ARMOR HOLDINGS INC
Form 10-Q
May 05, 2006
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2006, or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM TO .

Commission File Number 0-18863

ARMOR HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of ''accelerated filer and large accelerated filer'' in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer Accelerated filer Non-accelerated filer

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

The number of shares outstanding of the registrant's Common Stock as of May 3, 2006 is 35,381,829.

Armor Holdings, Inc.

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PART I — FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

The accompanying unaudited condensed consolidated financial statements of Armor Holdings, Inc. and its wholly-owned subsidiaries include all adjustments which management considers necessary for a fair presentation of operating results and financial position as of March 31, 2006, and for the three month periods ended March 31, 2006, and March 31, 2005.

These unaudited condensed consolidated financial statements should be read in conjunction with the financial statements included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2005.

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

	March 31, 2006 (unaudited)	December 31, 2005*
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 97,420	$ 471,841
Short-term investment securities	391,500	—
Accounts receivable (net of allowance for doubtful accounts of $6,826 and $6,763)	212,766	212,124
Inventories	232,914	210,517
Prepaid expenses and other current assets	43,143	38,087
Total current assets	977,743	932,569
PROPERTY AND EQUIPMENT (net of accumulated depreciation of $39,784 and $37,041)	86,644	79,929
GOODWILL (net of accumulated amortization of $4,024 and $4,024)	273,806	273,696
PATENTS, LICENSES AND TRADEMARKS (net of accumulated amortization of $17,514 and $15,256)	128,443	130,620
OTHER ASSETS	65,088	46,048
TOTAL ASSETS	$ 1,531,724	$ 1,462,862

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

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

	March 31, 2006 (unaudited)	December 31, 2005*
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current portion of long-term debt	$ 300	$ 430
Short-term debt	343,810	344,274
Accounts payable	104,200	90,963
Accrued expenses and other current liabilities	91,341	100,924
Income taxes payable	7,715	8,767
Total current liabilities	547,366	545,358
LONG-TERM LIABILITIES:		
Long-term debt, less current portion	150,475	151,910
Other long-term liabilities	12,086	10,475
Deferred income taxes	46,979	44,537
Total liabilities	756,906	752,280
COMMITMENTS AND CONTINGENCIES (NOTE 11)		
STOCKHOLDERS' EQUITY:		
Preferred stock, $.01 par value, 5,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock, $.01 par value; 75,000,000 shares authorized; 41,422,262 and 41,347,628 issued and 35,362,040 and 35,287,406 outstanding at March 31, 2006, and December 31, 2005, respectively	415	415
Additional paid-in capital	526,904	525,890
Retained earnings	299,400	257,991
Accumulated other comprehensive income (loss)	20,416	(1,397)
Treasury stock	(72,317)	(72,317)
Total stockholders' equity	774,818	710,582
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 1,531,724	$ 1,462,862

* Condensed from audited financial statements.

See notes to condensed consolidated financial statements.

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

	Three Months Ended	
	March 31, 2006	March 31, 2005
REVENUES:		

Aerospace & Defense	$ 345,103	$ 265,695
Products	76,836	63,333
Mobile Security	23,501	35,937
Total revenues	445,440	364,965
COSTS AND EXPENSES:		
Cost of revenues	340,810	273,655
Selling, general and administrative expenses	36,142	33,816
Amortization	2,259	2,038
Integration	470	800
OPERATING INCOME	65,759	54,656
Interest expense, net	259	2,245
Other (income) expense, net	(807)	1,123
INCOME BEFORE PROVISION FOR INCOME TAXES	66,307	51,288
PROVISION FOR INCOME TAXES	24,898	20,259
NET INCOME	$ 41,409	$ 31,029
BASIC EARNINGS PER SHARE	$ 1.17	$ 0.90
DILUTED EARNINGS PER SHARE	$ 1.11	$ 0.87
WEIGHTED AVERAGE SHARES – BASIC	35,342	34,509
WEIGHTED AVERAGE SHARES – DILUTED	37,205	35,832

See notes to condensed consolidated financial statements.

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

	Three Months Ended	
	March 31, 2006	March 31, 2005
CASH FLOW FROM OPERATING ACTIVITIES:		
Net income	$ 41,409	$ 31,029
Adjustments to net income to cash provided by operating activities:		
Depreciation and amortization	5,643	5,203
Loss on disposal of fixed assets	124	30
Deferred income taxes	4,044	2,616
Fair value adjustment for put options	(710)	1,121
SERP expense	725	—
Changes in operating assets and liabilities, net of acquisitions:		
Increase in accounts receivable	(394)	(14,322)
Increase in inventories	(22,136)	(7,842)
Increase in prepaid expenses and other assets	(4,726)	(1,574)

Increase in accounts payable, accrued expenses and other current liabilities	5,277	2,658
(Decrease) increase in income taxes payable	(962)	742
Net cash provided by operating activities	28,294	19,661
CASH FLOW FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(9,199)	(3,223)
Purchase of patents and trademarks	(85)	(34)
Purchases of short-term investment securities	(489,000)	(469,800)
Proceeds from sales of short-term investment securities	97,500	77,825
Sale of put options	—	1,687
Collection of note receivable	252	—
Costs related to pending acquisitions	(2,849)	—
Additional consideration for purchased businesses	(85)	(1,081)
Purchase of businesses, net of cash acquired	—	(1,362)
Net cash used in investing activities	(403,466)	(395,988)
CASH FLOW FROM FINANCING ACTIVITIES:		
Proceeds from the exercise of stock options	724	3,903
Taxes paid for withheld shares on restricted stock issuances	(430)	(180)
Windfall tax benefit of stock options	312	—
Repayments of long-term debt	(208)	(190)
Borrowings under lines of credit	840	8,325
Repayments under lines of credit	(1,362)	(6,505)
Net cash (used in)/provided by financing activities	(124)	5,353
Effect of exchange rate changes on cash and cash equivalents	875	(1,099)
Net decrease in cash and cash equivalents	(374,421)	(372,073)
Cash and cash equivalents, beginning of period	471,841	421,209
Cash and cash equivalents, end of period	$ 97,420	$ 49,136

See notes to condensed consolidated financial statements.

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

NOTE 1 — BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of Armor Holdings, Inc. and its wholly-owned subsidiaries (the ‘‘Company’’, ‘‘we’’, ‘‘our’’, ‘‘us’’) have been prepared in accordance with accounting princip generally accepted in the United States of America (‘‘U.S. GAAP’’) for interim information and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X, and do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments considered necessary to present a fair presentation have been included. The results of operations for the three month periods are not necessarily indicative of the results to be expected for the full year and should be read in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2005. Certain prior year amounts have been reclassified to conform to the current year presentation.

NOTE 2 — COMPREHENSIVE INCOME

The components of comprehensive income, net of tax provision of $237,000 and tax benefit of $114,000 for the three months ended March 31, 2006 and 2005, respectively, are listed below:

	Three Months Ended	
	March 31, 2006	March 31, 2005
	(In thousands)	
Net income	$ 41,409	$ 31,029
Other comprehensive income:		
Unrealized gain on equity securities	20,745	—
Foreign currency translation, net of tax	1,068	(2,043)
Comprehensive income	$ 63,222	$ 28,986

NOTE 3 — INVENTORIES

The components of inventory as of March 31, 2006, and December 31, 2005, are summarized as follows:

	March 31, 2006	December 31, 2005
	(In thousands)	
Raw material	$ 140,592	$ 127,465
Work-in-process	58,658	48,900
Finished goods	33,664	34,152
Total inventories	$ 232,914	$ 210,517

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

NOTE 4 — ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

Accrued expenses and other current liabilities as of March 31, 2006, and December 31, 2005, are summarized as follows:

	March 31, 2006	December 31, 2005

	(In thousands)			
Accrued expenses and other current liabilities	$	65,285	$	75,505
Vest exchange program / warranty revision accrual (See Note 13)		14,776		18,511
Customer deposits		10,309		5,837
Deferred consideration for acquisitions		971		1,071
Total accrued expenses and other current liabilities	$	91,341	$	100,924

NOTE 5 — DERIVATIVE FINANCIAL INSTRUMENTS

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

On October 29, 2004, we completed the placement of the 2.00% Senior Subordinated Convertible Notes due November 1, 2024 (the ‘‘2% Convertible Notes’’). On November 5, 2004, Goldman, Sachs & Co. exercised its option to purchase an additional $45 million principal amount of the 2% Convertible Notes. The 2% Convertible Notes will bear interest at a rate of 2.00% per year, payable on November 1 and May 1 of each year beginning on May 1, 2005, and ending on November 1, 2011. The 2% Convertible Notes will be subject to accretion of the principal amount beginning on November 1, 2011, at a rate that provides holders with an aggregate annual yield to maturity of 2.00%, as defined in the agreement. The 2% Convertible Notes will bear contingent interest during any six-month period beginning November 1, 2011, of 15 basis points paid in cash if the average trading price of the notes is above certain levels. As defined in SFAS 133, ‘‘Accounting for Derivative Instruments and Hedge Activities’’ the contingent interest feature of the 2% Convertible Notes is an embedded derivative that is not considered clearly and closely related to the host contract. The fair value of this bifurcated derivative at March 31, 2006, and December 31, 2005, is immaterial to our financial position.

We hedge the fair value of our 8¼% Senior Subordinated Notes due 2013 (the ‘‘8.25% Notes’’) using interest rate swaps. We enter into these derivative contracts to manage fair value changes which could be caused by our exposure to interest rate changes. On September 2, 2003, we entered into interest rate swap agreements, designated as fair value hedges as defined under SFAS 133 with an aggregate notional amount totaling $150 million. The agreements were entered into to exchange the fixed interest rate on the 8.25% Notes for a variable interest rate equal to six-month LIBOR (5.1% at March 31, 2006), set in arrears, plus a spread ranging from 2.735% to 2.75% fixed semi-annually on the fifteenth of February and August each year through maturity. The agreements are subject to other terms and conditions common to transactions of this type. These fair value hedges qualify for hedge accounting using the short-cut method since the swap terms match the critical terms of the 8.25% Notes. Accordingly, changes in the fair value of the interest rate swap agreements offset changes in

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (UNAUDITED)
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the fair value of the 8.25% Notes due to changes in the market interest rate. As a result, no ineffectiveness is expected to be recognized in our earnings associated with the interest rate swap agreements on the 8.25% Notes. For the three months ended March 31, 2006, the fair value for interest swaps changed in value by $3.1 million. At December 31, 2005, there was a $1.4 million asset included in other assets, which, as a result of the change in fair value, is a $1.7 million hedge liability at March 31, 2006.

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

NOTE 6 — GOODWILL AND IDENTIFIED INTANGIBLE ASSETS

Under Statement of Financial Accounting Standards No. 142, ‘‘Goodwill and Other Intangible Assets’’ (‘‘SFAS 142’’), goodwill and intangible assets with indefinite lives are no longer amortized, but are tested for impairment at least annually or more often if indicators of impairment arise. The changes in the carrying amount of goodwill for the three months ended March 31, 2006, are as follows:

	Aerospace & Defense	Products	Mobile Security	Corporate	Total
			(In thousands)		
Balance at December 31, 2005	$ 155,772	$ 109,791	$ 6,490	$ 1,643	$ 273,696
Finalization of purchase price	—	85	—	—	85
Foreign currency translation and other adjustments	—	16	9	—	25
Balance at March 31, 2006	$ 155,772	$ 109,892	$ 6,499	$ 1,643	$ 273,806

Included in patents, licenses and trademarks in the accompanying condensed consolidated balance sheets are the following intangible assets as of March 31, 2006:

	Customer Relationships	Technology	Marketing	Total
		(In thousands)		
Gross amount	$ 60,552	$ 20,071	$ 65,334	$ 145,957
Accumulated amortization	(10,340)	(4,270)	(2,904)	(17,514)
Net amount	$ 50,212	$ 15,801	$ 62,430	$ 128,443

Included in Marketing are approximately $60.7 million of marketing-related intangible assets that have indefinite lives.

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

NOTE 7 — INFORMATION CONCERNING BUSINESS SEGMENTS AND GEOGRAPHICAL REVENUES

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

	Three Months Ended	
	March 31, 2006	March 31, 2005
	(In thousands)	
Revenues:		
Aerospace & Defense	$ 345,103	$ 265,695
Products	76,836	63,333
Mobile Security	23,501	35,937
Total revenues	$ 445,440	$ 364,965
Operating income (loss):		
Aerospace & Defense	$ 58,588	$ 48,068
Products	12,152	8,471
Mobile Security	889	5,606
Corporate	(5,870)	(7,489)
Total operating income	$ 65,759	$ 54,656

	March 31, 2006	December 31, 2005
	(In thousands)	
Total assets:		
Aerospace & Defense	$ 580,692	$ 546,141
Products	341,659	347,932
Mobile Security	87,723	87,866
Corporate	521,650	480,923
Total assets	$ 1,531,724	$ 1,462,862

Beginning in 2006, responsibility of Cyconics International Training Systems, Inc., a subsidiary providing certain training services, was transferred from the Products segment to the Aerospace & Defense segment. Accordingly, business segment information presented for the first quarter of 2005 has been reclassified to conform with the current period's presentation.

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

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

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005
	(In thousands)	
Revenues:		
United States of America	$ 415,975	$ 319,260
North America (excluding the United States of America)	1,670	2,189
South America	4,969	4,393
Africa	2,361	4,744
Europe/Asia	20,465	34,379
Total revenue	$ 445,440	$ 364,965

	March 31, 2006	December 31, 2005
	(In thousands)	
Total property and equipment, net:		
North America	$ 68,225	$ 60,573
South America	1,356	1,419
Europe/Asia	17,063	17,937
Total property and equipment, net	$ 86,644	$ 79,929

NOTE 8 — EARNINGS PER SHARE

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

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005
	(In thousands, except per share data)	
Numerator for basic and diluted earnings per share:		
Net income	$ 41,409	$ 31,029
Denominator for basic earnings per share – weighted average shares outstanding:	35,342	34,509
Effect of shares issuable under stock option and stock grant plans, based on the treasury stock method	1,414	1,323
Effect of shares issuable under the net share settlement of the conversion option of our 2% Convertible Notes, based on the treasury method	449	—
Denominator for diluted earnings per share – adjusted weighted average shares outstanding	37,205	35,832
Basic earnings per share	$ 1.17	$ 0.90

Diluted earnings per share	$	1.11	$	0.87

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (UNAUDITED)
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NOTE 9 — STOCKHOLDERS' EQUITY

Preferred stock. On July 16, 1996, our stockholders authorized a series of preferred stock with such rights, privileges and preferences as the Board of Directors shall from time to time determine. We have not issued any of this preferred stock.

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

Treasury stock. We had 6,060,222 shares in treasury as of March 31, 2006, and December 31, 2005.

Stock options and grants. On June 22, 2005, we implemented the 2005 Stock Incentive Plan. The 2005 Stock Incentive Plan authorizes the issuance of up to 2,500,000 shares of our common stock. Any shares of our common stock granted as restricted stock, performance stock or other stock-based awards will be counted against the shares authorized as one and eight-tenths (1.8) shares for every one share issued in connection with such award. The 2005 Stock Incentive Plan authorizes the granting of stock options, restricted stock, performance awards and other stock-based awards to employees, officers, directors and consultants, independent contractors and advisors of the Company and its subsidiaries. Upon adoption of our 2005 Stock Incentive Plan, we agreed to not grant awards under any of our pre-existing stock incentive plans.

During 2002, we implemented two new stock option plans. The 2002 Stock Incentive Plan authorizes the issuance of up to 2,700,000 shares of our common stock upon the exercise of stock options or in connection with the issuance of restricted stock and stock bonuses. On June 22, 2004, our stockholders approved an amendment to increase, by 2,000,000 shares, the total number of shares of common stock that may be awarded under the 2002 Stock Incentive Plan. The 2002 Stock Incentive Plan authorizes the granting of stock options, restricted stock and stock bonuses to employees, officers, directors and consultants, independent contractors and advisors of the Company and its subsidiaries. The 2002 Executive Stock Plan provides for the grant of a total of 470,000 stock options and stock awards to our key employees. The terms and provisions of the 2002 Executive Stock Plan are substantially the same as the 2002 Stock Incentive Plan, except that we may only grant non-qualified stock options under the 2002 Executive Stock Plan. The 2002 Executive Stock Plan was adopted on March 13, 2002, and all shares available for grant under the 2002 Executive Stock Plan were granted to our executive officers on March 13, 2002.

In 1999, we implemented the 1999 Stock Incentive Plan. We reserved 2,000,000 shares of our common stock for the 1999 Stock Incentive Plan. The 1999 Stock Incentive Plan provides for the granting of options to employees, officers, directors, consultants, independent contractors and advisors of the Company. The option prices of stock which may be purchased under the 1999 Stock Incentive Plan are not less than the fair market value of common stock on the dates of the grants. During 1998, we implemented a new non-qualified stock option plan. Pursuant to the new plan, 725,000 shares of common stock were reserved and made available for distribution. On January 1, 1999, we distributed all 725,000 shares allocated under the plan.

In 1996, we implemented an incentive stock plan and an outside directors' stock plan. These plans collectively provide for the granting of options to certain key employees and directors. Pursuant to such plans, as amended, 2,200,000 shares of common stock were reserved and made available for distribution. The option prices of stock that may be purchased under the incentive stock plan are not less than the fair market value of common stock on the dates of the grants.

In 1994, we implemented an incentive stock plan and an outside directors' stock plan. These plans collectively provide for the granting of options to certain key employees as well as providing for the

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

grant of common stock to outside directors and to all full time employees. Pursuant to such plans, 1,050,000 shares of common stock were reserved and made available for distribution. The option prices of stock that may be purchased under the incentive stock plan are not less than the fair market value of common stock on the dates of the grants. Effective January 19, 1996, all stock grants awarded under the 1994 incentive stock plan were accelerated and considered fully vested.

On January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), ‘‘Share-Based Payments’’ (‘‘FAS 123R’’), requiring us to recognize expense related to the fair value of our stock option awards. We recognize the cost of share-based awards on a straight-line basis over the vesting period of the award. Prior to January 1, 2006, we accounted for our stock option plans under the recognition and measurement provisions of Accounting Principles Board Opinion No. 25, ‘‘Accounting for Stock Issued to Employees’’ (‘‘APB 25’’) and related interpretations, as permitted by Statement of Financial Accountant Standard No. 123, ‘‘Accounting for Stock-Based Compensation’’ (‘‘SFAS 123’’). Excluding modification to stock option agreements, no stock option-based employee compensation cost was recognized in the income statement, as all stock options granted under those plans had an exercise price equal to or greater than the market value of the underlying common stock on the date of grant.

Effective January 1, 2006, we adopted the fair value recognition provisions of FAS 123R, using the modified prospective transition method. Under this transition method, compensation cost recognized during the first quarter of 2006 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123, and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of FAS 123R. Results for prior periods have not been restated. As a result of adopting FAS 123R on January 1, 2006, our income before income taxes and net income for the three months ended March 31, 2006, was $203,000 and $132,000 lower, respectively, than if we had continued to account for share-based compensation under ABP 25.

Prior to the adoption of FAS 123R, we presented all tax benefits of deductions resulting from the exercise of stock options as operating cash flows in the statement of cash flows. Beginning on January 1, 2006, we changed our cash flow presentation in accordance with FAS 123R, which requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (windfall tax benefits) to be classified as financing cash flows.

We have estimated the fair value of our option awards granted after January 1, 2006, using a Black-Scholes option pricing model. The expected life of the options granted is management's estimate and represents the period of time that options granted are expected to be outstanding. We currently do not pay dividends. Volatility is based on the historical volatility of our stock price. The risk-free interest rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. The fair value of each option grant during the three months ended March 31, 2006 and 2005 is estimated on the date of grant with the following weighted-average assumptions:

	March 31, 2006	March 31, 2005
Expected life of option	5.0 yrs	5.3 yrs
Dividend yield	0%	0%
Volatility	46.4%	48.6%
Risk free interest rate	4.3%	4.1%

The weighted average fair value of options granted during the three months ended March 31, 2006 and 2005 are as follows:

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (UNAUDITED)
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	March 31, 2006	March 31, 2005
	(In thousands, except per share data)	
Fair value of each option granted	$ 20.84	$ 19.54
Total number of options granted	25	1,430
Total fair value of all options granted	$ 521	$ 27,942

Outstanding options, consisting of incentive and non-qualified stock options, generally vest and become exercisable over a three to five year period from the date of grant. Other options granted are immediately vested, but are subject to lock-up provisions that disallow the recipient from selling the shares until the lock-up expires, which is generally staggered over a seven year period. The outstanding options generally expire ten or seven years from the date of grant or upon retirement from the Company, respectively, and are contingent upon continued employment during the applicable ten year or seven year period.

The following table illustrates the effect on net income and earnings per share if we had applied the fair value recognition provisions of SFAS 123, to options granted under our stock option plans during the three month period ended March 31, 2005. For purposes of this pro forma disclosure, the value of the options is amortized to expense on a straight-line basis over the vesting period and forfeitures are recognized as they occur. Our pro forma information follows for the three months ended March 31, 2005:

	Three Months Ended March 31, 2005 (In thousands, except for per share amounts)
Net income as reported	$ 31,029
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(33,545)
Add: Employee compensation expense for modification of stock option awards included in reported net income, net of income taxes	118
Pro forma net loss	$ (2,398)
Earnings (loss) per share:	
Basic – as reported	$ 0.90
Basic – pro forma	$ (0.07)
Diluted – as reported	$ 0.87
Diluted – pro forma	$ (0.07)

$15.3 million of the stock-based employee compensation expense for the three months ended March 31, 2005, is related to accelerated vesting of certain existing stock options and $17.6 million is related to certain stock options issued in the three months ended March 31, 2005.

A summary of the status of stock option grants as of March 31, 2006, and changes during the three months ending March 31, 2006, is presented below:

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

	Options	Weighted Average Exercise Price	Aggregate Intrinsic Value
Outstanding at December 31, 2005	3,810,557	$ 31.51	
Granted	25,000	$ 45.26	
Exercised	(41,461)	$ 17.81	
Forfeited	(16,800)	$ 39.15	
Outstanding at March 31, 2006	3,777,296	$ 31.74	$ 100,292
Options exercisable at March 31, 2006	3,599,359	$ 31.58	$ 96,154

The following table summarizes information about stock options outstanding at March 31, 2006:

Exercise Price Range	Outstanding	Exercisable	Remaining Life In Years
$7.50 – $11.19	72,150	72,150	2.3
13.19 – 13.98	55,797	43,961	5.8
14.00 – 14.55	435,789	435,789	7.0
15.05 – 17.12	273,010	273,010	7.0
23.09 – 23.26	46,117	46,117	5.8
24.07 – 25.07	269,300	265,966	6.3
25.69 – 28.90	367,833	364,500	7.8
33.04 – 36.05	447,800	318,366	8.3
37.90 – 38.99	938,000	938,000	9.0
39.20 – 45.93	871,500	841,500	8.1
Total	3,777,296	3,599,359	7.8

Remaining non-exercisable options as of March 31, 2006, become exercisable as follows:

Remainder of 2006	40,402
2007	44,733
2008	41,399
2009	41,403
Thereafter	10,000

ARMOR HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (UNAUDITED)
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The fair value of nonvested shares is determined based on the market price of our shares on the grant date. A summary of the status of our nonvested shares as of March 31, 2006, and changes during the three-month period ended March 31, 2006, is as follows:

	Shares	Fair Value
	(In thousands, except share data)	
Nonvested at December 31, 2005	178,906	$ 2,415
Granted	25,000	521
Vested	(9,169)	(504)

Forfeited	(16,800)	(274)
Nonvested at March 31, 2006	177,937	$ 2,158

As of March 31, 2006, there was $2.2 million of unrecognized compensation cost related to nonvested stock options that is expected to be recognized over a weighted average period of 2.6 years.

Restricted stock and stock bonuses. We granted the following restricted stock and stock bonuses during the three months ended March 31, 2006 and 2005:

	Three Months Ended	
	March 31, 2006	March 31, 2005
	(In thousands, except per share data)	
Restricted stock and stock bonus shares granted	—	48,402
Weighted-average fair value per share at grant date	$ —	$ 43.99
Compensation cost recognized	$ 110	$ 127

Other contingent shares. The dilutive effect of shares issuable under stock award plans does not include 14,152 stock options awarded that were anti-dilutive as of March 31, 2006. In addition, certain of our executives are entitled to receive performance stock bonus awards of 450,000 shares of our common stock if at any time between January 1, 2005, and December 31, 2007, certain conditions are met as defined in their employment agreements. At our discretion, we are able to settle these performance stock bonus awards in cash.

NOTE 10 — RECENT ACCOUNTING PRONOUNCEMENTS

There were no new significant accounting pronouncements issued during the three months ended March 31, 2006, that are expected to have a material impact on the Company's financial statements.

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

NOTE 11 — LEGAL PROCEEDINGS

On January 16, 1998, our Services Division ceased operations in Angola and subsequently became involved in various disputes with SHRM S.A. (‘‘SHRM’’), its minority joint venture partner, relating to the Angolan joint venture known as Defense System International Africa (‘‘DSIA’’). Since March 1998, we have been and continue to be involved in various legal proceedings before French courts with SHRM, which is part of the Compass Group, regarding damages from the circumstances under which DSIA ceased doing business in Angola due to the decree of the Angolan government expelling the employees of our Services Division from Angola. A possible loss estimate related to this case cannot be reasonably made and no accrual has been recorded.

Kroll, Inc. Matters

O'Gara-Hess & Eisenhardt Armoring do Brasil Ltda. ("OHE Brazil") was audited by the Brazilian federal tax authorities and the Company has been informed that they were assessed over 10 Million Reals (US $4.55 million based on the exchange rate as of March 31, 2006). In addition, in January 2004, OHE Brazil was audited and the Company has been informed that they were assessed over 20 Million Reals (US $9.1 million based on the exchange rate as of March 31, 2006) for activities that occurred prior to the Company's acquisition of the O'Gara Companies in 2001. OHE Brazil has appealed both tax assessments and the cases are pending. To the extent that there may be any liability resulting from such assessments, we believe that we are entitled to indemnification from Kroll, Inc. for up to $7.8 million under the terms of our purchase agreement dated April 20, 2001, because the events in question with respect to up to $7.8 million of such assessments occurred prior to our purchase of the O'Gara Companies from Kroll, Inc.

In December 2001, O'Gara-Hess & Eisenhardt France S.A., which was acquired from Kroll, Inc. ("OHE France") in August 2001, sold its industrial bodywork business operated under the name Labbe/Division de O'Gara Hess & Eisenhardt France/ Carrosserie Industrielle ("Carrosserie") to SNC Labbe. Subsequent to the sale, the members of Labbe Family Estate ("LFE"), who are joint owners of the leasehold interest upon which the Carrosserie business is operated, sued OHE France and SNC Labbe claiming the transfer of the leasehold was not valid because they did not give their consent to the transfer as allegedly required under the terms of the lease. LFE members sought to have OHE France, as sole tenant, maintain and repair the leased building with an estimated cost of between US $3.85 and US $7.4 million, based on the exchange rate as of March 31, 2006. In a decision dated February 28, 2006, the French "Tribunal de Grande Instance" (Court of First Degree) of Saint-Brieuc decided that the transfer of the leasehold was not valid regarding LFE members, but rejected their claim concerning the maintaining and repairing of the leased building. The court also decided that SNC Labbe was to indemnify the Company for all condemnations pursuant to its decision, including judicial fees and costs. An appeal is still possible against such court's decision and we are unable to predict the outcome of this matter and as such, no accrual has been made. In the meantime, actions have been undertaken in order to organize a new transfer of the leasehold in conformity with the applicable regulations. Such new transfer is currently pending and has not yet been completed. Although we do not have any insurance coverage for this matter, at this time, we do not believe this matter will have a material impact on our financial position, operations or liquidity.

Zylon®

In April, 2004, two class action lawsuits were filed against us in Florida state court by police organizations and individual police officers, alleging that ballistic-resistant soft body armor (vests) containing Zylon®, manufactured and sold by American Body Armor,™ Safariland® and PROTECH®, failed to meet the warranties provided with the vests. On November 5, 2004, the Jacksonville, Florida (Duval County) Circuit Court gave final approval to a settlement reached with the Southern States Police Benevolent Association (‘‘SSPBA’’) which provided that (i) purchasers of certain Zylon®-containing vest models could exchange their vests for other vests manufactured by the

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Company and, (ii) the Company would continue its internal used-vest testing program (VestCheck).™ The other class action suit filed by the National Association of Police Organizations, Inc. (‘‘NAPO’’), in Ft. Myers, Florida (Lee

County), was voluntarily dismissed with prejudice on November 16, 2004.

On August 24, 2005, the United States Department of Justice, National Institute of Justice (‘‘NIJ’’), released its Third Status Report to the Attorney General on Body Armor Safety Initiative Testing and Activities (the ‘‘Third NIJ Report’’). The Third NIJ Report contained, among other items, information and testing data on Zylon® and Zylon®-containing vests, and substantially modified compliance standards for all ballistic-resistant vests with the implementation of the NIJ 2005 Interim Requirements for Ballistic-Resistant Body Armor. As a result of the actions of the NIJ, the Company halted all sales or shipment of any Zylon®-containing vest models effective August 25, 2005, and immediately established a Supplemental Relief (renamed the Zylon® Vest Exchange (‘‘ZVE’’)) Program that provides either a cash or voucher option to those who purchased any Zylon®-containing vests from us through August 29, 2005. The ZVE Program, with the consent of the SSPBA, was given final approval by the Jacksonville, Florida Court on October 27, 2005. (See also Note 13 for information regarding the estimated cost of the ZVE program.)

We are also voluntarily cooperating with a request for documents and data received from the Department of Justice, which is reviewing the entire body armor industry’s use of Zylon®, and a subpoena served by the General Services Administration for information relating to Zylon®. On March 27, 2006, we entered into an agreement with the Department of Justice to toll the statute of limitations until September 30, 2006, with regard to possible civil claims the United States could assert against the Company with respect to certain body armor products made by us which contain Zylon®.

Other Matters

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

On February 9, 2006, we were notified by the IRS that our tax returns for the taxable years ended December 31, 2003 and 2004, had been selected for examination. We do not expect this examination will have a material impact on our financial position, operations or liquidity.

NOTE 12 — GUARANTOR AND NONGUARANTOR FINANCIAL STATEMENTS

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

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

The following consolidating financial information presents the Condensed Consolidating Balance Sheets as of March 31, 2006 and December 31, 2005, and the related Condensed Consolidating Statements of Operations and Statements of Cash Flows for the three months ended March 31, 2006, and 2005 for:

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

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

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

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

Armor Holdings, Inc. and Subsidiaries
Condensed Consolidating Balance Sheets

	March 31, 2006				
	Parent	Guarantor Subsidiaries	Nonguarantor Subsidiaries	Eliminations	Consolidated Total
			(In thousands)		
Assets					
Current assets:					
Cash and cash equivalents	$ 48,418	$ 24,702	$ 24,300	$ —	$ 97,420
	391,500	—	—	—	391,500

Short-term investment securities					
Accounts receivable, net	—	194,345	18,421	—	212,766
Intercompany receivables	176,882	125,672	38,400	(340,954)	—
Inventories	—	205,948	26,966	—	232,914
Prepaid expenses and other current assets	7,023	33,358	2,762	—	43,143
Total current assets	623,823	584,025	110,849	(340,954)	977,743
Property and equipment, net	1,932	63,348	21,364	—	86,644
Goodwill, net	—	271,792	2,014	—	273,806
Patents, licenses and trademarks, net	—	128,040	403	—	128,443
Other assets	13,727	1,873	49,488	—	65,088
Investment in subsidiaries	841,010	119,217	—	(960,227)	—
Total assets	$1,480,492	$1,168,295	$ 184,118	$ (1,301,181)	$1,531,724
Liabilities and stockholders' equity					
Current liabilities:					
Current portion of long-term debt	$ —	$ 149	$ 151	$ —	$ 300
Short-term debt	341,795	—	2,015	—	343,810
Accounts payable	1,497	94,717	7,986	—	104,200
Accrued expenses and other current liabilities	10,830	61,793	18,718	—	91,341
Income taxes payable	(5,211)	12,251	675	—	7,715
Intercompany payable	193,196	13,494	134,264	(340,954)	—
Total current liabilities	542,107	182,404	163,809	(340,954)	547,366
Long-term debt, less current portion	148,163	2,079	233	—	150,475
Other long-term liabilities	8,447	3,639	—	—	12,086
Deferred income taxes	6,957	38,976	1,046	—	46,979
Total liabilities	705,674	227,098	165,088	(340,954)	756,906
Stockholders' equity:					
Preferred stock	—	1,450	—	(1,450)	—
Common stock	415	3,193	7,852	(11,045)	415
Additional paid in capital	526,904	533,682	14,779	(548,461)	526,904
Retained earnings (accumulated deficit)	299,400	402,872	(3,601)	(399,271)	299,400
Accumulated other comprehensive income	20,416	—	—	—	20,416
Treasury stock	(72,317)	—	—	—	(72,317)
Total stockholders' equity	774,818	941,197	19,030	(960,227)	774,818
Total liabilities and stockholders' equity	$1,480,492	$1,168,295	$ 184,118	$ (1,301,181)	$1,531,724

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

Armor Holdings, Inc. and Subsidiaries
Condensed Consolidating Balance Sheets

	December 31, 2005				
	Parent	Guarantor Subsidiaries	Nonguarantor Subsidiaries	Eliminations	Consolidated Total
			(In thousands)		
Assets					
Current assets:					
Cash and cash equivalents	$ 423,961	$ 23,879	$ 24,001	$ —	$ 471,841
Accounts receivable, net	—	191,583	20,541	—	212,124
Intercompany receivables	101,956	109,177	39,170	(250,303)	—
Inventories	—	185,032	25,485	—	210,517
Prepaid expenses and other current assets	2,316	32,806	2,965	—	38,087
Total current assets	528,233	542,477	112,162	(250,303)	932,569
Property and equipment, net	2,052	57,326	20,551	—	79,929
Goodwill, net	—	271,708	1,988	—	273,696
Patents, licenses and trademarks, net	—	130,216	404	—	130,620
Other assets	15,221	2,089	28,738	—	46,048
Investment in subsidiaries	795,098	117,776	—	(912,874)	—
Total assets	$1,340,604	$1,121,592	$ 163,843	$ (1,163,177)	$1,462,862
Liabilities and stockholders' equity					
Current liabilities:					
Current portion of long-term debt	$ —	$ 283	$ 147	$ —	$ 430
Short-term debt	341,752	—	2,522	—	344,274
Accounts payable	607	80,300	10,056	—	90,963
Accrued expenses and other current liabilities	16,660	65,346	18,918	—	100,924
Income taxes payable	(5,105)	12,257	1,615	—	8,767
Intercompany payables	115,076	22,682	112,545	(250,303)	—
Total current liabilities	468,990	180,868	145,803	(250,303)	545,358
Long-term debt, less current portion	149,528	2,115	267	—	151,910
Other long-term liabilities	7,333	3,142	—	—	10,475
Deferred income taxes	4,171	39,390	976	—	44,537
Total liabilities	630,022	225,515	147,046	(250,303)	752,280
Stockholders' equity:					
Preferred stock	—	1,450	—	(1,450)	—
Common stock	415	3,193	7,852	(11,045)	415
Additional paid – in capital	525,890	533,682	14,778	(548,460)	525,890

Retained earnings (accumulated deficit)	257,991	357,752	(5,833)	(351,919)	257,991
Accumulated other comprehensive loss	(1,397)	—	—	—	(1,397)
Treasury stock	(72,317)	—	—	—	(72,317)
Total stockholders' equity	710,582	896,077	16,797	(912,874)	710,582
Total liabilities and stockholders' equity	$1,340,604	$1,121,592	$ 163,843	$ (1,163,177)	$1,462,862

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

Armor Holdings Inc. and Subsidiaries
Condensed Consolidating Statements of Operations

	Three Months ended March 31, 2006				
	Parent	Guarantor Subsidiaries	Nonguarantor Subsidiaries	Eliminations	Consolidated Total
			(In thousands)		
Revenues:					
Aerospace & Defense	$ —	$ 339,995	$ 7,023	$ (1,915)	$ 345,103
Products	—	71,581	5,255	—	76,836
Mobile Security	—	1,454	22,549	(502)	23,501
Total revenues	—	413,030	34,827	(2,417)	445,440
Costs and expenses:					
Cost of revenues	—	315,578	27,649	(2,417)	340,810
Selling, general and administrative expenses	5,614	26,854	3,674	—	36,142
Amortization	—	2,257	2	—	2,259
Integration	145	325	—	—	470
Related party fees (income)	16	(17)	1	—	—
Operating (loss) income	(5,775)	68,033	3,501	—	65,759
Interest expense (income), net	594	(387)	52	—	259
Other (income) expense, net	(710)	50	(147)	—	(807)
Equity in earnings of subsidiaries	(45,912)	(1,440)	—	47,352	—
Income before (benefit) provision for income taxes	40,253	69,810	3,596	(47,352)	66,307
(Benefit) provision for income taxes	(1,156)	24,690	1,364	—	24,898
Net income	$ 41,409	$ 45,120	$ 2,232	$ (47,352)	$ 41,409

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

Armor Holdings Inc. and Subsidiaries
Condensed Consolidating Statements of Operations

	Three Months ended March 31, 2005				
	Parent	Guarantor Subsidiaries	Nonguarantor Subsidiaries	Eliminations	Consolidated Total
	(In thousands)				
Revenues:					
Aerospace & Defense	$ —	$ 272,804	$ —	$ (7,109)	$ 265,695
Products	—	51,960	11,373	—	63,333
Mobile Security	—	12,204	23,903	(170)	35,937
Total revenues	—	336,968	35,276	(7,279)	364,965
Costs and expenses:					
Cost of revenues	—	253,462	27,472	(7,279)	273,655
Selling, general and administrative expenses	7,473	22,954	3,389	—	33,816
Amortization	—	2,038	—	—	2,038
Integration	147	653	—	—	800
Related party fees (income)	16	(17)	1	—	—
Operating (loss) income	(7,636)	57,878	4,414	—	54,656
Interest expense (income), net	2,193	(49)	101	—	2,245
Other expense (income), net	1,122	(16)	17	—	1,123
Equity in earnings of subsidiaries	(39,838)	(1,769)	—	41,607	—
Income before (benefit) provision for income taxes	28,887	59,712	4,296	(41,607)	51,288
(Benefit) provision for income taxes	(2,142)	20,738	1,663	—	20,259
Net income	$ 31,029	$ 38,974	$ 2,633	$ (41,607)	$ 31,029

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (UNAUDITED)
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Armor Holdings, Inc. and Subsidiaries
Condensed Consolidating Statements of Cash Flow

	Three Months ended March 31, 2006				
	Parent	Guarantor Subsidiaries	Nonguarantor Subsidiaries	Eliminations	Consolidated Total
			(In thousands)		
Cash flow from operating activities:					
Net income	$ 41,409	$ 45,120	$ 2,232	$ (47,352)	$ 41,409
Adjustments to reconcile net income to cash provided by operating activities:					
Depreciation and amortization	650	4,374	619	—	5,643
Loss on disposal of fixed assets	—	77	47	—	124
Deferred income taxes	2,550	1,447	47	—	4,044
Fair value adjustment for put options	(710)	—	—	—	(710)
SERP expense	725	—	—	—	725
Equity in earnings of subsidiaries	(45,912)	(1,440)	—	47,352	—
Changes in operating assets and liabilities, net of acquisitions:					
(Increase) decrease in accounts receivable	—	(2,762)	2,368	—	(394)
Decrease (increase) in intercompany receivables and payables	25,371	(25,811)	440	—	—
Increase in inventories	—	(20,916)	(1,220)	—	(22,136)
(Increase) decrease in prepaid expenses and other assets	(2,187)	(2,787)	248	—	(4,726)
(Decrease) increase in accounts payable, accrued expenses and other current liabilities	(3,528)	11,514	(2,709)	—	5,277
Decrease in income taxes payable	(11)	(6)	(945)	—	(962)
Net cash provided by operating activities	18,357	8,810	1,127	—	28,294
Cash flow from investing activities:					
Purchase of property and equipment	(157)	(7,905)	(1,137)	—	(9,199)
Purchase of patents and trademarks	—	(79)	(6)	—	(85)
Purchases of short-term investment securities	(489,000)	—	—	—	(489,000)

Proceeds from sales of short-term investment securities	97,500	—	—	—	97,500
Collection of note receivable	—	252	—	—	252
Costs related to pending acquisitions	(2,849)	—	—	—	(2,849)
Additional consideration for purchased businesses	—	(85)	—	—	(85)
Net cash used in investing activities	(394,506)	(7,817)	(1,143)	—	(403,466)
Cash flow from financing activities:					
Proceeds from exercise of stock options	724	—	—	—	724
Taxes paid for withheld shares on restricted stock issuances	(430)	—	—	—	(430)
Windfall tax benefit of stock options	312	—	—	—	312
Repayments of long-term debt	—	(170)	(38)	—	(208)
Borrowings under lines of credit	—	—	840	—	840
Repayments under lines of credit	—	—	(1,362)	—	(1,362)
Net cash provided by (used in) financing activities	606	(170)	(560)	—	(124)
Effect of exchange rate on cash and cash equivalents	—	—	875	—	875
Net (decrease) increase in cash and cash equivalents	(375,543)	823	299	—	(374,421)
Cash and cash equivalents, beginning of period	423,961	23,879	24,001	—	471,841
Cash and cash equivalents, end of period	$ 48,418	$ 24,702	$ 24,300	$ —	$ 97,420

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ARMOR HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (UNAUDITED)
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Armor Holdings, Inc. and Subsidiaries
Condensed Consolidating Statements of Cash Flow

	Three Months ended March 31, 2005				
	Parent	Guarantor Subsidiaries	Nonguarantor Subsidiaries	Eliminations	Consolidated Total
			(In thousands)		

Cash flow from operating activities:					
Net income	$ 31,029	$ 38,974	$ 2,633	$ (41,607)	$ 31,029
Adjustments to reconcile net income to cash provided by (used in) operating activities:					
Depreciation and amortization	702	3,813	688	—	5,203
Loss on disposal of fixed assets	—	26	4	—	30
Deferred income taxes	769	1,706	141	—	2,616
Fair value adjustment for put options	1,121	—	—	—	1,121
Equity in earnings of subsidiaries	(39,838)	(1,769)	—	41,607	—
Changes in operating assets and liabilities, net of acquisitions:					
Increase in accounts receivable	—	(13,539)	(783)	—	(14,322)
Decrease (increase) in intercompany receivables and payables	28,249	(30,018)	1,769	—	—
Increase in inventories	—	(6,480)	(1,362)	—	(7,842)
(Increase) decrease in prepaid expenses and other assets	(1,407)	621	(788)	—	(1,574)
Increase (decrease) in accounts payable, accrued expenses and other current liabilities	1,307	2,510	(1,159)	—	2,658
Increase (decrease) in income taxes payable	1,170	417	(845)	—	742
Net cash provided by (used in) operating activities	23,102	(3,739)	298	—	19,661
Cash flow from investing activities:					
Purchase of property and equipment	(602)	(2,185)	(436)	—	(3,223)
Purchase of patents and trademarks	—	(34)	—	—	(34)
Purchases of short-term investment securities	(469,800)	—	—	—	(469,800)
Proceeds from sales of short-term investment securities	77,825	—	—	—	77,825
Sale of put options	1,687	—	—	—	1,687
Additional consideration for purchased businesses	(227)	(854)	—	—	(1,081)
Purchase of businesses net of cash acquired	(1,362)	—	—	—	(1,362)
Net cash used in investing activities	(392,479)	(3,073)	(436)	—	(395,988)
Cash flow from financing activities:					
Proceeds from exercise of stock options	3,903	—	—	—	3,903
	(180)	—	—	—	(180)

Taxes paid for withheld shares on restricted stock issuances					
Repayments of long-term debt	—	(152)	(38)	—	(190)
Borrowings under lines of credit	5,485	—	2,840	—	8,325
Repayments under lines of credit	(5,485)	—	(1,020)	—	(6,505)
Net cash provided by (used in) financing activities	3,723	(152)	1,782	—	5,353
Effect of exchange rate on cash and cash equivalents	—	—	(1,099)	—	(1,099)
Net (decrease) increase in cash and cash equivalents	(365,654)	(6,964)	545	—	(372,073)
Cash and cash equivalents, beginning of period	388,727	21,173	11,309	—	421,209
Cash and cash equivalents, end of period	$ 23,073	$ 14,209	$ 11,854	$ —	$ 49,136

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

NOTE 13 — VEST EXCHANGE PROGRAM/WARRANTY REVISION

As discussed in Note 11, as a result of our voluntary ZVE Program relating to our Zylon® — containing vests, we recorded a pre-tax charge of $19.9 million in the year ended December 31, 2005, which is net of the remaining $1.1 million liability from the Exchange Program previously announced in the third quarter of 2004. Since December 31, 2005, we have incurred $3.7 million of ZVE Program costs against the liability. We have a remaining liability of $14.8 million at March 31, 2006. The liability has been classified in accrued expenses and other current liabilities on the accompanying condensed consolidated balance sheet at March 31, 2006.

NOTE 14 — PUT OPTION TRANSACTIONS

We account for put option transactions on Company stock in accordance with Statement of Financial Accounting Standards No. 150, ‘‘Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity,’’ (‘‘SFAS 150’’). SFAS 150 requires put options to be measured at fair value and recognized on the balance sheet as liabilities.

During the year ended December 31, 2005, we sold put options on Company stock in various private transactions covering 3.5 million shares of Company stock for $6.6 million in premiums. During the year ended December 31, 2005, put options covering 2.5 million shares expired unexercised. In February 2006, the remaining outstanding put options covering 1 million shares expired unexercised. Accordingly, we recognized $700,000 in other (income) expense, net, in the three months ended March 31, 2006. In the three months ended March 31, 2005, we recognized fair value losses of $1.1 million recorded in other (income) expense, net, related to outstanding put options on Company stock. The fair values of the put options of Company stock are obtained from our counter-parties and represent the estimated amount we would have received or paid to terminate the put options, taking into account the consideration we received for the sale of the put options. We had no put options on Company stock remaining as of March 31, 2006.

NOTE 15 — INTEREST EXPENSE, NET

Interest expense, net is comprised of the following:

	Three Months Ended	
	March 31, 2006	March 31, 2005
	(In thousands)	
Interest expense	$ 5,531	$ 4,858
Interest income	(5,272)	(2,613)
Interest expense, net	$ 259	$ 2,245

NOTE 16 — PENDING ACQUISITION

On February 27, 2006, we announced that we signed a definitive agreement to acquire all of the outstanding stock of Stewart & Stevenson Services, Inc. (''SVC''), a leading manufacturer of military tactical wheeled vehicles including the Family of Medium Tactical Vehicles (''FMTV''), the U.S. Army's primary transport platform, for $35 per share in a cash merger transaction. The total value of the transaction is expected to be approximately $755 million after deducting SVC's net cash balance which was $312 million as of January 31, 2006. The transaction is subject to SVC shareholder approval and other customary conditions. The transaction is expected to close in May 2006. We expect to finance the transaction through available cash and cash equivalents, short-term investments of the Company and SVC and with proceeds from pending senior credit facilities. On April 19, 2006, we announced that the U.S. Department of Justice and the U.S. Federal Trade Commission have granted early termination of the waiting period under the Hart-Scott-Rodino Antitrust Improvement Act of 1976, as amended, in connection with our pending acquisition of SVC.

NOTE 17 — SUBSEQUENT EVENT

On April 7, 2006, we announced the acquisition of 100% of the stock of Swiss-Photonics AG. Swiss-Photonics, through its trade name, Projectina, manufactures, markets and distributes highly specialized document examination equipment used in verifying document authenticity and detecting counterfeit currency and crime lab microscopes used to evaluate ballistics and bullet casings. Projectina also develops optical subsystems for leading electronic original equipment manufacturers. Based in Heerbrugg, Switzerland, Projectina serves the forensics, homeland security and crime scene markets, predominantly in Europe and Asia. Projectina generated revenue of approximately $9.2 million in 2005.

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

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

The following is a discussion of the results of operations and analysis of financial condition for the three months ended March 31, 2006. The results of operations for purchase business combinations are included since their effective acquisition dates. The following discussion may be understood more fully by reference to the consolidated financial statements, notes to the consolidated financial statements, and management's discussion and analysis contained in our Annual Report on Form 10-K for the year ended December 31, 2005, as filed with the Securities and Exchange Commission.

CRITICAL ACCOUNTING POLICIES

There have been no material changes to our critical accounting policies and estimates from the information provided in Item 7, ‘‘Management’s Discussion and Analysis of Financial Condition and Results of Operations’’, included in our 10-K for the fiscal year ended December 31, 2005, except as follows:

Stock options and grants. On January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), ‘‘Share-Based Payments’’ (‘‘FAS 123R’’), requiring us to recognize expense related to the fair value of our stock option awards. We recognize the cost of share-based awards on a straight-line basis over the vesting period of the award. Prior to January 1, 2006, we accounted for our stock option plans under the recognition and measurement provisions of Accounting Principles Board Opinion No. 25, ‘‘Accounting for Stock Issued to Employees’’ (‘‘APB 25’’) and related interpretations, as permitted by Statement of Financial Accountant Standard No. 123, ‘‘Accounting for Stock-Based Compensation’’ (‘‘SFAS 123’’). Excluding modification to stock option agreements, no stock option-based employee compensation cost was recognized in the income statement, as all stock options granted under those plans had an exercise price equal to or greater than the market value of the underlying common stock on the date of grant.

Effective January 1, 2006, we adopted the fair value recognition provisions of FAS 123R, using the modified prospective transition method. Under this transition method, compensation cost recognized includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123, and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of FAS 123R. Results for prior periods have not been restated. As a result of adopting FAS 123R on January 1, 2006, our income before income taxes and net income for the three months ended March 31, 2006, was $203,000 and $132,000 lower, respectively, than if we had continued to account for share-based compensation under ABP 25. We expect that total stock compensation expense for 2006 related to stock options will be approximately $1.0 million before the effect of income taxes.

Prior to the adoption of FAS 123R, we presented all tax benefits of deductions resulting from the exercise of stock options as operating cash flows in the statement of cash flows. Beginning on January 1, 2006, we changed our cash flow presentation in accordance with FAS 123R, which requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (windfall tax benefits) to be classified as financing cash flows.

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

We have estimated the fair value of our option awards granted after January 1, 2006, using a Black-Scholes option pricing model. The expected life of the options granted is management's estimate and represents the period of time that options granted are expected to be outstanding. We currently do not pay dividends. Volatility is based on the historical volatility of our stock price. The risk-free interest rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. The fair value of each option grant is estimated on the date of grant with the following weighted-average assumptions for the three months ended March 31, 2006 and 2005:

	March 31, 2006	March 31, 2005
Expected life of option	5.0 yrs	5.3 yrs
Dividend yield	0%	0%
Volatility	46.4%	48.6%
Risk free interest rate	4.3%	4.1%

The weighted average fair value of options granted during the three months ended March 31, 2006 and 2005 are as follows:

	March 31, 2006	March 31, 2005
	(In thousands, except per share data)	
Fair value of each option granted	$ 20.84	$ 19.54
Total number of options granted		