

**Number  
of  
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