FORCE PROTECTION INC
Form 10-Q
November 07, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2011

OR

o 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.)
1520 Old Trolley Road **Summerville, South Carolina** (Address of Principal Executive Offices)	**29485** (Zip Code)

(843) 574-7001

(Registrant s Telephone Number, Including Area Code)

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. x Yes o No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). x Yes o No

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 the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer x
Non-accelerated filero (Do not check if a smaller reporting company)	Smaller reporting companyo

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

The registrant had 64,986,234 shares of common stock outstanding as of October 21, 2011.

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PART I. FINANCIAL STATEMENTS

Item 1. Financial Statements

Force Protection, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(Unaudited)

	As of September 30, 2011	As of December 31, 2010
	(In Thousands)	
Assets		
Current assets:		
Cash and cash equivalents	$ 121,898	$ 149,965
Accounts receivable, net	115,650	124,831
Inventories	115,311	90,110
Deferred income tax assets	13,745	12,336
Other current assets	25,516	41,520
Total current assets	392,120	418,762
Property and equipment, net	54,731	60,422
Investment in unconsolidated joint ventures	2,627	2,815
Other assets	1,012	705
Total assets	$ 450,490	$ 482,704
Liabilities and Shareholders Equity		
Current liabilities:		
Accounts payable	$ 97,028	$ 94,593
Due to United States government	3,421	1,331
Advance payments on contracts	24,942	5,875
Other current liabilities	23,903	50,943
Total current liabilities	149,294	152,742
Deferred income tax liabilities	1,382	973
Other long-term liabilities	1,796	562
	152,472	154,277
Commitments and contingencies		
Shareholders equity:		
Common stock	72	71
Additional paid-in capital	265,415	262,451
Accumulated other comprehensive loss	(740)	(88)
Treasury stock, at cost	(22,032)	
Retained earnings	55,303	65,993
Total shareholders equity	298,018	328,427
Total liabilities and shareholders equity	$ 450,490	$ 482,704

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

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Force Protection, Inc. and Subsidiaries

Condensed Consolidated Statements of Operations

(Unaudited)

	For the three months ended September 30, 2011	2010	For the nine months ended September 30, 2011	2010
	(In Thousands, Except Per Share Data)		(In Thousands, Except Per Share Data)	
Net sales	$ 143,597	$ 176,265	$ 377,176	$ 448,251
Cost of sales	111,646	142,690	310,675	357,605
Gross profit	31,951	33,575	66,501	90,646
General and administrative expenses	19,893	27,868	62,799	65,732
Asset impairment expense			3,200	
Research and development expenses	5,287	7,314	17,610	17,445
Operating profit (loss)	6,771	(1,607)	(17,108)	7,469
Other (expense) income, net	(32)	(187)	(94)	75
Interest expense, net	(27)	(22)	(82)	(216)
Income (loss) before income tax	6,712	(1,816)	(17,284)	7,328
Income tax (expense) benefit	(2,174)	(48)	6,596	(3,279)
Net income (loss)	$ 4,538	$ (1,864)	$ (10,688)	$ 4,049
Earnings (loss) per common share:				
Basic	$ 0.07	$ (0.03)	$ (0.16)	$ 0.06
Diluted	$ 0.07	$ (0.03)	$ (0.16)	$ 0.06
Weighted average common shares outstanding:				
Basic	66,758	68,799	68,227	68,753
Diluted	67,387	68,799	68,227	69,681

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

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Force Protection, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited)

	For the nine months ended September 30, 2011	2010
	(In Thousands)	
Cash flows from operating activities:		
Net (loss) income	$ (10,688)	$ 4,049
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities		
Depreciation and amortization	12,834	12,099
Deferred income tax (benefit) provision	(629)	7,475
Income tax effect realized from stock transactions	(122)	(11)
Stock-based compensation	2,877	2,486
Provision for estimated litigation settlement		8,500
Provision for inventory	2,320	3,084
Provision for asset impairment	3,200	
Other	326	106
(Increase) decrease in assets		
Accounts receivable	10,381	(43,127)
Inventories	(24,967)	(11,716)
Other assets	(8,401)	(5,848)
Increase (decrease) in liabilities		
Accounts payable	(643)	5,866
Due to United States government	2,090	(3,525)
Advance payments on contracts	19,066	(484)
Other liabilities	(3,452)	(6,843)
Total adjustments	14,880	(31,938)
Net cash provided by (used in) operating activities	4,192	(27,889)
Cash flows from investing activities:		
Capital expenditures	(9,776)	(12,307)
Purchase of JAMMA assets		(1,650)
Other	19	22
Net cash used in investing activities	(9,757)	(13,935)
Cash flows from financing activities:		
Purchase of treasury stock	(22,032)	
Proceeds from issuance of common stock	208	17
Income tax effect realized from stock transactions	122	11
Other	(100)	
Net cash (used in) provided by financing activities	(21,802)	28
Effect of foreign currency rate changes on cash	(700)	(20)
Decrease in cash and cash equivalents	(28,067)	(41,816)
Cash and cash equivalents at beginning of year	149,965	147,254
Cash and cash equivalents at end of period	$ 121,898	$ 105,438
Supplemental cash flow information:		
Cash paid during the period for		
Income taxes	$ 7,732	$ 6,975
Interest, net of amounts capitalized	$ 61	$ 232
Supplemental noncash investing and financing activities:		
Property and equipment additions in accounts payable	$ 141	$ 1,029
Property and equipment additions in financing arrangement	$ 1,300	$

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

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1. Summary of Significant Accounting Policies

Organization and Description of the Business

Force Protection, Inc. provides survivability solutions to support the armed forces of the United States (U.S.) and its allies. We design, manufacture, test, deliver and support our blast- and ballistic-protected products to increase survivability for the users of our products. Currently, we have one segment of operations, our survivability solutions. We believe our specialty vehicles, including the Buffalo, Cougar and Ocelot, are at the forefront of blast- and ballistic-protected technology. These vehicles are designed for reconnaissance and other operations and to protect their occupants from landmines, hostile fire and improvised explosive devices (commonly referred to as roadside bombs). We are a key provider of the U.S. military s Mine Resistant Ambush Protected vehicle program and have sold and delivered over 3,000 vehicles under this program. We also provide our Cougar and Buffalo mine-protected vehicles to several foreign customers, including the United Kingdom Ministry of Defence (U.K. MoD) which has purchased three variants of our Cougar vehicle as well as a U.K.-specific variant of the Buffalo. The U.K. MoD is also under contract to purchase 200 Foxhounds, an Ocelot variant, with deliveries scheduled to begin in the fourth quarter of 2011. Complementing these efforts, we are developing and marketing a new vehicle platform, the Joint All-Terrain Modular Mobility Asset (JAMMA), which provides increased modularity, transportability, speed and mobility. Across all vehicle programs we have sold approximately 4,700 vehicles since 2005. Supporting our vehicle design, development and production initiatives, we develop, manufacture, test, deliver and support products and services aimed at further enhancing the survivability of our users against additional threats. In addition, we provide long-term life cycle support services for our vehicles that involve development of technical data packages, supply of spares, field and depot maintenance activities, assignment of skilled field service representatives, and related training programs. Our services are based on establishing and maintaining long-term relationships with the U.S. government and foreign military users.

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

In 2009, we formed Integrated Survivability Technologies Limited, an England and Wales company, referred to as IST, a joint venture between Force Protection Europe Limited, a subsidiary of Force Protection Industries, Inc., and NP Aerospace Limited, a subsidiary of The Morgan Crucible Company plc. Pursuant to the terms of the joint venture, IST acts as the prime contractor for vehicles and related total life cycle support awarded by the U.K. MoD to ensure that this customer has a single point of contact for its Wolfhound, Mastiff and Ridgback vehicles. We account for this joint venture as an equity-method investment. In September 2009, we formed Force Protection Australasia Pty Ltd, an Australian company, to pursue market opportunities in Australia and Asia. Force Protection Australasia Pty Ltd is a wholly-owned subsidiary of Force Protection Europe Limited. In January 2011, we formed Force Protection Survivability Solutions Canada, Inc., a Canadian company, to pursue market opportunities in Canada. Force Protection Survivability Solutions Canada, Inc. is a wholly-owned subsidiary of Force Protection Industries, Inc.

Basis of Presentation and Consolidation

The accompanying unaudited condensed consolidated financial statements should be read in conjunction with our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2010 filed with the United States Securities and Exchange Commission (SEC) on March 9, 2011. These unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the SEC. Certain information and note disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles in the United States of America (GAAP) have been condensed or omitted pursuant to those rules and regulations, although we believe that the disclosures made herein are adequate to make the information not misleading.

The unaudited results of operations for the interim periods shown in these condensed consolidated financial statements are not necessarily indicative of operating results for the entire year. In our opinion, the accompanying unaudited condensed consolidated financial statements recognize all adjustments of a normal recurring nature considered necessary to fairly state the financial position, results of operations and cash flows for each interim period presented.

These unaudited condensed consolidated financial statements include the assets, liabilities, revenues and expenses of our wholly-owned subsidiaries, Force Protection Industries, Inc. and Force Protection Technologies, Inc. We eliminate from our financial results all significant intercompany accounts and transactions.

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Certain prior period information has been reclassified to conform to the current period presentation.

Recent Accounting Pronouncements

In October 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2009-13 (ASU 2009-13), an update to Accounting Standards Codification (ASC) Topic 605 *Revenue Recognition*, which addresses the accounting for multiple-deliverable arrangements to enable vendors to account for products or services (deliverables) separately rather than as a combined unit. ASU 2009-13 is effective prospectively for revenue recognition arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. We adopted this guidance on January 1, 2011. This guidance did not have a material impact on our consolidated financial position, results of operations or cash flows.

In January 2010, the FASB issued ASU No. 2010-06, *Improving Disclosures About Fair Value Measurements,* which updates the guidance in ASC Topic 820, *Fair Value Measurements and Disclosures*, related to disclosures about fair value measurements. New disclosures will require entities to disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and to describe the reasons for the transfers; and to present separately in the reconciliation for fair value measurements in Level 3 information about purchases, sales, issuances and settlements on a gross basis rather than as one net amount. This ASU also amends ASC Subtopic 820-10 to clarify certain existing disclosures regarding the level of disaggregation at which fair value measurements are provided for each class of assets and liabilities; and disclosures about inputs and valuation techniques used to measure fair value for both recurring and nonrecurring fair value measurements that fall in either Level 2 or Level 3. The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances and settlements in the reconciliation of Level 3 fair value measurements, which became effective for fiscal years beginning after December 15, 2010. We implemented ASU 2010-06 as of January 1, 2011. The adoption of this guidance did not have, and is not expected to have, a material impact on our consolidated financial position, results of operations or cash flows.

In May 2011, the FASB issued ASU No. 2011-04, *Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs,* which updated the guidance in ASC Topic 820, *Fair Value Measurement.* ASU 2011-04 improves comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with GAAP and International Financial Reporting Standards (IFRS). ASU 2011-04 clarifies the application of existing fair value measurement requirements including (1) the application of the highest and best use and valuation premise concepts, (2) measuring the fair value of an instrument classified in a reporting entity s shareholders equity, and (3) quantitative information required for fair value measurements categorized within Level 3. ASU 2011-04 also provides guidance on measuring the fair value of financial instruments managed within a portfolio, and application of premiums and discounts in a fair value measurement. In addition, ASU 2011-04 requires additional disclosure for Level 3 measurements regarding the sensitivity of fair value to changes in unobservable inputs and any interrelationships between those inputs. The amendments in this guidance are to be applied prospectively, and are effective for interim and annual periods beginning after December 15, 2011, and early application is not permitted. This guidance will become effective for us as of the beginning of our first quarter of 2012. The adoption of this guidance is presentation and disclosure related and, therefore, will not have a material impact on our consolidated financial position, results of operations or cash flows.

In June 2011, the FASB issued ASU No. 2011-05, *Presentation of Comprehensive Income,* which updated the guidance in ASC Topic 220, *Comprehensive Income*. Under the amendments in this ASU, an entity has the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. This ASU eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders equity. The amendments in this update do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. This new guidance was originally proposed to be effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 and applied retrospectively. In October 2011, the FASB proposed to defer the specific requirement to present items that are reclassified from other comprehensive income to net income alongside their respective components of net income and other comprehensive income. However, the remaining requirements of ASU 2011-05 are effective for us as of the beginning of our first quarter of 2012. The adoption of this guidance is presentation and disclosure related and,

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therefore, will not have a material impact on our consolidated financial position, results of operations or cash flows.

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

2. Accounts Receivable

Accounts receivable consist of the following (in thousands):

	As of September 30, 2011	As of December 31, 2010
United States government	$ 86,266	$ 104,730
Other accounts receivable	29,384	20,101
Accounts receivable, net	$ 115,650	$ 124,831

As of September 30, 2011 and December 31, 2010, our accounts receivable included $41.6 million and $53.8 million, respectively, of earned and unbilled accounts receivable, of which $6.1 million and $1.9 million, respectively, is earned and unbilled to IST and $35.5 million and $51.9 million, respectively, is earned and unbilled to the U.S. government. The earned and unbilled accounts receivable as of September 30, 2011 and December 31, 2010 are primarily due to a significant number of not-to-exceed undefinitized contracts whereby we cannot fully bill until the contracts are definitized although the products have been delivered, and accrued service revenues that are generally billed one month in arrears.

3. Inventories

Inventories consist of the following (in thousands):

	As of September 30, 2011	As of December 31, 2010
Raw material and supplies	$ 55,845	$ 51,142
Work in process	56,358	20,751
Finished goods	3,108	18,217
Inventories	$ 115,311	$ 90,110

Work in process mostly consists of vehicles and subassemblies in process. As of September 30, 2011 and December 31, 2010, our work in process included $37.4 million and $3.3 million, respectively, of Foxhound-related materials and capitalized labor and overhead costs of our European operation for the Light Protected Patrol Vehicle (LPPV) program, which is scheduled to begin deliveries in the fourth quarter of 2011.

As of December 31, 2010, finished goods mostly consisted of Mastiff vehicles in-transit to IST as well as completed Buffalo vehicles and modernization kits that were not accepted by the customer until the first quarter of 2011.

4. Property and Equipment

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

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	As of September 30, 2011	As of December 31, 2010
Land	$ 4,901	$ 4,901
Buildings	13,043	16,117
Leasehold improvements	16,867	16,359
Machinery and equipment; including tooling and molds	40,686	36,370
Computer equipment and software	23,291	18,980
Furniture and fixtures	3,895	3,826
Demonstration and other vehicles	7,897	7,476
Manuals	705	705
	111,285	104,734
Less: Accumulated depreciation	(60,147)	(47,728)
	51,138	57,006
Construction in progress	3,593	3,416
Property and equipment, net	$ 54,731	$ 60,422

Asset Impairment Expense

During the second quarter of 2011, we determined that the carrying value of our Roxboro, North Carolina facility had been impaired based on our estimate of future cash flows to be generated from the facility. As a result, we recorded a $3.2 million charge to operating expense for asset impairment to reflect the write-down of the Roxboro fixed assets to estimated fair value during the second quarter of 2011. We are currently evaluating alternative uses for this facility.

5. Income Taxes

We provide for income taxes using the liability method in accordance with FASB ASC Topic 740, *Income Taxes*. In accordance with this guidance, the provision for taxes on income recognizes our estimate of the effective tax rate expected to be applicable for the full year, adjusted for the impact of any discrete events, which are reported in the period in which they occur. Each quarter, we re-evaluate our estimated tax expense for the year and make adjustments for changes in the estimated tax rate. Additionally, we evaluate the realizability of our deferred tax assets on a quarterly basis. Our evaluation considers all positive and negative evidence and factors, such as the scheduled reversal of temporary differences, historical and projected future taxable income or losses, and prudent and feasible tax planning strategies.

The income tax (expense) benefit for the three and nine months ended September 30, 2011, respectively, is based on the estimated effective tax rates applicable for the fiscal year ending December 31, 2011, after considering items specifically related to the interim periods. The income tax expense for the three and nine months ended September 30, 2010 was based on the estimated effective tax rates applicable for the fiscal year ended December 31, 2010, after considering items specifically related to the interim periods.

Force Protection is subject to United States federal, state, and local income taxes. *Income (loss) before income tax* is as follows (in thousands):

	For the three months ended	For the nine months ended

	September 30, 2011	September 30, 2010	September 30, 2011	September 30, 2010
Income (loss) before income tax	$ 6,712	$ (1,816)	$ (17,284)	$ 7,328

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A reconciliation of the statutory federal income tax rate to the effective income tax rate is as follows:

	For the three months ended September 30, 2011	2010	For the nine months ended September 30, 2011	2010
Statutory federal income tax rate	35.0%	35.0%	35.0%	35.0%
Increase (decrease) in tax rate resulting from:				
State income taxes, net of federal tax benefit	0.6	1.1	1.1	1.4
Research and development credit	(4.9)	(8.0)	(1.6)	2.0
Domestic Production Activities Deduction		(27.5)		3.7
Interest expense related to uncertain tax benefits	(0.4)	(0.3)	0.1	0.2
Other	(0.3)		0.1	
Nondeductible items	2.4	(3.0)	3.4	2.5
Effective income tax rate	32.4%	(2.7)%	38.1%	44.8%

The effective income tax rate is the provision for income tax as a percent of income (loss) before income taxes. The effective rate differs from the expected federal statutory rate of 35% primarily due to the research and development credit, the domestic production activities deduction, state income taxes, interest expense related to uncertain tax benefits, and nondeductible items.

Tax years ended December 31, 2008 through December 31, 2010 remain open and are subject to examination by the Internal Revenue Service. Tax years ended December 31, 2002 and December 31, 2007 also remain open to a limited extent due to carryovers from those years used in tax years 2008 and after. We believe that we have appropriate support for the income tax positions taken and to be taken on our income tax returns and that our income taxes receivable and accruals for tax liabilities are adequate for all open years based on an assessment of many factors including past experience and interpretations of tax laws applied to the facts of each matter. However, we do have a $0.9 million reserve, which includes approximately $26,000 of interest, for prior years income taxes as a result of applying the guidance in FASB ASC Topic 740, *Income Taxes*. If recognized, the entire $0.9 million would favorably impact the Company s effective tax rate. It is reasonably possible that certain unrecognized tax benefits as of September 30, 2011, could decrease by approximately $0.4 million during the subsequent twelve months due to the resolution of some or all of these matters by various taxing authorities or by the expiration of statutes of federal and state limitations.

6. Earnings (Loss) Per Common Share

The following table shows the information used in the calculation of basic and diluted earnings (loss) per common share (in thousands, except share and per share amounts):

	For the three months ended September 30, 2011	2010	For the nine months ended September 30, 2011	2010
Numerator Basic and diluted:				
Net income (loss)	$ 4,538	$ (1,864)	$ (10,688)	$ 4,049
Denominator:				
Weighted average common shares outstanding basic	66,758,268	68,798,918	68,227,059	68,752,757
Add: Stock options	117,540			115,338

Add: Stock grants		511,299						812,844
Weighted average common shares outstanding diluted		67,387,107		68,798,918		68,227,059		69,680,939
Basic earnings (loss) per common share:								
Net income (loss) basic	$	0.07	$	(0.03)	$	(0.16)	$	0.06
Diluted earnings (loss) per common share:								
Net income (loss) diluted	$	0.07	$	(0.03)	$	(0.16)	$	0.06

The calculation of basic earnings (loss) per common share is based on the weighted-average number of our common shares outstanding during the applicable period. The calculation for diluted earnings (loss) per common share recognizes the effect of all dilutive potential common shares that were outstanding during the respective

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periods, unless their impact would be anti-dilutive. We use the treasury stock method to calculate the dilutive effect of stock options and other common stock equivalents (potentially dilutive shares). These potentially dilutive shares include stock options and stock grants.

We did not include stock options to purchase 197,002 shares of common stock in our computation of diluted loss per common share for the nine months ended September 30, 2011 as the effect of including such options would be anti-dilutive. For the three and nine months ended September 30, 2010, we did not include stock options to purchase 75,582 and 65,169 shares of common stock, respectively, in our computation of diluted earnings per common share as the effect of including such options would be anti-dilutive.

In addition, we did not include 654,088 and 738,711 of unvested restricted stock grants in the computation of diluted loss per common share for the nine months ended September 30, 2011 and the three months ended September 30, 2010, respectively, since inclusion would be anti-dilutive in our computation of diluted loss per common share because we recorded a net loss in each of these periods.

7. Comprehensive Income (Loss)

The following table shows the components of comprehensive income (loss):

	For the three months ended September 30,		For the nine months ended September 30,
(in thousands)	**2011**	**2010**	**2011**