



Press Release

30 June 2010

**Armor Designs, Inc.**

**Results for year ended 31 December, 2009**

Armor Designs, Inc., ("ADI", "Armor" or the "Company"), a knowledge-based designer, developer and manufacturer of next generation composite protective products, today announces its audited results for the year ended 31 December 2009.

**Business Developments**

- Ongoing transition from development company to commercial entity;
- Introduction of the first U.S. NIJ .06 certified Stand Alone Level IV plate (advanced protection body armour plates);
- First sales into U.S. government Homeland Security departments and governmental agencies in the Philippines and Korea;
- Established design, manufacturing and distribution joint venture in Asia;
- ISO 9001:2008 Certification obtained for design and manufacturing; and
- Scorpion Works achievement of multiple technology milestones and product certifications.

**Financial Developments**

- First full year of revenues generated from commercial operations;
- Sales of US\$1.05m for the year ended 31 December 2009;
- Operating loss of US\$11.7m, (US\$9.1m after US\$2.6m of non-cash items) in 2009;
- Equity fundraising in 2009 of US\$1.5m closed;
- Reduced operating expenses by over 41% from prior year levels, from US\$15.8m in 2008 to US\$9.2m in 2009;
- Established accounts receivable financing facility with a credit capacity of US\$0.25m;
- The Company continues its efforts to correct and strengthen the balance sheet conditions previously announced and described more fully in footnotes 2 and 16 to the financial statements; and

- Correction of an error, dating back to 2007, in the fair value of stock based compensation (a non-cash item) calculated for 2008, resulting in restatement of the financial statements for the year ended 31 December 2008. The re-statement had no impact on cash, other assets or any liabilities.

#### **Post Balance Sheet Events**

- As announced on 28 June 2010, closing of US\$3.6m equity fundraising; and
- Commitment for a US\$10.0m line of credit as announced on 28 June 2010. Fulfillment of the commitment is subject to completion of due diligence and execution of legal documents. Availability of funds to be dependent on achievement of commercial and product development milestones.

Commenting on the results, Philip Clement, CEO of Armor Designs, Inc., said: "2009 was a challenging year, but a year that brought us another step towards achievement of our long term strategy. As a result of the significant expense reductions made during the year, we have streamlined our cost structure and are now well positioned for business development growth and profitability. We have continued to build on the reputation which has set us apart for providing leading edge armour solutions using our proprietary IP know-how. Our existing products are meeting good acceptance in the market and our VCM technology is leading customers to ask us for solutions to their problems. Now that we have commitments to address the short term working capital requirements which constrained us in 2009, we are confident that we can move forward to commercially exploit our technology."

The Company confirms that copies of the annual report and accounts for the period ended 31 December 2009 have been sent to shareholders and copies will shortly be available on the Company's website [www.armordesigns.com](http://www.armordesigns.com)

The Chairman and Chief Executive's Statement and the financial report, which are contained below and form part of this announcement, include further important information and disclosures; the announcement should be read in its entirety.

#### **For further information:**

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## **Chairman's and Chief Executive's Statement**

The Board is pleased to report Armor Designs Inc. results for the year ended 31 December 2009. 2009 was the Company's initial year of commercial production, realising its first sales to U.S. government Homeland Security Departments and governmental agencies in the Philippines and Korea. Through a concerted effort, the Company implemented a strategic cost reduction program resulting in improved gross margin on product sales and better positioning the Company to take advantage of future opportunities.

### **Strategic and Operational Progress**

As expected, 2009 was challenging due to working capital constraints and weak global business opportunities. During the year, the Company obtained improved quality assurance through "ISO 9001:2008" certification for design and manufacturing of ADI products. In late 2009, Armor was the first company to certify a level-4 protection plate as per U.S. National Institute of Justice-06 (NIJ-06) standards. The Company also introduced its lightest NIJ certified level-3 protection "Stand Alone" plate. The Company was selected to provide solutions to U.S. Special Operations Command (SOCOM) for the development of lighter plates. Currently, the plates from Armor Designs are being evaluated at SOCOM.

In 2009, Scorpion Works, ADI's expanded research and development team, developed a series of body armour plates, which can be integrated with the universal level-3A protection vests or can be used as a stand-alone plate for foreign markets. These designs were done in considerably less time than current industry practices using ADI's VCM technology and IP know-how. The Company believes the research and development efforts will generate significant opportunities in 2010. In addition, the Company designed and delivered the first batch of synthetic panels for the air lifts used in Afghanistan for military applications.

Throughout 2009 the Company strengthened its manufacturing capabilities by optimising its existing processes and implementing new process controls at every critical operation step. The 6-sigma approach along with Continuous Improvement Programs (CIP's), both recognised in industry as best practice, were introduced and implemented during the later part of 2009. The results achieved via the implementation of 6-sigma and CIP's were significant and helped contribute to the reduction of the Company's monthly cash burn rate.

In 2009 the Company won several key new customers, and the Company continued to build on the reputation which has set it apart for providing leading edge armour solutions using its proprietary IP know-how. Although there was a limited marketing and sales effort during the year, a number of new distribution channels opened both domestically and overseas. In addition, the Company was able to expand its International Traffic in Arms Regulations (ITAR) licenses as a defence industry exporter in a number of overseas countries.

### **Financial**

The Company generated US\$1.05 million in its full first year of commercial operation. However, the fundamental infrastructure needed to execute the transition from a development company to a commercial entity resulted in an operating loss of US\$(11.7) million (2008: US\$(17.8) million, as restated). The results continue to be affected by non-cash charges relating to the ongoing expense associated with the grant of Restricted Stock Units and Stock Appreciation Rights by the Company along with Non-qualifying Stock Options and the award of shares by its majority shareholder, Hawthorne and York International Ltd (HYI). Due to HYI's majority ownership of the Company, US GAAP accounting rules require the Company to reflect awards granted by HYI in its financial results. These charges are non-cash items and totaled US\$1.7 million in 2009.

In 2009, as part of moving the Company's transition from a development stage company to full commercial operations, management reduced operating expenses and associated cash expenditures by approximately 41% as compared to the same period the prior year. As a result, during the year ended 31 December 2009, general and administrative expenses decreased to US\$6.9 million (2008: US\$12.9 million, as restated). Selling and marketing expenses increased to US\$0.9 million (2008: US\$0.7 million) as a result of costs incurred to respond to longer term payoff projects and to a lesser degree the

establishment of an international distribution network. Research and development costs for the period decreased to US\$1.4 million (2008: US\$1.9 million).

During the year ended 31 December 2009, capital expenditures decreased to US\$0.1 million as compared to US\$5.0 million for 2008.

Subsequent to 2009, there continues to be improvement in order activity as evidenced by a steady increase in monthly sales in the first five months of 2010 which are substantially above the run rate for the same period in 2009.

During the audit of the results to December 2009, an error was discovered, discussed further below, that required the Company to restate its financial statements for the year ended 31 December 2008, the restatement had no impact on cash, other assets or any liabilities.

During the audit of the results to December 2009, it was determined that the calculation of expected volatility, the expected life of the options and the number of options granted in 2008 were incorrect resulting in an error in the estimated fair value of the options granted in 2008 (See Notes 3 and 5 of the footnotes to the financial statements). As a result, the fair value of stock based compensation for the year ended 31 December 2008 was understated. Stock options granted in 2008 were previously reported as 2,600,000 have been revised and presented as 1,300,000 in the accompanying consolidated financial statements. The fair value of the stock awards has been recomputed and reflected in the accompanying consolidated financial statements. The correction had the effect of increasing the net loss by US\$2,427,217 or US\$(0.10) per share for the year ended 31 December 2008, with an offsetting increase in additional paid in capital. As such, there was no impact on cash or other assets or any liabilities. The deficit accumulated during development stage increased by US\$2,427,217 as of 31 December 2008. There was no impact to the deficit accumulated during development stage for 31 December 2007 or prior periods.

## **Fund Raising**

On 28 June 2010 the Company announced it had completed a secondary fund-raising of US\$3.6 million prior to expenses, through a placing with a number of existing and new investors of 238,335 new common shares at a placing price of US\$15 per new common share. The net proceeds were used for short term working capital requirements.

In addition, on 28 June 2010, the Company announced that it has received a letter of commitment from a boutique U.S. based investment fund, specialising in debt financing for companies in the knowledge-based or intellectual property sectors. The letter of commitment is in the form of a US\$10.0 million Senior Debt Facility (the "Facility") in the form of a line of credit. The availability of the Facility is subject to completion of due diligence and execution of legal documents, with an anticipated close on or around July 15, 2010. The Facility is expected to include an immediate advance of US\$4.0 million with follow-on advances, up to a cumulative total of US\$10.0 million, made available based on the Company's achievement of certain operational and financial milestones. The Facility has a proposed 5-year term, two warrant provisions (with strike prices of US\$22.50 and US\$24.00, respectively), conversion rights (at US\$15 per share) and is collateralized, in part, by the Company's intellectual property. In addition, the Company will be expected to maintain certain usual and customary Covenants during the term of the Facility.

The Company will update the market, on or around July 15<sup>th</sup>, 2010, as to the status of the close of the Credit Facility.

As previously disclosed, the Company announced that it closed a fund-raising by which it has raised US\$1.5 million, before expenses, through a placing with investors of 100,000 new common shares. In the second quarter 2009, the Company established an accounts receivable financing facility to contribute towards its working capital needs. The amount expected to be made available to the Company pursuant to this facility in the next 12 months is approximately \$0.25 million.

US GAAP accounting rules require the Company to validate that it has sufficient working capital either on hand, irrevocably pledged or reasonably secured through ongoing operational activity. If there is any shortfall or material uncertainty that the Company may not have or generate the working capital it requires

for a minimum period of twelve months subsequent to the date of the accounts, then the Company is required to disclose this in the footnotes to the financial statements. The recently completed round of equity fund raising is insufficient to meet the Company's capital requirements over the required period and so the Company has included a formal disclosure note (Note 2) on its Going Concern situation. The note refers to certain events and circumstances which give rise to funding uncertainties. However, the Directors believe that Armor has adequate resources and financing options available to support the going concern basis.

### **Board, Management, Nominated Advisor and Broker**

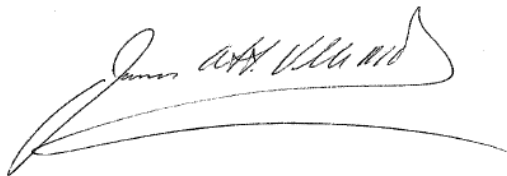
As previously announced, during the second quarter 2009 the Board accepted the resignations of Charles Snyder, CEO and David Seaton, CFO. The Company appointed a new CEO, Philip A. Clement (interim) and CFO, J. Craig Johnson to strengthen the management team. In addition, William A. Roper, an experienced corporate executive, was brought onto the Board as a non executive director.

The Company also announced that following completion of the Annual General Meeting of the Company, on 29 September 2009, Sir Richard Johns and Nicholas Smith had retired as directors of the Company. The board thanked each of them for their significant contributions to the development of the business during their respective terms of office.

In addition, the Company appointed Shore Capital and Corporate Limited as Nominated Adviser ("Nomad") and Shore Capital Stockbrokers Limited as broker to the Company and accepted the resignations of ZAI Corporate Finance Limited as its Nomad and Alexander David Securities Limited as its broker.

### **Outlook**

We expect 2010 to be the year during which Armor completes the transition from the development stage to full commercial operations. Securing a commitment for debt financing has put the Company in a position to move forward on the important product development opportunities that exist in vehicle, infrastructure and energy installation protection as well as rounding out Armor's body armour plate offering. Armor's products have gained considerable acceptance and management believes the Company will be able to capitalise on that acceptance by increasing unit sales and average revenue per unit. There are a number of significant opportunities that Armor is pursuing and several of these opportunities have sales potential that is in excess of the total sales achieved since inception. Also, the Company is now in a position to establish the appropriate capital structure expected for a knowledge based company.



**James A. St. Ville**  
Chairman  
30 June 2010



**Philip A. Clement**  
Chief Executive Officer (Interim)  
30 June 2010



## Annual Report & Accounts

2009 and 2008

Report of Independent Certified Public Accountants

Board of Directors  
Armor Designs, Inc.

We have audited the accompanying consolidated balance sheets of Armor Designs, Inc. (a Delaware corporation) and Subsidiary as of 31 December 2009 and 2008, and the related consolidated statements of operations, changes in equity (deficit), and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Armor Designs, Inc. and Subsidiary as of 31 December 2009 and 2008, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 17 to the consolidated financial statements, the Company has restated its financial statements as of and for the year ended 31 December 2008.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, the Company incurred a net loss of US\$11.7 million during the year ended 31 December 2009, and, as of that date, the Company's current liabilities exceeded its current assets by US\$3.8M. These factors, among others, as discussed in Note 2, raise substantial doubt about the Company's ability to continue as a going concern. Management's plans with regard to these matters are also described in Note 2. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.



Phoenix, Arizona  
June 29, 2010

**CONSOLIDATED BALANCE SHEET**

**31 December**

|  | <u>2009</u><br>US\$ | <u>2008</u><br>US\$             |
|--|---------------------|---------------------------------|
| <b>ASSETS</b>                                |                     | <b>As revised - see Note 17</b> |
| <b>CURRENT ASSETS</b>                        |                     |                                 |
| Cash and cash equivalents                    | \$ 21,435           | \$ 1,199,179                    |
| Receivable from sale of common stock         | -                   | 1,189,922                       |
| Accounts receivable, net                     | 139,168             | 176,642                         |
| Inventory                                    | 237,794             | 456,194                         |
| Prepaid expenses and deposits                | 119,700             | 181,140                         |
|  | <hr/>               | <hr/>                           |
| Total current assets                         | 518,097             | 3,203,077                       |
|  | <hr/>               | <hr/>                           |
| NOTES RECEIVABLE, RELATED PARTY              | 277,552             | 830,000                         |
|  | <hr/>               | <hr/>                           |
| PROPERTY AND EQUIPMENT, NET                  | 4,937,302           | 3,461,623                       |
|  | <hr/>               | <hr/>                           |
| <b>DEPOSITS</b>                              |                     |                                 |
| Equipment                                    | -                   | 2,374,359                       |
| Other  | 130,616             | 130,616                         |
|  | <hr/>               | <hr/>                           |
| Total deposits                               | 130,616             | 2,504,975                       |
|  | <hr/>               | <hr/>                           |
| <b>TOTAL ASSETS</b>                          | <u>\$ 5,863,567</u> | <u>\$ 9,999,675</u>             |
|  | <hr/>               | <hr/>                           |
| <b>LIABILITIES AND EQUITY (DEFICIT)</b>      |                     |                                 |
| <b>CURRENT LIABILITIES</b>                   |                     |                                 |
| Accounts payable                             | \$ 1,718,559        | \$ 289,351                      |
| Accounts payable, related party              | 896,897             | 202,584                         |
| Accrued expenses                             | 498,480             | 861,527                         |
| Accrued expenses, related party              | 312,000             | -                               |
| Notes payable, related party                 | 510,000             | -                               |
| Notes payable                                | 358,956             | -                               |
|  | <hr/>               | <hr/>                           |
| Total current liabilities                    | 4,294,892           | 1,353,462                       |
|  | <hr/>               | <hr/>                           |
| Commitments and contingencies (Note 9)       | -                   | -                               |
|  | <hr/>               | <hr/>                           |
| <b>EQUITY (DEFICIT)</b>                      |                     |                                 |
| Common stock, \$0.001 par value;             | 26,787              | 26,625                          |
| Authorized shares                            | 50,000,000          |                                 |
| Issued Shares:                               | 26,786,801          | 26,524,300                      |
|  | <hr/>               | <hr/>                           |
| Additional paid-in capital                   | 41,966,160          | 37,344,558                      |
| Deficit accumulated during development stage | (40,424,272)        | (28,724,970)                    |
|  | <hr/>               | <hr/>                           |
| <b>TOTAL EQUITY</b>                          | 1,568,675           | 8,646,213                       |
|  | <hr/>               | <hr/>                           |
| <b>TOTAL LIABILITIES AND EQUITY</b>          | <u>\$ 5,863,567</u> | <u>\$ 9,999,675</u>             |
|  | <hr/>               | <hr/>                           |

The accompanying notes are an integral part of the financial statements.

**CONSOLIDATED STATEMENT OF OPERATIONS**

|  | <b>Unaudited</b>   |                                 |                                 |
|--|--|---------------------------------|---------------------------------|
|  | <b>From 30 Sept. 2004<br/>(Inception) to 31 Dec.<br/>2009<br/>US\$</b> | <b>Years ended 31 December,</b> |                                 |
|  |  | <b>2009<br/>US\$</b>            | <b>2008<br/>US\$</b>            |
|  |  |                                 | <b>As revised - see Note 17</b> |
| REVENUE  | \$ 1,237,923   | \$ 1,045,107                    | \$ 192,816                      |
| COST OF GOODS SOLD   | <u>5,239,647</u>   | <u>3,434,641</u>                | <u>1,805,006</u>                |
| GROSS MARGIN   | (4,001,724)  | (2,389,534)                     | (1,612,190)                     |
| OPERATING EXPENSES:  |  |                                 |                                 |
| Research and development                                       | 10,468,468   | 1,417,673                       | 1,914,040                       |
| General and administrative                                     | 21,790,286   | 6,867,606                       | 12,912,927                      |
| Selling and marketing  | 1,884,889  | 872,269                         | 744,742                         |
| Other  | <u>317,003</u>   | <u>83,042</u>                   | <u>233,960</u>                  |
| Total operating expenses                                       | 34,460,646   | 9,240,590                       | 15,805,669                      |
| OTHER INCOME/EXPENSE   |  |                                 |                                 |
| Interest income/(expense), net                                 | (1,616,653)  | (69,178)                        | 6,647                           |
| Loss on investment, net  | <u>(345,249)</u>   | <u>-</u>                        | <u>(345,249)</u>                |
| Total other income/(expense)                                   | (1,961,902)  | (69,178)                        | (338,602)                       |
| Loss before income taxes                                       | (40,424,272)   | (11,699,302)                    | (17,756,461)                    |
| Provision for income taxes                                     | <u>-</u>   | <u>-</u>                        | <u>-</u>                        |
| NET LOSS   | <u><u>\$ (40,424,272)</u></u>  | <u><u>(11,699,302)</u></u>      | <u><u>\$ (17,756,461)</u></u>   |
| Basic and diluted loss per share                               |  | \$ (0.44)                       | \$ (0.68)                       |
| Shares used in computation of basic and diluted loss per share |  | 26,646,428                      | 26,233,893                      |

The accompanying notes are an integral part of the financial statements.

**CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (DEFICIT)**

As revised - see Note 17

|   | <b>Common<br/>Stock Shares</b> | <b>Common<br/>Stock<br/>Amount<br/>US\$</b> | <b>Additional<br/>Paid-In<br/>Capital<br/>US\$</b> | <b>Deficit<br/>Accumulated<br/>During the<br/>Development<br/>Stage<br/>US\$</b> | <b>Total<br/>US\$</b> |
|---|--------------------------------|---|--|--|-----------------------|
| 30 September 2004   | -                              | \$ -  | \$ -   | \$ -   | \$ -                  |
| Issuance of Common Stock  | 22,500,000                     | 22,500                                      | 727,900  | -  | 750,400               |
| Net loss  | -                              | -   | -  | (1,854,065)  | (1,854,065)           |
| 31 December 2004  | 22,500,000                     | 22,500                                      | 727,900  | (1,854,065)  | (1,103,665)           |
| Net loss  | -                              | -   | -  | (3,220,019)  | (3,220,019)           |
| 31 December 2005  | 22,500,000                     | 22,500                                      | 727,900  | (5,074,084)  | (4,323,684)           |
| Member contributions  | -                              | -   | 100  | -  | 100                   |
| Net loss  | -                              | -   | -  | (2,400,458)  | (2,400,458)           |
| 31 December 2006  | 22,500,000                     | 22,500                                      | 728,000  | (7,474,542)  | (6,724,042)           |
| Issuance of common stock in<br>exchange<br>for convertible debt                   | 1,822,500                      | 1,823                                       | 8,998,177  | -  | 9,000,000             |
| Issuance of common stock<br>on London<br>AIM, net of expenses of<br>US\$2,243,406 | 1,600,000                      | 1,600                                       | 13,754,994   | -  | 13,756,594            |
| Net loss  | -                              | -   | -  | (3,493,967)  | (3,493,967)           |
| 31 December 2007  | 25,922,500                     | 25,923                                      | 23,481,171   | (10,968,509)   | 12,538,585            |
| Issuance of common stock<br>on London AIM<br>net of expenses of US<br>\$489,786   | 601,800                        | 602   | 6,527,613  | -  | 6,528,215             |
| Issuance of common stock<br>by majority shareholder                               | -                              | -   | 3,614,985  | -  | 3,614,985             |
| Stock based compensation  | -                              | -   | 3,720,889  | -  | 3,720,889             |
| Net loss  | -                              | -   | -  | (17,756,461)   | (17,756,461)          |
| 31 December 2008  | 26,524,300                     | 26,525                                      | 37,344,658   | (28,724,970)   | 8,646,213             |
| Private placement of<br>common stock  | 215,000                        | 215   | 1,499,785  | -  | 1,500,000             |
| Capital stock subscribed, not<br>issued   | -                              | -   | 1,350,000  | -  | 1,350,000             |
| Exercise of restricted stock  | 47,501                         | 47  | (47)   | -  | -                     |
| Stock based compensation  | -                              | -   | 1,771,764  | -  | 1,771,764             |
| Net loss  | -                              | -   | -  | (11,699,302)   | (11,699,302)          |
| 31 December 2009  | <u>26,786,801</u>              | <u>\$ 26,787</u>                            | <u>\$ 41,966,160</u>                               | <u>\$ (40,424,272)</u>   | <u>\$ 1,568,675</u>   |

The accompanying notes are an integral part of the financial statements.

**CONSOLIDATED STATEMENT OF CASH FLOWS**

**Unaudited**

|  | <b>From 30 September<br/>2004 (Inception)<br/>to 31 December 2009</b> | <b>Years ended 31 December<br/>2009</b> | <b>2008</b>                     |
|--|---|---|---------------------------------|
|  | <b>US\$</b>   | <b>US\$</b>                             | <b>US\$</b>                     |
| Cash flows from operating activities:  |   |   | <b>As revised - see Note 17</b> |
| Net loss   | \$ (40,424,272)   | \$ (11,699,302)                         | \$ (17,756,461)                 |
| <i>Adjustments to reconcile net loss to net<br/>cash provided by (used in) operating activities:</i> |   |   |                                 |
| Depreciation and Amortization  | 1,091,216   | 790,304                                 | 296,630                         |
| Stock based compensation   | 9,107,638   | 1,771,764                               | 7,335,874                       |
| Changes in assets and liabilities:   |   |   |                                 |
| Accounts receivable and other receivables  | (139,168)   | 1,227,396                               | 1,945,199                       |
| Inventory  | (237,794)   | 218,400                                 | (456,194)                       |
| Prepaid expenses and deposits  | (43,879)  | 267,877                                 | (195,367)                       |
| Notes receivable, related party  | (642,552)   | 187,448                                 | (830,000)                       |
| Forgiveness of note receivable, related party  | 365,000   | 365,000                                 | -                               |
| Accounts payable and accrued expense   | 3,425,936   | 2,072,474                               | (1,244,246)                     |
| Net cash used in operating activities  | <u>(27,497,875)</u>   | <u>(4,798,639)</u>                      | <u>(10,904,565)</u>             |
| Cash flows from investing activities   |   |   |                                 |
| Purchase of property and equipment   | <u>(6,234,955)</u>  | <u>(98,061)</u>                         | <u>(5,004,457)</u>              |
| Net cash (used in) investing activities  | <u>(6,234,955)</u>  | <u>(98,061)</u>                         | <u>(5,004,457)</u>              |
| Cash flows from financing activities   |   |   |                                 |
| Payments on line of credit - related party   | (5,435,554)   | -                                       | (2,941,467)                     |
| Borrowings on line of credit - related party   | 5,435,554   | -                                       | -                               |
| Note payable payments - related party  | (113,000)   | (113,000)                               | -                               |
| Note payable proceeds - related party  | 623,000   | 623,000                                 | -                               |
| Note payable payments  | (201,057)   | (201,057)                               | -                               |
| Note payable proceeds  | 560,013   | 560,013                                 | -                               |
| Proceeds from issuance of convertible bonds  | 9,000,000   | -                                       | -                               |
| Proceeds from the sale of common stock and stock subscriptions                                       | 23,134,809  | 2,850,000                               | 6,528,215                       |
| Members contributions  | 750,500   | -                                       | -                               |
| Net cash provided by financing activities  | <u>33,754,265</u>   | <u>3,718,956</u>                        | <u>3,586,748</u>                |
| Net increase (decrease) in cash and cash equivalents   | 21,435  | (1,177,744)                             | (12,322,274)                    |
| Cash and cash equivalents:   |   |   |                                 |
| Beginning  | <u>-</u>  | <u>1,199,179</u>                        | <u>13,521,453</u>               |
| Ending   | <u>\$ 21,435</u>  | <u>\$ 21,435</u>                        | <u>\$ 1,199,179</u>             |
| Supplemental cash flow information   |   |   |                                 |
| Cash paid for interest   | 1,460,189   | 69,178                                  | 6,776                           |
| Supplemental disclosure of non-cash investing<br>and financing activities                            |   |   |                                 |
| Conversion of bonds into common stock and warrants   | 9,000,000   | -                                       | -                               |
| Application of deposits to purchases of equipment  | -   | 2,374,359                               | -                               |

The accompanying notes are an integral part of the financial statements.

## **NOTE 1 - NATURE OF BUSINESS**

Armor Designs, Inc. (the Parent) was incorporated in Delaware on 30 March 2006. On 1 January 2007, 100% of the membership interests of Armor Designs LLC (the Subsidiary) were exchanged for common stock of the Parent.

The Subsidiary was organised in Delaware on 30 September 2004. The financial statements prior to incorporation of the Parent represent activities of the Subsidiary. The Parent and Subsidiary (collectively the Company) are engaged in the business of developing, manufacturing and marketing innovative armour products to the defense and law enforcement industries. The Company's focus is primarily on introducing next generation armour based on patented Volumetrically Controlled Manufacturing (VCM) technology.

The Company continued to focus on transitioning from a development stage entity to commercialisation of its products. The focus of the Company's efforts is the generation, testing, manufacture and marketing of armour products. The Company's success will depend on its ability to effectively develop, manufacture, obtain certification, and market innovative armour for military and law enforcement use.

These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("US GAAP"). These financial statements are presented in US dollars, unless otherwise stated.

## **NOTE 2 — GOING CONCERN**

The accompanying financial statements have been prepared on a going concern basis which contemplates the realisation of assets and the satisfaction of liabilities in the normal course of business as they become due.

For the year ended 31 December, 2009, the Company incurred net losses from operations of approximately US\$11.7 million and has accumulated approximately US\$40.4 million in net losses from 30 September 2004 to 31 December 2009. Additionally, during the year ended 31 December, 2009, the Company had negative cash flows from operating activities of approximately US\$4.8 million. The Company's current liabilities exceed its current assets by approximately US \$3.8 million as of 31 December 2009. Historically, the Company has relied, in part, upon debt financing, loans from related entities and raising new capital to fund its operations. In the past, the Company has been successful in obtaining the capital necessary to meet its obligations; however, there are no assurances that the Company will be able to continue to raise the sufficient funds needed for working capital until such time as the operations can provide positive cash flow.

The Company's ability to continue as a going concern is predicated upon its ability to improve operating results and to continue to fund its cash needs. Management is pursuing ways to improve operating results in order to generate additional cash flow from operations. The Company will consider undertaking further equity fundraisings to provide for working capital. The Company may also consider other forms of non-equity fundraisings for the same purpose which may include secured debt financing collateralised by the Company's assets. Management has the ability to curtail spending and negotiate payments to third parties, in the event that future funding takes longer than anticipated. There can be no assurance that the Company will be able to raise capital needed to fund its operations or implement management's plans.

The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result if the Company is unable to operate as a going concern.

## **NOTE 3 - SIGNIFICANT ACCOUNTING POLICIES (See Note 17)**

### Accounting Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as net sales and expenses reported for the periods presented. The most significant estimates

relate to inventory obsolescence, long-lived assets, stock-based compensation, and income taxes. The Company regularly assesses these estimates and actual results may differ significantly from these estimates.

#### Cash and Cash Equivalents

For purposes of the consolidated balance sheets and statements of cash flows, the Company considers all cash balances with original maturities of less than 90 days to be cash equivalents. While cash held by financial institutions may at times exceed federally insured limits, management believes that no material credit or market risk exposure exists due to the high quality of the institutions. The Company has not experienced any losses on such accounts.

#### Fair Value of Financial Instruments and Concentrations of Risk

Financial instruments, consisting of cash, accounts receivables, accounts payable, accrued expenses, and fixed rate short term debt are recorded at cost, which approximates fair value based on the short term maturities of these instruments at 31 December 2009 and 2008.

Guidance establishes a fair value hierarchy that prioritizes observable and unobservable inputs to valuation techniques used to measure fair value. These levels, in order of highest to lowest priority are described below:

Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities at the measurement date.

Level 2 – Observable price that are based on inputs not quoted on active markets, but corroborated by market data.

Level 3– Prices that are unobservable for the asset or liability and are developed based on the best information available in the circumstances which might include the company's own data.

#### Accounts Receivable

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. Based on historical experience and a review of individual customer balances the Company has recorded an allowance for uncollectible accounts as of 31 December 2009 and 2008 of \$11,651 and \$0, respectively.

#### Inventory Valuation

Inventories are valued at the lower of cost or market with cost determined using the First-In, First-Out (FIFO) method. Inventory balances at 31 December 2009 and 2008 were as follows:

|                 | <u>2009</u><br><u>US\$</u> | <u>2008</u><br><u>US\$</u> |
|-----------------|----------------------------|----------------------------|
| Raw Material    | \$35,777                   | \$264,548                  |
| Work in Process | 84,550                     | 3,725                      |
| Finished Goods  | <u>117,467</u>             | <u>187,921</u>             |
| Total Inventory | \$237,794                  | \$456,194                  |

#### Property and Equipment

Depreciation is provided using the straight-line method over an estimated useful life of three years for computer equipment and seven years for capital equipment. Leasehold improvements are amortised using the straight-line method over the remaining term of the facility lease. Depreciation and amortisation expense for the years ended 31 December 2009 and 2008 were as follows:

|              | <b>2009</b>      | <b>2008</b>      |
|--------------|------------------|------------------|
|              | <b>US\$</b>      | <b>US\$</b>      |
| Depreciation | \$510,691        | \$230,096        |
| Amortisation | 279,613          | 66,534           |
|              | <u>\$790,304</u> | <u>\$296,630</u> |

### Revenue Recognition

The Company sells its armour products primarily to the defence and law enforcement industries. A portion of the Company's products are also sold through third party distributors or resellers. The Company recognises revenue on product sales when persuasive evidence of an arrangement with the customer exists, title to the product passes to the customer (usually occurs at the time of shipment), the sales price is fixed or determinable, and collectability of the related billing is reasonably assured. Advance payments from customers are deferred and recognised when the related products are shipped and all other recognition criteria have been met.

### Shipping Costs

Shipping costs include charges associated with delivery of goods from the Company's facilities to its customers and are reflected in cost of goods sold. Shipping costs paid to the Company by our customers only for amounts that are a direct reimbursement for shipping are classified as an offset to cost of goods sold.

### Product Warranties

Estimated future warranty obligations related to certain products will be provided by charges to operations in the period in which the related revenue is recognized. The Company has not established a reserve for warranty obligations as warranty claims have been insignificant.

### Research and Development

Research and development costs are expensed as incurred and are detailed in Note 6.

### Stock-Based Compensation

The Company records stock-based compensation expense for all share-based awards to employees and others based on estimated fair values. Compensation expense includes the estimated fair value of equity awards vested during the reported period. For the period ended 31 December 2009 and 2008, the Company has recorded stock-based compensation expense as follows:

|  | <b>2009</b> | <b>2008</b>      |
|--|-------------|------------------|
|  | <b>US\$</b> | <b>US\$</b>      |
|  |             | (as revised)     |
| Restricted Stock Units (RSUs)                    | 1,520,476   | 878,397          |
| Stock Appreciation Rights (SARs)                 | 190,692     | 381,672          |
| Non-Qualified Stock Options                      | 60,596      | 2,460,820        |
| Issuance of common stock by majority shareholder | <u>-</u>    | <u>3,614,985</u> |
|  | 1,771,764   | 7,335,874        |

A summary of the Company's activity for restricted stock, stock appreciation rights, and non-qualified stock options for the years ended 31 December 2009 and 2008 follows:

|                              | <u>RSUs</u>                |   | <u>SARs</u>                |   | <u>Stock Options</u>       |   |
|------------------------------|----------------------------|---|----------------------------|---|----------------------------|---|
|                              | <u>Shares Under Option</u> | <u>Weighted Average Exercise Price per Share US\$</u> | <u>Shares Under Option</u> | <u>Weighted Average Exercise Price per Share US\$</u> | <u>Shares Under Option</u> | <u>Weighted Average Exercise Price per Share US\$</u> |
| 31 December 2007             | 438,500                    | -   | 69,400                     | 10.00   | -                          | -   |
| Granted in 2008 (as revised) | 205,000                    | -   | 103,000                    | 10.00   | 1,300,000                  | 10.00   |
| Forfeited in 2008            | <u>(100,000)</u>           | -   | <u>(6,300)</u>             | 10.00   | -                          | -   |
| 31 December 2008             | 543,500                    | -   | 166,100                    | 10.00   | 1,300,000                  | 10.00   |
| Granted in 2009              | 41,505                     | -   | 56,000                     | 8.05  | 23,385                     | 8.05  |
| Exercised in 2009            | (47,501)                   | -   | -                          | -   | -                          | -   |
| Forfeited in 2009            | <u>(150,000)</u>           | -   | -                          | -   | -                          | -   |
| 31 December 2009             | 387,504                    | -   | 222,100                    | 9.51  | 1,323,385                  | 9.97  |

The Company recognises compensation expense using the straight-line method for stock option awards that vest ratably over the vesting period. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

The fair value of each option was estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

|                               | <u>Year ended<br/>31 December<br/>2009</u> | <u>Year ended<br/>31 December<br/>2008</u> |
|-------------------------------|--|--|
| Expected options term (years) | 5  | (as revised)<br>5                          |
| Risk free interest rate       | 1.62%                                      | 2.03%                                      |
| Dividend yield                | -  | -  |
| Volatility                    | 33.75%                                     | 33.75%                                     |

The table above is based on the Company's use of (i) the expected life of the awards representing the weighted-average period the awards are expected to remain outstanding; (ii) the risk-free interest rate assumption based upon observed interest rates appropriate for the weighted average expected option life of the Company's employee stock options; (iii) the dividend yield assumption based on the Company's history and expectation of dividend payouts; and (iv) historical volatility of the selected peer group as the expected volatility in the Black-Scholes model.

#### Income Taxes

The Company accounts for income taxes using the asset and liability method recognising temporary differences between the financial reporting and tax bases of its assets and liabilities. This method results in deferred income tax assets and liabilities at the balance sheet date measured by the statutory tax rates in effect as enacted. The Company's deferred income tax assets include certain future income tax benefits net of

appropriate valuation allowances. Recognition of deferred tax assets is limited to amounts considered by the Company to be more likely than not realisable in future periods with all tax benefits associated with losses incurred having been reserved. The Company has no unrecognized tax benefits.

#### Principles of Consolidation

The financial statements include the accounts of Armor Designs, Inc. and Armor Designs, LLC. All material intercompany balances and transactions have been eliminated in consolidation.

#### Accounting Developments

In May 2009, the Financial Accounting Standards Board (FASB) issued authoritative guidance intended to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. It requires disclosure of the date through which an entity has evaluated subsequent events and the basis for selecting that date, that is, whether that date represents the date the financial statements were issued or were available to be issued. We have evaluated subsequent events through June 29, 2010, which is the date the financial statements were issued.

#### **NOTE 4 - PUBLIC OFFERING AND STOCK SPLIT**

On 20 December 2007, the Company effected a 450 for 1 stock split. Each holder of record as of that date received four hundred fifty shares for each share of common stock held. The par value of US\$0.001 per share did not change with the stock split. The accompanying financial statements reflect this transaction retroactively.

On 31 December 2007, the common shares of the Company were admitted to trading on the AIM Market of the London Stock Exchange ("Admission"). The Company raised US\$16,000,000, before expenses, by issuing 1,600,000 common shares at a price of US\$10 per share pursuant to a placing (the "Placing") in conjunction with the Admission. These shares constitute approximately 6.0 percent of the Company's share capital at 31 December 2007. At admission, the Company had 25,922,500 common shares in issue and a market capitalisation of US\$259,225,000 at the placing price of US\$10.

The Placing shares were not registered under the US Securities Act of 1933. The shares were only offered (i) outside the United States to non-US persons in reliance on Regulation S under the Securities Act and (ii) within the US to Accredited US investors in reliance on Regulation D under the Securities Act. Of the 1,600,000 common shares issued in connection with the Admission 1,275,000 were issued in reliance on Regulation S and 325,000 were issued in reliance on Regulation D.

Upon admission to AIM, the conversion features of outstanding convertible bonds were triggered. Each convertible bond unit issued converted to 2.025 shares of Common Stock and 2.025 warrants to purchase one share of Common Stock in the Company. Each warrant granted entitled the holder to purchase one Common Share at a price per share of 125 percent of the placing price of US\$10, or US\$12.50, exercisable on or before the second anniversary of admission or the date of any secondary issue of Common Shares by the Company following admission. All Bond Warrants expire if they are not exercised on the Warrant Exercise Date. In December 2009, our Board of Directors agreed to extend the exercise term of the warrants to 31 December 2010. There was no material impact to our financial statements as a result of extending the warrant exercise term. A total of 1,822,500 common shares and 1,822,500 warrants were issued as a result of the conversion.

During the period ended 31 December 2008 the Company received subscriptions for 701,800 common shares at a price of US\$10 per share pursuant to Market Demand Arrangements put in place in conjunction with the Admission. These shares constituted approximately 2.6 percent of the Company's share capital at 31 December 2008. As of 31 December 2008, funds in the amount of US\$5,810,078 were collected from this sale of common stock and 601,800 shares were issued. Funds in the amount of US\$1,189,922 were included in the Balance Sheet as a receivable from the sale of stock as of 31 December 2008. The amounts outstanding as of 31 December 2008 were collected during the year ended 31 December 2009 and the remaining 100,000 shares were issued.

During the period ended 31 December 2009 the Company raised \$1,500,000 by issuing 100,000 common shares at a price of US\$15 pursuant to a private placement. In addition, during the period ended 31 December 2009, the Company collected \$1,350,000 related to shares subscribed but not issued as of 31 December 2009. These shares were issued subsequent to 31 December 2009 as described in Note 16.

As of 31 December 2009, the Company had 26,786,801 common shares in issue and a market capitalization of US\$192,061,363 based on the Company's closing stock price of US\$7.17 (trading price of £4.50 converted utilising an exchange rate of 1.593) on 31 December 2009.

#### **NOTE 5 - WARRANTS AND OPTIONS (See Note 17)**

Warrants for 1,822,500 shares of Common Stock were outstanding at 31 December 2009 and 2008. Each warrant entitles the holder to purchase one Common Share at a price per share of US\$12.50, with an original expiration date of 31 December 2009. On 31 December 2009 the Company's Board of Directors extended the exercise term of these warrants from 31 December 2009 to 31 December 2010.

The Company issued stock awards to various advisors and key employees as a means of attracting and retaining quality personnel. The award holders have the right to purchase a stated number of shares at the exercise price determined in the agreement. These options are issued under the Armor Designs, Inc 2007 Omnibus Incentive Plan (Plan). The Plan allows the Company to issue RSUs, SARs and Stock Options. Awards may be made under the Plan over shares of common stock not to exceed 10% of the issued share capital of the Company at the date of the award.

A summary of the Company's option activity and related full grant date fair value is as follows:

|                              | <u>RSUs</u>                |             | <u>SARs</u>                |             | <u>Stock Options</u>       |             |
|------------------------------|----------------------------|-------------|----------------------------|-------------|----------------------------|-------------|
|                              | <u>Shares Under Option</u> | <u>US\$</u> | <u>Shares Under Option</u> | <u>US\$</u> | <u>Shares Under Option</u> | <u>US\$</u> |
| Granted in 2007              | 438,500                    | 4,381,836   | 69,400                     | 245,144     | -                          | -           |
| 31 December 2007             | 438,500                    | 4,381,836   | 69,400                     | 245,144     | -                          | -           |
| Granted in 2008 (as revised) | 205,000                    | 1,682,282   | 103,000                    | 332,039     | 1,300,000                  | 2,460,820   |
| Forfeited in 2008            | (100,000)                  | (999,278)   | (6,300)                    | (22,254)    | -                          | -           |
| 31 December 2008             | 543,500                    | 5,064,840   | 166,100                    | 554,929     | 1,300,000                  | 2,460,820   |
| Granted in 2009              | 41,505                     | 380,296     | 56,000                     | 145,108     | 23,385                     | 60,596      |
| Exercised in 2009            | (47,501)                   | (430,150)   | -                          | -           | -                          | -           |
| Forfeited in 2009            | (150,000)                  | (1,230,938) | -                          | -           | -                          | -           |
| 31 December 2009             | 387,504                    | 3,784,048   | 222,100                    | 700,037     | 1,323,385                  | 2,521,416   |

Based on the Company's closing stock price of US\$7.17 (trading price of £4.50 converted utilising an exchange rate of 1.593) on 31 December 2009, the last day of trading in period, there were no in-the-money options exercisable at 31 December 2009.

A summary of the Company's option activity and related value of grant date vesting is as follows

|   | RSUs                |             | SARs                |           | Stock Options       |             |
|---|---------------------|-------------|---------------------|-----------|---------------------|-------------|
|   | Shares Under Option | US\$        | Shares Under Option | US\$      | Shares Under Option | US\$        |
| Granted in 2007                               | 438,500             | 4,381,836   | 69,400              | 245,144   | -                   | -           |
| Vested in 2007                                | -                   | -           | -                   | -         | -                   | -           |
| Nonvested at 31 December 2007                 | 438,500             | 4,381,836   | 69,400              | 245,144   | -                   | -           |
| Granted in 2008 (as revised)                  | 205,000             | 1,682,282   | 103,000             | 332,039   | 1,300,000           | 2,460,820   |
| Vested in 2008 (as revised)                   | (134,625)           | (1,256,183) | (40,775)            | (137,130) | (1,300,000)         | (2,460,820) |
| Forfeited in 2008                             | (100,000)           | (999,278)   | (6,300)             | (22,254)  | -                   | -           |
| Nonvested at 31 December 2008                 | 408,875             | 3,808,657   | 125,325             | 417,799   | -                   | -           |
| Granted in 2009                               | 41,505              | 380,296     | 56,000              | 145,108   | 23,385              | 60,596      |
| Vested in 2009                                | (119,057)           | (1,169,299) | (147,525)           | (446,656) | (23,385)            | (60,596)    |
| Forfeited in 2009                             | (150,000)           | (1,231,629) | -                   | -         | -                   | -           |
| Nonvested at 31 December 2009                 | 181,323             | 1,788,025   | 33,800              | 116,251   | -                   | -           |
| Available to be Exercised at 31 December 2009 | 206,181             |             | 188,300             |           | 1,323,385           |             |

The following table shows unrecognised compensation expense related to unvested RSUs and SARs outstanding as of 31 December 2009. This table does not include an estimate for future grants that may be issued.

|       | Amount      |
|-------|-------------|
|       | US\$        |
| 2010  | \$946,323   |
| 2011  | \$946,323   |
| 2012  | \$11,630    |
| Total | \$1,904,276 |

As outlined in the Placing Document, Hawthorne & York International, Ltd. (HYI), the principal shareholder in ADI, has gifted 3.4 million shares of its ADI shareholding, for distribution to a number of individuals who have primarily assisted HYI in the years prior to bringing ADI to market. This equity compensation plan is separate from the 2007 Omnibus Incentive Plan approved by security holders. The shares gifted have been transferred into an irrevocable trust controlled by an independent trustee that will be used to distribute awards to the recipients. Of the 3.4 million total shares, 450,000 have been issued in the form of shares of common stock, 1.3 million have been awarded in the form of non-qualified stock options, 100,000 have been awarded in the form of SARs, and 1,550,000 remain available for future issuance as share equivalents (non-qualified stock options and restricted stock units).

During the year ended 31 December 2008, HYI transferred 3,000,000 of its ADI shares into a securities investment portfolio account. The securities investment portfolio account into which the shares have been transferred enables borrowing against all shares within this portfolio account and, therefore, from time-to-time, some or all of the shares within this portfolio account, including some ADI shares, could be subject to creditor liability. As of 31 December 2009, HYI has not divested any shares.

#### **NOTE 6 – RESEARCH & DEVELOPMENT COSTS**

Expenditures for research activities relating to product development are charged to expense as incurred. Research and development costs for the periods ended 31 December 2009 and 2008 were US\$1,417,673 and US\$1,914,040, respectively.

#### **NOTE 7 - RELATED PARTY TRANSACTIONS**

##### **Hawthorne & York International, Ltd**

Since inception, the Subsidiary, Armor Designs, LLC, has conducted business through transactions with a related corporation, Hawthorne & York International, Ltd. (HYI), owned by James A. St. Ville. HYI owns approximately 81 percent of Armor Designs, Inc. as of 31 December 2009, including 11 percent held in an irrevocable trust.

During 2004, the Subsidiary entered into a services agreement with HYI whereby HYI provides interim research and development services, including labour, subcontracting, consulting, equipment and technical upgrades, materials, and other related research and development activities.

Also during 2004, the Subsidiary, entered into a contract with HYI for use of certain licensed technological products and processes, as described in Note 9 of these consolidated financial statements. Billings from the related party for the use of licensed technology, and research and development services conducted on behalf of the Subsidiary were as follows:

|   |               |             |
|---|---------------|-------------|
| Periods ended 31 December 2009 and 2008 | US\$1,285,707 | US\$714,174 |
|---|---------------|-------------|

Included in the accompanying consolidated balance sheets is accounts payable of US\$515,588 and US\$202,584 due to the related party at 31 December 2009 and 2008, respectively, for billings related to the use of licensed technology and research and development activities.

The Subsidiary paid rent and other facility occupancy costs on behalf of the related party for the periods ended 31 December 2009 and 2008. Facility occupancy costs incurred on behalf of the related party for the periods ended 31 December 2009 and 2008 were US\$50,262 and US\$35,886, respectively. Costs paid on behalf of the related party are reimbursed in full by the related party.

The Company maintains independent management and human resources. The Company has also entered into a lease for independent facilities. The Company continues to utilise the related party for select research and development activities.

In May 2009 the Company entered a US\$185,000 note payable with a related party, Hawthorne & York International, Ltd. This note bears interest on unpaid principal balances at a rate of 8% per annum. As of 31 December 2009 the outstanding balance on this note was US\$185,000.

##### **Aztec IP, LLC**

The Subsidiary entered into a contract on 13 September 2004 with Aztec IP, LLC, a company owned by James A. St. Ville, for use of licensed patents as described in Note 9 of these consolidated financial statements. Billings from the related party for the use of this licensed technology were US\$14,200 and US\$0 for the year ended 31 December 2009 and 2008, respectively. Included in the accompanying consolidated balance sheets is accounts payable of US\$14,200 and US\$0 due to Aztec IP at 31 December 2009 and 2008, respectively

**Philip A. Clement**

In December 2009 the Company entered a US\$325,000 secured note payable with Philip A. Clement, Interim CEO of the Company. This note bears interest on unpaid principal balances at a simple interest rate of 1% per month, has a maturity date of 31 January 2010, and contains certain affirmative covenants. As of 31 December 2009 the outstanding balance on this note was US\$325,000 and the Company was in compliance with all covenants. Effective 31 January 2010 the Company entered an agreement with Phillip A. Clement to extend the maturity date of this loan to 31 December 2010. In addition to this note payable and included in the accompanying consolidated balance sheets is accounts payable of US\$180,910 due to Mr. Clement related to services performed as Interim CEO of the Company.

**James A. St. Ville**

Included in the accompanying consolidated balance sheets is accounts payable of US\$115,678 and US\$0 due to James A. St. Ville for billings related to general and administrative expenses at 31 December 2009 and 2008, respectively.

**Charles Snyder**

On 3 July 2008 the Company executed a Multiple Advance Revolving Credit Note with Mr. Charles Snyder, former Chief Executive Officer of the Company. The Note provided Mr. Snyder the ability to borrow up to US\$1,000,000 at a Stated Interest Rate of 1% per annum. The Note is secured by a Deed of Trust, Assignment of Rents, Security Agreement, Fixture Filing and Stock Pledge Agreement. Following Mr. Snyder's resignation from the Company in June 2009, 50 percent of the outstanding balance on the note totaling \$730,000 was forgiven by the Company and is included as compensation cost in general and administrative expenses. As of 31 December 2009, the outstanding balance to the Company was US\$365,000 and was due from Mr. Snyder on 22 December 2009. This balance is reflected on our balance sheet as of 31 December 2009 as a note receivable, net of amounts due to Mr. Snyder relating to outstanding salary and bonus of \$187,448.

**Robert McConnell**

On 3 December 2008 the Company loaned Mr. Robert McConnell, Vice President of the Company, US\$100,000. The Company has received a non-interest bearing Promissory Note reflecting the commitment to repay the loan in full by 30 June 2009. The Note provides the Company the ability to offset the amount of the loan against the stock in the Company held by Mr. McConnell. As of 31 December 2009 this loan remains outstanding. Effective 24 June 2010 the Company entered an agreement with Robert McConnell to extend the maturity date of this loan to 3 January 2012.

**David Seaton**

Included on the Company's consolidated balance sheet as of 31 December 2009 is a liability of \$312,000 relating to accrued fees for David Seaton, former contract CFO.

**Other Related Parties**

The remaining balance of \$70,521 in accounts payable - related party relates to reimbursable expenses or fees due to Directors incurred during the year.

**NOTE 8 - PROPERTY, PLANT AND EQUIPMENT**

The Company policy is to capitalise all equipment, either moveable or fixed, with a unit acquisition cost of US\$1,000 or greater and a useful life of two years or more. Acquisition value includes the cost of the equipment and any associated costs incurred to make the equipment usable for the purpose for which it was intended, including installation costs.

As of 31 December 2009, the Company capitalised and was depreciating fixed assets per the following schedule:

|                      | <u>Expected<br/>life, in years</u>                 | US\$<br>2009 | US\$<br>2008 |
|----------------------|--|--------------|--------------|
| Computer equipment   | 3  | \$107,828    | \$107,828    |
| Computer software    | 3  | 138,425      | 130,113      |
| Equipment            | 7  | 4,446,864    | 2,026,528    |
| Production Molds     | 3  | 309,769      | 309,769      |
| Furniture & Fixtures | 7  | 34,121       | 34,121       |
| Leaseholds           | 3 to 5   | 991,511      | 1,154,176    |
|                      | Subtotal:  | 6,028,518    | 3,762,535    |
|                      | Less: accumulated depreciation and<br>amortisation | (1,091,216)  | (300,912)    |
|                      | Total:   | \$4,937,302  | \$3,461,623  |

#### NOTE 9 - COMMITMENTS

In December 2007, the Company entered into an operating lease agreement for its facility located at 4645 S. 35<sup>th</sup> Street in Phoenix, Arizona. Rental expense for the periods ending 31 December 2009 and 2008 were US\$539,490 and US\$530,807, respectively. Under the agreement, the Company is required to pay rent through December 2012 as follows:

| Years ending 31 December, | US\$             |
|---------------------------|------------------|
| 2010                      | 547,930          |
| 2011                      | 565,052          |
| 2012                      | 582,175          |
|                           | <u>1,695,157</u> |

Effective 13 September 2004, the Subsidiary, Armor Designs, LLC, entered into a contract with Hawthorne & York International, Ltd. for use of certain licensed technological products and processes owned by the related party, until September 13, 2009, at such time the contract will automatically renew for five-year terms. The Subsidiary is obligated to pay 4% of gross sales on a quarterly basis to the related party subject to a maximum amount payable of US\$7,000 per quarter for the first 18 months after the Company commences production or sub-licenses. Beginning April 1, 2010 this contract provides for a guaranteed minimum fee to Hawthorne & York International of US\$250,000 per quarter.

In addition, the Subsidiary entered into a contract on the same date with Aztec IP, a company owned by James A. St Ville for use of licensed patents owned by the related party. Under this contract, the Subsidiary is obligated to pay the related entity 2% of gross sales on a quarterly basis subject to a maximum amount payable of US\$3,000 per quarter for the first 18 months after the Company commences production or sub-licenses. Beginning April 1, 2010 this contract provides for a guaranteed minimum fee of US\$125,000 per quarter. This contract has the same expiration and renewal dates. The following table summarizes the amounts due under these contracts.

| Years ending 31 December | Hawthorne & York<br>International, Ltd. | Aztec IP    |
|--------------------------|---|-------------|
|                          | US\$                                    | US\$        |
| 2010                     | \$750,000                               | \$375,000   |
| 2011                     | 1,000,000                               | 500,000     |
| 2012                     | 1,000,000                               | 500,000     |
| 2013                     | 1,000,000                               | 500,000     |
| 2014                     | 750,000                                 | 375,000     |
|                          | \$4,500,000                             | \$2,250,000 |

#### NOTE 10 – Notes Payable

In February 2009 the Company executed a Commercial Loan Agreement with Republic Bank and Trust for a Commercial Revolving Draw Loan of up to US\$400,000. The loan accrues interest at 6.00% per annum and has a maturity date of 19 February 2010. The loan is guaranteed by Hawthorne and York International, Ltd., which also provided security in the form of a deposit/share account. As of 31 December 2009 the outstanding balance on this loan was US\$309,440. Effective 19 February 2010 the Company entered an agreement with Republic Bank and Trust to extend the maturity date of this loan to 19 February 2011.

In March 2009 the Company executed a US\$200,000 note payable with Arizona Business Bank with an original maturity date of 10 May 2009. The note bears interest on unpaid principal balances at a rate of 7.00% per annum, subject to certain adjustments. This note is secured by substantially all of our tangible and intangible assets. During the year ended 31 December 2009 the terms of the note were changed to extend the maturity date to 10 January 2010. Subsequent to 31 December 2009 the maturity date of this note was extended to 10 July 2010. As of 31 December 2009 the outstanding balance on this note was US\$49,516.

In May 2009 The Company entered a US\$185,000 note payable with Hawthorne & York International, Ltd. This note has a maturity date of 31 December 2010 and bears interest on unpaid principal balances at a rate of 8.00% per annum. As of 31 December, 2009 the outstanding balance on this note was US\$185,000.

In December 2009 the Company entered a US\$325,000 secured note payable with Philip A. Clement, Interim CEO of the Company. This note bears interest on unpaid principal balances at a simple interest rate of 1% per month, has a maturity date of 31 January 2010, and contains certain affirmative covenants. As of 31 December 2009 the outstanding balance on this note was US\$325,000 and the Company was in compliance with all covenants. Effective 31 January 2010 the Company entered an agreement with Phillip A. Clement to extend the maturity date of this loan to 31 December 2010.

#### NOTE 11 – RETIREMENT PLAN

Employees of the Company that meet certain age and service requirements are eligible to participate in the Armor Designs, Inc. 401(k) and Profit Sharing Plan (formerly the James A. St. Ville, M.D. Savings and Profit Sharing Plan). Employer profit sharing and matching contributions to the 401(k) component of the plan and profit sharing contributions may be made at the discretion of the Company's management. The Company did not make matching or profit sharing contributions for the years ended 31 December 2009 and 2008.

#### NOTE 12 - LOSS PER SHARE

The income (loss) per share accounting guidance provides for the calculation of basic and diluted income (loss) per share. Basic income per share includes no dilution and is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the periods presented. Diluted income per share reflects the potential dilution that could occur if outstanding stock options were exercised utilising the treasury stock method. The effect of dilutive securities is not included in the weighted average number of shares outstanding when inclusion would increase the earnings per share or decrease the loss per share. The computation of diluted income (loss) per share equals the basic calculation for the years ended 31 December

2009 and 2008 because all potentially dilutive securities were excluded from the per share computations due to their anti-dilutive effect. The calculation of the weighted average number of shares outstanding and earnings per share are as follows:

| <u>Basic Earnings Per Share</u>    | <u>31 December 2009</u> | <u>31 December<br/>2008</u> |
|------------------------------------|-------------------------|-----------------------------|
| Net loss after tax                 | US\$(11,699,302)        | US\$(17,756,461)            |
| Divided by weighted average shares | 26,646,428              | 26,233,893                  |
| Basic loss per share               | US\$(0.44)              | US\$(0.68)                  |
| <br>Diluted loss per share         | <br>US\$(0.44)          | <br>US\$(0.68)              |

#### **NOTE 13– Financing Arrangements**

Effective April 9, 2009, the Company entered an agreement to assign substantially all of its trade accounts receivable to a commercial factor. Under the terms of the factoring agreement, the factor remits invoiced amounts to the Company, up to a maximum credit limit established by the factor for each customer. All accounts sold to the factor are with recourse to the Company. Amounts paid under this agreement, included in the Consolidated Statement of Operations as interest expense, totaled US\$36,093 and US\$0 for the years ended 31 December 2009 and 2008, respectively. As of 31 December 2009 and 2008 the Company had accrued \$63,907 and \$0 for accounts receivable sold with full recourse, respectively.

#### **NOTE 14 – Common Stock**

The Company shareholders passed a resolution at the Annual Meeting held on 23 September, 2008, that empowered the Board to repurchase or otherwise acquire shares of the Company's Common Stock in the open market or in private transactions, with such repurchases not to exceed US\$5,000,000 in the aggregate. The resolution states that no such repurchase shall be made when the capital of the Company is impaired or when such purchase or acquisition would cause any impairment of the capital of the Company. The authority granted by this resolution remains in effect as of 31 December 2009. As of 31 December 2009 the Company has not repurchased any shares of the Company's Common Stock.

#### **NOTE 15 – INCOME TAXES**

For Fiscal 2009 and 2008, the Company recorded no current or deferred income tax provision expense for state or federal taxes.

The provision for income taxes for the years ended December 31, 2009 differ from the amount computed by applying the statutory U.S. federal income tax rate to pre-tax loss as a result of the following:

|  | <u>US\$</u>      | <u>%</u>    |
|--|------------------|-------------|
| Computed tax benefit   | (4,516,000)      | (38.6)      |
| Permanent items  | 9,000            | .1          |
| Credits  | (128,000)        | (1.1)       |
| <u>Change in valuation allowance for deferred tax assets</u> | <u>4,635,000</u> | <u>39.6</u> |
| <u>Provision for income taxes</u>                            | <u>-</u>         | <u>-</u>    |

The Company provides deferred income taxes which reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and for income tax purposes. Significant components of the Company's deferred tax assets and liabilities at 31 December 2009 and 2008 were as follows:

| <b>Deferred tax assets:</b>                           | <b>2009</b>      | <b>2008</b>      |
|---|------------------|------------------|
|   | <b>US\$</b>      | <b>US\$</b>      |
|   |                  | (As revised)     |
| <i>Non-current deferred tax assets (liabilities):</i> |                  |                  |
| Net operating loss carryforwards                      | 9,420,000        | 5,370,000        |
| Depreciation and amortization                         | (110,000)        | (11,000)         |
| Research and development tax credits                  | 457,000          | 329,000          |
| <b>Total non-current</b>                              | <b>9,767,000</b> | <b>5,688,000</b> |
| <i>Current deferred tax assets (liabilities):</i>     |                  |                  |
| Accruals  | 2,189,000        | 1,633,000        |
| <b>Total current</b>                                  | <b>2,189,000</b> | <b>1,633,000</b> |
| Total deferred tax assets                             | 11,956,000       | 7,321,000        |
| Valuation allowance                                   | (11,956,000)     | (7,321,000)      |
| <b>Net deferred tax assets</b>                        | <b>-</b>         | <b>-</b>         |

The Company has available at December 31, 2009, unused federal net operating loss carryforwards of approximately US\$24,407,000 and state net operating loss carryforwards of approximately US\$24,390,000 which may be applied against future taxable income. The carryforwards begin expiring in 2027 and 2012, respectively.

Since the Company is a development stage entity in the reporting period and future revenues are unpredictable, a valuation allowance equal to net deferred tax benefits associated with the above items has been provided. The valuation allowance increased by US\$4,635,000 in 2009.

The Company accounts for uncertain tax positions by recognizing the financial statement effects of a tax position only when, based upon the technical merits of the position, it is "more-likely-than-not" that the tax position will be sustained upon examination. As of 31 December 2009, all of the uncertain tax positions reported by the Company meet the "more-likely-than-not" test; therefore, the Company has not provided for any unrecognized tax benefits.

The Company and its subsidiaries are subject to the following significant jurisdictions: US Federal and Arizona. The statute of limitations for a particular tax year for examination by the Internal Revenue Service is three years, and four years in its state jurisdiction. Accordingly, there are multiple years open to examination.

#### **NOTE 16 - SUBSEQUENT EVENTS**

Subsequent to 31 December 2009 the Company closed (the "Closing") a fundraising (the "Fundraising") by which the Company has raised US\$3,575,000, before expenses, through a placing with investors of 238,335 new common shares of US\$0.001 each in the Company (the "Placing Shares"). The Closing has been completed at a price of US\$15 per Placing Share (the "Placing Price"). As part of the Closing the Company has agreed with the investors that in the event the Company issues any shares in the capital of the Company as part of a fundraising prior to 31 December 2010 at a price less than the Placing Price (the "Lower Price") the investors will have the option to subscribe at par (being US\$0.001 per share), for such number of additional shares as they would have received had the subscription price per share at Closing been the Lower Price rather than the Placing Price. The net proceeds of the Closing totaled US\$3,575,000 and were used for initial short term working capital needs.

Subsequent to 31 December 2009 the Company has received a letter of commitment from a boutique U.S. based investment fund, specialising in debt financing for companies in the knowledge-based or intellectual property sectors. The letter of commitment is in the form of a US\$10.0 million Senior Debt Facility (the "Facility") in the form of a line of credit. The availability of the Facility is subject to completion of due diligence and execution of legal documents, with an anticipated close on or around July 15, 2010. The Facility is expected to include an immediate advance of US\$4.0 million with follow-on advances, up to a cumulative total of US\$10.0 million, made available based on the Company's achievement of certain operational and financial milestones. The Facility has a proposed 5-year term, two warrant provisions (with strike prices of US\$22.50 and US\$24.00, respectively), conversion rights (at US\$15 per share) and is collateralized, in part, by the Company's intellectual property. In addition, the Company will be expected to maintain certain usual and customary Covenants during the term of the Facility.

#### **NOTE 17 – CORRECTION OF ERROR**

During 2010, an error was discovered that required the Company to restate its financial statements for the year ended 31 December 2008. The Company determined that its calculation of expected volatility, the expected life of options and the number of options granted in 2008 were incorrect, resulting in an error in the estimated fair value of options granted in 2008 (See Notes 3 and 5). As a result, the fair value of stock based compensation for the year ended 31 December 2008 was understated. Stock options granted in 2008 were previously reported as 2,600,000 and have been revised and presented as 1,300,000 in the accompanying consolidated financial statements. The fair value of the stock awards has been recomputed and reflected in the accompanying consolidated financial statements. The correction had the effect of increasing the net loss by US\$2,427,217 or \$(.10) per share for the year ended 31 December 2008, with an offsetting increase in additional paid in capital. As such, there was no impact on cash or other assets and liabilities. The deficit accumulated during development stage increased by US\$2,427,217 as of 31 December 2008. There was no impact to deficit accumulated during development stage for 31 December 2007 or prior periods.

**- Ends -**