

FORWARD INDUSTRIES INC  
Form 10-Q  
August 12, 2013

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

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**FORM 10-Q**

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

**For the quarterly period ended June 30, 2013.**

**OR**

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

**For the transition period from \_\_\_\_ to \_\_\_\_.**

**Commission File Number: 0-6669**

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**FORWARD INDUSTRIES, INC.**

(Exact name of registrant as specified in its charter)

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**New York**

**13-1950672**

(State or other jurisdiction of  
incorporation or organization)

(I.R.S.  
Employer  
Identification  
No.)

**477 Rosemary Ave., Suite 219, West Palm Beach, FL 33401**

(Address of principal executive offices, including zip code)

**(561) 465-0030**

(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 twelve months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  Yes  No

Indicate by check mark whether the registrant 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

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

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

The number of shares outstanding of the registrant's common stock, par value \$0.01 per share, at the latest practical date July 31, 2013, was 8,819,095 shares.



Forward Industries, Inc.

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### **Note Regarding Use of Certain Terms**

In this Quarterly Report on Form 10-Q, unless the context otherwise requires, the following terms have the meanings assigned to them as set forth below:

"we", "our", and the "Company" refer to Forward Industries, Inc., a New York corporation, together with its consolidated subsidiaries;

Forward or Forward Industries refers to Forward Industries, Inc.;

common stock refers to the common stock, \$.01 par value per share, of Forward Industries, Inc.;

"Forward US" refers to Forward Industries wholly owned subsidiary Forward Industries (IN), Inc., an Indiana corporation;

Forward HK refers to Forward Industries wholly owned subsidiary Forward Industries HK, Ltd., a Hong Kong corporation;

Forward Switzerland refers to Forward Industries wholly owned subsidiary Forward Industries (Switzerland) GmbH, a Swiss corporation;

Forward APAC refers to Forward Industries wholly owned subsidiary Forward Asia Pacific Limited, a Hong Kong corporation;

Forward UK refers to Forward Industries wholly owned subsidiary Forward Ind. (UK) Limited, a limited company of England and Wales;

Forward China refers to Forward Industries Asia-Pacific Corporation (f/k/a Seaton Global Corporation), Forward's exclusive sourcing agent in the Asia-Pacific region;

GAAP refers to accounting principles generally accepted in the United States;

Commission refers to the United States Securities and Exchange Commission;

Exchange Act refers to the United States Securities Exchange Act of 1934, as amended;

Fiscal 2011 refers to our fiscal year ended September 30, 2011;

Fiscal 2012 refers to our fiscal year ended September 30, 2012;

Fiscal 2013 refers to our fiscal year ending September 30, 2013;

Europe refers to the countries included in the European Union;

EMEA Region means the geographic area encompassing Europe, the Middle East and Africa;

APAC Region refers to the Asia Pacific Region, consisting of Australia, New Zealand, Hong Kong, Taiwan, China, South Korea, Japan, Singapore, Malaysia, Thailand, Indonesia, India, the Philippines and Vietnam;

Americas refers to the geographic area encompassing North, Central, and South America;

OEM refers to Original Equipment Manufacturer;

Retail refers to the retail distribution channel; and

Corporate refers to the corporate distribution channel.

**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements**

Forward Industries, Inc.

**CONSOLIDATED BALANCE SHEETS**

	<b>June 30, 2013 (Unaudited)</b>	<b>September 30, 2012 (Note 1)</b>
<b><u>Assets:</u></b>		
<b>Current assets:</b>		
Cash and cash equivalents.....	\$5,011,600	\$4,608,246
Marketable securities.....	405,721	420,605
Accounts receivable, net .....	6,222,761	7,533,491
Inventories, net.....	2,363,833	3,380,813
Prepaid expenses and other current assets.....	755,826	367,552
Assets of discontinued operations.....	312,319	621,879
<b>Total current assets</b> .....	<b>15,072,060</b>	<b>16,932,586</b>
Property and equipment, net.....	123,533	138,774
Other assets.....	40,442	40,442
<b>Total Assets</b> .....	<b>\$15,236,035</b>	<b>\$17,111,802</b>
<b><u>Liabilities and shareholders equity</u></b>		
<b>Current liabilities:</b>		
Accounts payable.....	\$4,223,383	\$5,936,848
Accrued expenses and other current liabilities.....	868,741	1,725,185
Liabilities of discontinued operations.....	35,391	261,806
<b>Total current liabilities</b> .....	<b>5,127,515</b>	<b>7,923,839</b>
Other liabilities.....	82,811	--
<b>Total Liabilities</b> .....	<b>5,210,326</b>	<b>7,923,839</b>
6% Senior Convertible Preferred Stock, par value \$0.01 per share; 1,500,000 shares authorized; 381,674 shares issued and outstanding (aggregate liquidation value of \$750,000).....	447,983	--
Commitments and contingencies		



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**Shareholders equity:**

Preferred stock, par value \$0.01 per share; 4,000,000 shares authorized;

no shares issued and outstanding..... -- --

Series A Participating Preferred stock, par value \$0.01; 100,000 authorized; no shares issued and outstanding..... -- --

Common stock, par value \$0.01 per share; 40,000,000 shares authorized, 8,819,095 and 8,811,595 shares issued; and

8,112,685 and 8,105,185 shares outstanding, respectively.....

	88,191	88,116
Capital in excess of par value.....	17,353,932	17,020,771
Treasury stock, 706,410 shares at cost.....	(1,260,057)	(1,260,057)
Accumulated deficit.....	(6,582,790)	(6,624,926)
Accumulated other comprehensive loss.....	(21,550)	(35,941)
<b>Total shareholders equity.....</b>	<b>9,577,726</b>	<b>9,187,963</b>
<b>Total liabilities and shareholders equity.....</b>	<b>\$15,236,035</b>	<b>\$17,111,802</b>

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

Forward Industries, Inc.

**CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)****(UNAUDITED)**

	<b>Three Months Ended June 30,</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>
<b>Net sales</b> .....	\$8,590,248	\$7,664,252	\$23,350,344	\$23,350,344
<b>Cost of goods sold</b> .....	6,747,066	6,906,769	18,489,104	16,489,104
<b>Gross profit</b> .....	1,843,182	757,483	4,861,240	3,000,000
<b>Operating expenses:</b>				
Sales and marketing.....	602,038	282,020	1,620,880	920,000
General and administrative.....	767,588	1,088,552	2,612,398	3,800,000
<b>Total operating expenses</b> .....	1,369,626	1,370,572	4,233,278	4,720,000
<b>Income (loss) from operations</b> .....	473,556	(613,089)	627,962	(1,000,000)
<b>Other income (expense):</b>				
Interest income (expense).....	(120)	21,234	(376)	88,000
Loss on marketable securities, net.....	(702,377)	--	(374,160)	--
Other income (expense), net.....	2,897	(38,998)	(11,285)	(4,000)
<b>Total other income (expense), net</b> .....	(699,600)	(17,764)	(385,821)	42,000
<b>Income (loss) from continuing operations before income tax expense</b>	(226,044)	(630,853)	242,141	(1,000,000)
Income tax expense.....	--	--	507	--
<b>Income (loss) from continuing operations</b>	(226,044)	(630,853)	241,634	(1,000,000)
Loss from discontinued operations, net of tax expense (benefit) of \$(8,977) and \$(130); and \$(6,002) and \$4,850, respectively....	(18,659)	(2,678,075)	(199,498)	(4,000)
<b>Net income (loss)</b> .....	(244,703)	(3,308,928)	42,136	(6,000)
<b>Other comprehensive income (loss):</b>				
Change in unrealized gains on marketable securities.....	--	--	23,744	--
Translation adjustments.....	(152)	(7,446)	(9,353)	(1,000)
<b>Comprehensive income (loss)</b> .....	\$(244,855)	\$(3,316,374)	\$56,527	\$(7,000)
<b>Net income (loss) per basic and diluted common share:</b>				
Income (loss) from continuing operations.....	\$(0.03)	\$(0.08)	\$0.03	\$(0.03)

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Loss from discontinued operations.....	\$(0.00)	\$(0.33)	\$(0.02)	\$(0.00)
<b>Net income (loss) per share.....</b>	<b>\$(0.03)</b>	<b>\$(0.41)</b>	<b>\$0.01</b>	<b>\$(0.00)</b>
<b>Weighted average number of common and common equivalent shares outstanding</b>				
Basic.....	8,112,685	8,105,185	8,110,734	8,112,685
Diluted.....	8,112,685	8,105,185	8,120,909	8,112,685

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

**Forward Industries, Inc.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(UNAUDITED)**

	<b>Nine Months Ended</b>	
	<b>June 30,</b>	
	<b>2013</b>	<b>2012</b>
<b>Operating activities:</b>		
Net income (loss).....	\$42,136	\$(6,365,983)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Realized loss on marketable securities.....	374,160	--
Share-based compensation.....	333,236	124,195
Depreciation and amortization.....	55,634	82,657
Bad debt expense.....	59,915	26,311
Loss on disposal of property and equipment.....		35,411
Changes in operating assets and liabilities:		
Accounts receivable.....	1,277,001	(3,324,422)
Inventories.....	1,188,894	(2,270,600)
Prepaid expenses and other current assets.....	222,475	120,614
Other assets.....		61,115
Accounts payable.....	(1,735,053)	1,553,434
Accrued expenses and other current liabilities.....	(1,220,634)	1,285,019
<b>Net cash provided by (used in) operating activities.....</b>	<b>597,764</b>	<b>(8,672,249)</b>
<b>Investing activities:</b>		
Repayments received from note receivable.....		1,000,000
Purchases of marketable securities.....	(54,984,355)	
Proceeds from sales of marketable securities.....	54,648,823	
Purchases of property and equipment.....	(39,686)	(54,057)
<b>Net cash (used in) provided by investing activities.....</b>	<b>(375,218)</b>	<b>945,943</b>
<b>Financing activities:</b>		
Proceeds from the issuance of convertible preferred stock, net.....	180,808	--
<b>Net cash provided by financing activities.....</b>	<b>180,808</b>	<b>--</b>
	<b>403,354</b>	<b>(7,726,306)</b>

**Net increase (decrease) in cash and cash equivalents**.....

<b>Cash and cash equivalents at beginning of period</b> .....	<b>4,608,246</b>	<b>14,911,844</b>
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<b>Cash and cash equivalents at end of period</b> .....	<b>\$5,011,600</b>	<b>\$7,185,538</b>
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**Supplemental Disclosures of Cash Flow Information:**

Cash paid for:

Income taxes.....	\$507	\$--
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**Supplemental Disclosure of Non-Cash Financing Activities:**

Receivable from issuance of convertible preferred stock.....	\$499,995	\$--
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The accompanying notes are an integral part of the consolidated financial statements.

**Forward Industries, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**NOTE 1 OVERVIEW**

Forward Industries, Inc. ("Forward" or the Company) was incorporated under the laws of the State of New York and began operations in 1961 as a manufacturer and distributor of specialty and promotional products. The Company designs, markets, and distributes carry and protective solutions, primarily for hand held electronic devices. The Company's principal customer market is original equipment manufacturers, or OEMs (or the contract manufacturing firms of these OEM customers), that either package its products as accessories in box together with their branded product offerings, or sell them through their retail distribution channels. The Company's OEM products include carrying cases and other accessories for medical monitoring and diagnostic kits and a variety of other portable electronic and non-electronic products (such as sporting & recreational products, bar code scanners, smartphones, GPS location devices, tablets, and firearms). The Company's OEM customers are located in the Americas, the EMEA Region, and the APAC Region. The Company does not manufacture any of its OEM products and sources substantially all of its OEM products from independent suppliers in China (refer to Note 10 Buying Agency and Supply Agreement).

On June 21, 2012, the Company determined to exit its global Retail business and focus solely on growing its OEM business. The decision to eliminate the Retail division was primarily driven by the longer than estimated path to bring it to profitability and the strong top line growth and cost rationalizations in the OEM business.

In the opinion of management, the accompanying consolidated financial statements presented in this Quarterly Report on Form 10-Q reflect all normal recurring adjustments necessary to present fairly the financial position and results of operations and cash flows for the interim periods presented herein, but are not necessarily indicative of the results of operations for the fiscal year ending September 30, 2013. These financial statements should be read in conjunction with the Company's audited consolidated financial statements included in its Annual Report on Form 10-K for the fiscal year ended September 30, 2012, and with the disclosures and risk factors presented herein and therein, respectively. The September 30, 2012 balance sheet has been derived from the audited consolidated financial statements.

**NOTE 2 ACCOUNTING POLICIES**

**Accounting Estimates**

The preparation of the Company's consolidated financial statements in conformity 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 disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates and assumptions.

**Basis of Presentation**

The accompanying consolidated financial statements include the accounts of Forward and its wholly owned subsidiaries (Forward US, Forward Switzerland, Forward HK, Forward APAC, and Forward UK). All significant intercompany transactions and balances have been eliminated in consolidation.

**Reclassifications**

Certain prior period amounts have been reclassified to conform to the current period presentation.

**Forward Industries, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**NOTE 2 ACCOUNTING POLICIES (CONTINUED)**

**Cash and Cash Equivalents**

Cash and cash equivalents consist primarily of cash on deposit and highly liquid money market accounts, short-term bonds, and certificates of deposit with original contractual maturities of three months or less, predominately in U.S. dollar denominated instruments. The Company may purchase these short-term bonds with anticipated maturity of 90 days or less at a premium or discount. The Company records these investments as cash and cash equivalents net of amortization of premium or discount. The Company minimizes its credit risk associated with cash and cash equivalents by investing in high quality instruments and by periodically evaluating the credit quality of the primary financial institution issuers of such instruments. The Company holds cash and cash equivalents at major financial institutions in the United States, at which cash amounts may significantly exceed the Federal Deposit Insurance Corporation's insured limits. At June 30, 2013, this amount was approximately \$3.8 million. Historically, the Company has not experienced any losses due to such cash concentrations.

**Marketable Securities**

At June 30, 2013, the Company has investments in marketable securities that are classified as trading and are recorded at fair value with the corresponding unrealized holding gains or losses recognized in earnings. The fair value of marketable securities is determined based on quoted market prices at the consolidated balance sheet dates. The cost of marketable securities sold is determined by the specific identification method. At September 30, 2012, the Company classified its investments in marketable securities as available-for-sale. Securities that are classified as available-for-sale are recorded at fair value with the corresponding unrealized holding gains and losses, net of taxes, are recorded as a separate component of Accumulated Other Comprehensive Loss within shareholders' equity.

**Accounts Receivable**

Accounts receivable consist of unsecured trade accounts with customers or their contract manufacturers. The Company performs periodic credit evaluations of its customers including an evaluation of days outstanding, payment history, recent payment trends, and perceived creditworthiness, and believes that adequate allowances for any uncollectible receivables are maintained. Credit terms to customers generally range from net thirty (30) days to net ninety (90) days. The Company has not historically experienced significant credit or collection problems with its OEM customers or their contract manufacturers. At June 30, 2013, the allowance for doubtful accounts with respect to



its continuing operations was approximately \$22,000. The Company did not require an allowance for doubtful accounts with respect to its continuing operations at September 30, 2012.

### **Inventories**

Inventories consist primarily of finished goods and are stated at the lower of cost (determined by the first-in, first-out method) or market. Based on management's estimates, an allowance is made to reduce excess, obsolete, or otherwise un-saleable inventories to net realizable value. The allowance is established through charges to cost of goods sold in the Company's consolidated statements of operations and comprehensive income (loss). As reserved inventory is disposed of, the Company charges off the associated allowance. In determining the adequacy of the allowance, management's estimates are based upon several factors, including analyses of inventory levels, historical loss trends, sales history, and projections of future sales demand. The Company's estimates of the allowance may change from time to time based on management's assessments, and such changes could be material. The Company did not require an allowance for obsolete inventory with respect to its continuing operations at June 30, 2013. At September 30, 2012, the allowance for obsolete inventory of the Company's continuing operations was approximately \$99,000.

**Forward Industries, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**NOTE 2 ACCOUNTING POLICIES (CONTINUED)**

**Property and Equipment**

Property and equipment consist of furniture, fixtures, and equipment and leasehold improvements and are recorded at cost. Expenditures for major additions and improvements are capitalized, and minor replacements, maintenance, and repairs are charged to expense as incurred. When property and equipment are retired or otherwise disposed of, the cost and accumulated depreciation are removed from the accounts and any resulting gain or loss is included in the results of operations for the respective period. Depreciation is provided over the estimated useful lives of the related assets using the straight-line method. The estimated useful life for furniture, fixtures and equipment ranges from three to ten years. Amortization of leasehold improvements is computed using the straight-line method over the shorter of the remaining lease term or the estimated useful lives of the improvements. For the three-month periods ended June 30, 2013 and 2012, the Company recorded approximately \$19,000 and \$30,000 of depreciation and amortization expense from continuing operations, respectively. For the nine-month periods ended June 30, 2013 and 2012, the Company recorded approximately \$56,000 and \$83,000 of depreciation and amortization expense from continuing operations, respectively.

**Income Taxes**

The Company accounts for its income taxes in accordance with accounting principles generally accepted in the United States of America, which requires, among other things, recognition of future tax benefits and liabilities measured at enacted rates attributable to temporary differences between financial statement and income tax bases of assets and liabilities and to net tax operating loss carry-forwards to the extent that realization of these benefits is more likely than not. The Company periodically evaluates the realizability of its net deferred tax assets. See Note 7 to these Notes to Consolidated Financial Statements. The Company's policy is to account for interest and penalties relating to income taxes, if any, in income tax expense in its consolidated statements of operations and comprehensive income (loss) and include accrued interest and penalties within the accrued liabilities in its consolidated balance sheets, if applicable. For the three and nine month periods ended June 30, 2013 and 2012, no income tax related interest or penalties were assessed or recorded.

**6% Senior Convertible Preferred Stock**

*Temporary Equity*

In accordance with Accounting Standards Codification ( ASC ) 480-10-s99 and Accounting Series Release ( ASR ) ASR 268, equity securities are required to be classified out of permanent equity and classified as temporary equity, as the redemption of the convertible preferred stock is not solely within the control of the Company since it is at the option of the holder.

*Warrants*

In accordance with ASC 815-40, the Company s warrants have been classified as a liability, at fair value, as a result of a related registration rights agreement that contains certain requirements for registering the underlying common shares, but has no provision for penalties upon the failure to register. At each balance sheet date, this liability s fair value will be re-measured and adjusted.

*Preferred Stock Accretion*

The fair value, or carrying amount, at the date of issue is less than the redemption value. As a result, the carrying value will be increased by periodic accretions so that the carrying value will equal the redemption amount at the earliest redemption date. Such accretion is recorded as a preferred stock dividend.

**Forward Industries, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**NOTE 2 ACCOUNTING POLICIES (CONTINUED)**

**Revenue Recognition**

The Company generally recognizes revenue from product sales to its customers when: (1) title and risk of loss are transferred (in general, these conditions occur at either point of shipment or point of destination, depending on the terms of sale); (2) persuasive evidence of an arrangement exists; (3) the Company has no continuing obligations to the customer; and (4) collection of the related accounts receivable is reasonably assured.

**Shipping and Handling Costs**

The Company classifies shipping and handling costs including inbound and outbound freight charges, purchasing and receiving costs, inspection costs, warehousing costs, internal transfer costs, and other costs associated with the Company's Asia-based distribution capability, as a component of cost of goods sold in the accompanying consolidated statements of operations and comprehensive income (loss).

**Foreign Currency Transactions**

The functional currency of the Company and its wholly-owned foreign subsidiaries is the U.S. dollar (except for Forward UK, which is the British Pound). Foreign currency transactions may generate receivables or payables that are fixed in terms of the amount of foreign currency that will be received or paid. Fluctuations in exchange rates between such foreign currency and the functional currency increase or decrease the expected amount of functional currency cash flows upon settlement of the transaction. These increases or decreases in expected functional currency cash flows are foreign currency transaction gains or losses that are included in other income (expense), net in the accompanying consolidated statements of operations and comprehensive income (loss). The approximate net losses from foreign currency transactions for continuing operations was \$(3,000) and \$(26,000) for the three-month periods ended June 30, 2013 and 2012, respectively. For the nine-month periods ended June 30, 2013 and 2012, the Company recorded \$(17,000) and \$(46,000), respectively, in approximate foreign currency transaction losses. Such foreign currency transaction losses were primarily the result of Euro denominated sales to certain customers.

**Accumulated Other Comprehensive Loss**

Accumulated other comprehensive loss, which is included as a component of shareholders' equity, includes unrealized gains or losses on available-for-sale securities (as of September 30, 2012) and currency translation adjustments related to the Company's foreign subsidiaries.

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**Forward Industries, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**NOTE 2 ACCOUNTING POLICIES (CONTINUED)**

**Fair value of financial instruments**

For certain of the Company's financial instruments, including cash and cash equivalents, accounts receivable, accounts payable, and other accrued liabilities, the carrying amount approximates fair value due to the short-term maturities of these instruments. The Company records its financial instruments that are accounted for under Accounting Standard Codification (ASC) 320, Investments-Debt and Equity Securities (ASC 320) at fair value. The determination of fair value is based upon the fair value framework established by ASC 820. ASC 820 provides that a fair value measurement assumes that the transaction to sell an asset or transfer a liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The fair value hierarchy is broken down into three levels based on the source of inputs as follows: (a) Level 1 valuations based on unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities; (b) Level 2 valuations based on quoted prices in markets that are not active, or financial instruments for which all significant inputs are observable; either directly or indirectly; and (c) Level 3 valuations based on prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable, thus, reflecting assumptions about the market participants.

**Share-Based Compensation**

The Company recognizes share-based compensation in its consolidated statements of operations and comprehensive income (loss) at the grant-date fair value of stock options and other equity-based compensation. The determination of grant-date fair value is estimated using the Black-Scholes option-pricing model, which includes variables such as the expected volatility of the Company's share price, the exercise behavior of its grantees, interest rates, and dividend yields. These variables are projected based on the Company's historical data, experience, and other factors. Changes in any of these variables could result in material increases to the valuation of options granted in future periods and increases in the expense recognized for share-based payments. In the case of awards with multiple vesting periods, the Company has elected to use the graded vesting attribution method, which recognizes compensation cost on a straight-line basis over each separately vesting portion of the award as if the award was, in-substance, multiple awards. Refer to Note 6 Share-Based Compensation. In addition, the Company recognizes share-based compensation to non-employees based upon the fair value, using the Black-Scholes option pricing model, determined at the deemed measurement dates over the related contract service period.

### **Recent Accounting Pronouncements**

In February 2013, the Financial Accounting Standards Board ( FASB ) issued Accounting Standard Update 2013-02 Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income ( ASU 2013-02 ). ASU 2013-02 requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. ASU 2013-02 is effective for annual periods and interim periods within those periods beginning after December 15, 2012. ASU 2013-02 will be effective for the Company beginning in the first quarter of fiscal 2014 and is not expected to have a material impact on the Company s Consolidated Financial Statements.

In July 2013, the FASB issued ASU No. 2013-11, Income Taxes (ASC Topic 740) - Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. The objective is to end some inconsistent practices with regard to the presentation on the balance sheet of unrecognized tax benefits. The update is effective for financial statement periods beginning after December 15, 2013, with early adoption permitted. The Company will adopt this standard beginning January 1, 2014. The Company does not expect these changes to have a material impact on its consolidated financial statements.

**Forward Industries, Inc.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(UNAUDITED)****NOTE 3 DISCONTINUED OPERATIONS**

On June 21, 2012, the Company determined to exit its global Retail business and focus solely on growing its OEM business. The decision to eliminate the Retail division was primarily driven by the longer than estimated path to bring it to profitability and the strong top line growth and cost rationalizations in the OEM business. Accordingly, the results of operations for the Retail division have been recorded as discontinued operations in the accompanying consolidated financial statements for the fiscal periods presented. Summarized operating results of discontinued operations are presented in the following table:

	<b>For the Three-Month Periods Ended June 30</b>		<b>For the Nine-Month Periods Ended June 30,</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
Net sales.....	\$(9,701)	\$430,540	\$388,530	\$2,093,718
Gross profit (loss) .....	(10,223)	(1,524,337)	85,599	(1,084,894)
Operating expenses.....	(21,752)	(1,138,487)	(298,968)	(3,594,979)
Other income (expense).....	4,333	(15,251)	7,861	(42,343)
Loss from discontinued operations, net of tax expense (benefit) of \$(8,977) and \$(130); and \$(6,002) and \$4,850, respectively.....	\$(18,659)	\$(2,678,075)	\$(199,498)	\$(4,722,216)

Summarized assets and liabilities of discontinued operations are presented in the following table:

	<b>June 30, 2013</b>	<b>September 30, 2012</b>
Accounts receivable, net.....	\$--	\$26,186
Inventories, net.....	179,028	350,942
Prepaid assets and other current assets.....	133,291	244,751
<b>Total assets of discontinued operations.....</b>	<b>\$312,319</b>	<b>\$621,879</b>
Accounts payable.....	\$24,286	\$45,874
Accrued liabilities.....	11,105	215,932
<b>Total liabilities of discontinued operations.....</b>	<b>\$35,391</b>	<b>\$261,806</b>



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The above asset amounts as of June 30, 2013, include approximately \$311,000 relating to expected payments pursuant to a Settlement Agreement and General Release ( Settlement Agreement ) executed on July 3, 2013 between the Company and G-Form LLC ( G-Form ) in exchange for certain retail inventories, the Company's cooperation with certain administrative matters, and a mutual general release. G-Form paid \$31,000 of the settlement in July 2013 with the balance due 60 days after delivery of the retail inventory, which occurred in August 2013. The Company has substantially completed its exit of its Retail business as of March 31, 2013. The Company has not had, and does not expect to have, any continuing involvement in the Retail business after this date.

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**Forward Industries, Inc.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(UNAUDITED)****NOTE 4 MARKETABLE SECURITIES**

The Company classifies its marketable securities as either (i) held-to-maturity, (ii) trading, or (iii) available-for-sale. Effective October 1, 2012, the Company changed its classification of marketable equity securities and corporate bonds from available-for-sale to trading. As a result of this reclassification, a gross gain of \$4,764 and a gross loss of \$(28,508) was reclassified out of accumulated other comprehensive income (loss) and charged to earnings using a specific identification basis. Equity securities are carried at fair value, as determined by quoted market prices, which is a Level 1 input, as established by the fair value hierarchy under ASC 820. Corporate bonds are carried at amortized cost, which approximates market value. The corresponding unrealized holding gains or losses are recognized in earnings. The Company's marketable securities are summarized in the table below:

	June 30, 2013	September 30, 2012
<b>Trading:</b>		
Cost.....	\$532,445	\$--
Unrealized Losses.....	(126,724)	--
<b>Total Fair Value.....</b>	<b>\$405,721</b>	<b>\$--</b>
<b>Available-for-sale:</b>		
Cost.....	\$--	\$444,349
Unrealized Gains.....	--	4,764
Unrealized Losses.....	--	(28,508)
<b>Total Fair Value.....</b>	<b>\$--</b>	<b>\$420,605</b>

The net loss on marketable securities for the three and nine-month periods ended June 30, 2013 was approximately \$(702,000) and \$(374,000), respectively, in the accompanying consolidated statements of operations and comprehensive income (loss).

The following table presents the Company's fair value hierarchy for assets, consisting of marketable securities, measured at fair value on a recurring basis at June 30, 2013 and September 30, 2012:

	Level 1	Level 2	Level 3	Total
Equity securities.....	\$405,721	\$ --	\$--	\$405,721

<b>Total assets at fair value at June 30, 2013.....</b>	<b>\$405,721</b>	<b>\$--</b>	<b>\$--</b>	<b>\$405,721</b>
Equity securities.....	\$420,605	\$ --	\$--	\$420,605
<b>Total assets at fair value at September 30, 2012.....</b>	<b>\$420,605</b>	<b>\$--</b>	<b>\$--</b>	<b>\$420,605</b>

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**Forward Industries, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**NOTE 5 SHAREHOLDERS EQUITY**

***Blank Check Preferred Stock***

The Company is authorized to issue up to 4,000,000 shares of "blank check" preferred stock. The Board of Directors (the Board) has the authority and discretion, without shareholder approval, to issue preferred stock in one or more series for any consideration it deems appropriate, and to fix the relative rights and preferences thereof including their redemption, dividend and conversion rights. Of these shares, 1,500,000 shares have been authorized as the 6% Convertible Preferred Stock and 100,000 shares have been authorized as the Series A Preferred Stock.

**6% Senior Convertible Preferred Stock**

On June 28, 2013, the Company completed the sale of (i) 381,674 shares of its newly authorized 6% Senior Convertible Preferred Stock, par value \$0.01 per share (the Convertible Preferred Stock) and (ii) warrants to purchase a total of 381,674 shares of the Company's common stock, par value \$0.01 per share (Common Stock) (the Warrants and together with the Convertible Preferred Stock, the Securities) to accredited investors (Investors) in a private placement (the Private Placement) pursuant to the terms of securities purchase agreements, dated June 28, 2013 (the Purchase Agreements), by and between the Company and each Investor. The total purchase price paid by Investors for each share of Convertible Preferred Stock and Warrant purchased by them was \$1.965. The Private Placement resulted in gross proceeds of approximately \$750,000 to the Company. The Company has received \$180,000 of these proceeds in cash as of June 30, 2013, net of issuance costs of approximately \$70,000, which is reflected in the Cash and cash equivalents line of the Company's consolidated balance sheets. These proceeds of \$750,000 have been allocated to the Convertible Preferred Stock and the Warrants based upon their fair values of approximately \$448,000 (net of issuance costs) and \$233,000, respectively. The remaining approximate \$500,000 of proceeds was received in July 2013 and is reflected in Prepaid expenses and other current assets line on the Company's consolidated balance sheets as of June 30, 2013. The Company may sell additional shares of Convertible Preferred Stock, together with related Warrants, in one or more subsequent closings.

The Warrants have an initial exercise price of \$1.84 per share, subject to adjustment upon the occurrence of certain customary events. The Warrants are exercisable at any time on or after January 1, 2014 (the Initial Exercise Date) and terminate on the 10-year anniversary of the Initial Exercise Date.

Each share of Convertible Preferred Stock is convertible into one share of Common Stock at an initial conversion price of \$1.84 per share, subject to adjustment upon the occurrence of certain customary events (the Conversion Price ). At the initial Conversion Price, the 381,674 shares of Preferred Stock issued at the initial closing are convertible into an aggregate of 407,599 shares of Common Stock.

Dividends on the Convertible Preferred Stock will be payable, on a cumulative basis, in cash, at the rate per annum of 6% of the Liquidation Preference (as defined below) and will be payable quarterly, in arrears, on each March 31, June 30, September 30 and December 31, commencing on September 30, 2013. The Company is prohibited from paying any dividend with respect to shares of Common Stock or other junior securities in any quarter unless full dividends are paid on the Convertible Preferred Stock in such quarter.

In the event of a liquidation (or deemed liquidation, as described below) of the Company, the holders of the Convertible Preferred Stock shall receive in preference to the holders of Common Stock and any junior securities of the Company an amount (the Liquidation Preference ) equal to (i) \$1.965 (the Original Issue Price ) per each outstanding share of Convertible Preferred Stock (subject to adjustment upon the occurrence of certain customary events), plus (ii) any accrued but unpaid dividends. A Change of Control of the Company (as defined in the Certificate of Amendment) will be treated as a liquidation at the option of the holders of a majority of the Convertible Preferred Stock; provided that the amount paid to holders of Convertible Preferred Stock in such event will be equal to 101% of the Original Issue Price, plus accrued but unpaid dividends.

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**Forward Industries, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**NOTE 5 SHAREHOLDERS EQUITY (CONTINUED)**

**6% Senior Convertible Preferred Stock (Continued)**

Each share of Convertible Preferred Stock is convertible at any time, at the option of the holder, into one share of Common Stock at the then applicable Conversion Price. In addition, upon the consent of 80% of the holders of the Convertible Preferred Stock, the Convertible Preferred Stock automatically will be converted to shares of Common Stock at the then-applicable Conversion Price.

On or after June 28, 2018, the Company may, at its option and upon at least 30 days prior written notice to the holders of the Convertible Preferred Stock, redeem all or any portion of the outstanding Convertible Preferred Stock in cash at a redemption price equal to the full Liquidation Preference as of the redemption date. In addition, at any time on or after June 28, 2023, each holder of the Convertible Preferred Stock will have the right to require the Company to redeem (provided that funds are legally available to do so) all or any portion of such holder's outstanding Convertible Preferred Stock at a redemption price equal to the full Liquidation Preference of such shares of Convertible Preferred Stock as of the redemption date.

The Convertible Preferred Stock will vote together with the Common Stock on an as-converted basis on all matters except as required by law. In addition, for so long as 50% of the shares of Convertible Preferred Stock remains outstanding, without the approval of the holders of a majority of the Convertible Preferred Stock, voting as a separate class, the Company may not: (i) authorize or issue any equity security senior to the Convertible Preferred Stock; (ii) declare or pay any dividends on the Common Stock or any series of preferred stock that ranks junior to the Convertible Preferred Stock; (iii) increase or decrease the total number of authorized shares of Convertible Preferred Stock; (iv) alter or change the rights, preferences or privileges of the Convertible Preferred Stock so as to affect materially and adversely the Convertible Preferred Stock; or (v) increase the authorized capitalization of the Company, or otherwise amend its certificate of incorporation or bylaws in a manner which adversely affects the rights or preferences of the Convertible Preferred Stock.

**Anti-takeover Provisions**

*Shareholder Rights Plan*

On April 26, 2013, the Board adopted a Shareholder Rights Plan, as set forth in the Rights Agreement dated as of April 26, 2013 (the Rights Agreement ), between the Company and American Stock Transfer & Trust Company, LLC, as Rights Agent. Pursuant to the Rights Agreement, the Board declared a dividend distribution of one Right (a Right ) for each outstanding share of Company Common Stock, par value \$0.01 per share (the Common Stock ) to shareholders of record at the close of business on May 6, 2013, which date will be the record date, and for each share of Common Stock issued (including shares distributed from treasury) by the Company thereafter and prior to the Distribution Date (as described below and defined in the Rights Agreement). Each Right entitles the registered holder, subject to the terms of the Rights Agreement, to purchase from the Company one one-thousandth of a share of Series A Participating Preferred Stock, \$0.01 par value per share (the Series A Preferred Stock ), at an exercise price of \$4.00 per one one-thousandth of a share of Series A Preferred Stock, subject to adjustment.

Initially, no separate Rights Certificates will be distributed and instead the Rights will attach to all certificates representing shares of outstanding Common Stock. Subject to certain exceptions specified in the Rights Agreement, the Rights will separate from the Common and become exercisable on the distribution date (the Distribution Date ), which will occur on the earlier of (i) the 10<sup>th</sup> business day (or such later date as may be determined by the Board) after the public announcement that an Acquiring Person (as defined in the Rights Agreement) has acquired beneficial ownership of 20% or more of the Common Stock then outstanding or (ii) the 10<sup>th</sup> business day (or such later date as may be determined by the Board) after a person or group announces a tender or exchange offer that would result in a person or group of affiliated and associated persons beneficially owning 20% or more of the Common Stock then outstanding.

**Forward Industries, Inc.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(UNAUDITED)****NOTE 5 SHAREHOLDERS EQUITY (CONTINUED)****Anti-takeover Provisions (Continued)***Blank Check Preferred Stock*

As discussed above, the Company is authorized to issue up to 4,000,000 shares of "blank check" preferred stock. The Board has the authority and discretion, without shareholder approval, to issue preferred stock in one or more series for any consideration it deems appropriate, and to fix the relative rights and preferences thereof including their redemption, dividend and conversion rights.

**Stock Repurchase**

In September 2002 and January 2004, the Board authorized the repurchase of up to an aggregate of 486,200 shares of outstanding common stock. Under those authorizations, as of June 30, 2013, the Company had repurchased an aggregate of 172,603 shares at a cost of approximately \$403,000, but none during the three and nine-month periods ended June 30, 2013 and 2012.

**Changes in Shareholders Equity**

Changes in shareholders equity for the nine-month period ended June 30, 2013 are summarized below:

	Total	Common Stock			Retained Earnings (Accumulated Deficit)	Treasury Stock		Accumulated Other Comprehensive Income (Loss)
		Number of Shares	Par Value	Additional Paid-in Capital		Number of Shares	Amount	
<b>Balance at September 30, 2012</b>	<b>\$9,187,963</b>	<b>8,811,595</b>	<b>\$88,116</b>	<b>\$17,020,771</b>	<b>\$(6,624,926)</b>	<b>706,410</b>	<b>\$(1,260,057)</b>	<b>\$(35,941)</b>
Share-based compensation	333,236	7,500	75	333,161	--	--	--	--
Other comprehensive income (loss):								
Foreign currency translation	(9,353)	--	--	--	--	--	--	(9,353)



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Net reclassification of adjustments on marketable securities	23,744	--	--	--	--	--	--	23,744
Net income	42,136	--	--	--	42,136	--	--	--
<b>Balance at June 30, 2013</b>	<b>\$9,577,726</b>	<b>8,819,095</b>	<b>\$88,191</b>	<b>\$17,353,932</b>	<b>\$(6,582,790)</b>	<b>706,410</b>	<b>\$(1,260,057)</b>	<b>\$(21,550)</b>

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**Forward Industries, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**NOTE 6 SHARE-BASED COMPENSATION**

**2011 Long Term Incentive Plan**

In March 2011, shareholders of the Company approved the 2011 Long Term Incentive Plan (the 2011 Plan ), which authorizes 850,000 shares of common stock for grants of various types of equity awards to officers, directors, employees, consultants, and independent contractors. Under the 2011 Plan, as of June 30, 2013, the Compensation Committee of the Company's Board of Directors (the Compensation Committee ) has approved awards of stock options to purchase an aggregate of 1,315,000 shares of common stock to certain of the Company's executive officers and employees (1,020,000 shares), a consultant (160,000 shares), non-employee directors (130,000 shares), and to a non-employee executive officer (5,000 shares). Of these awards, as of June 30, 2013, 530,500 shares were forfeited and reverted to, and are eligible for re-grant under, the 2011 Plan. The total shares of common stock available for grants of equity awards under the 2011 Plan was 65,500 as of June 30, 2013. The prices at which equity awards may be granted and the exercise prices of stock options granted may not be less than the fair market value of the common stock as quoted at the close on the Nasdaq Stock Market on the grant date. The Compensation Committee administers the 2011 Plan. Options generally expire ten years after the date of grant and vest one year from the date of grant for non-employee directors, and, in the case of initial grants to officers and employees, vest over five years with 50%, 25% and 25% vesting on the third, fourth, and fifth anniversary of the grant date, respectively. Options granted under a consulting agreement in November 2011 expire three years after the grant date and vested equally over the term of the consulting agreement, which concluded February 29, 2012.

**2007 Equity Incentive Plan**

The 2007 Equity Incentive Plan (the 2007 Plan ), which was approved by shareholders of the Company in May 2007, and, as amended in February 2010, authorizes an aggregate of 800,000 shares of common stock for grants of restricted common stock and stock options to officers, employees, and non-employee directors of the Company. Under the 2007 Plan, the Compensation Committee approved awards of restricted common stock and stock options of 977,375, in the aggregate, to certain officers, employees and non-employee directors. Of these awards, as of June 30, 2013, 278,366 shares were forfeited and reverted to, and are eligible for re-grant under, the 2007 Plan. The total shares of common stock available for grants of equity awards under the 2007 Plan was 100,991 as of June 30, 2013. The prices at which restricted common stock may be granted and the exercise price of stock options granted may not be less than the fair market value of the common stock as quoted at the close on the Nasdaq Stock Market on the grant date. The Compensation Committee administers the 2007 Plan. Options generally expire ten years after the date of grant, and in

the case of non-employee directors, vest on the first anniversary of the date of grant. In the case of officers and employees, options either vest in equal amounts over three to five years or vest over five years with 50%, 25% and 25% vesting on the third, fourth, and fifth anniversary of the grant date, respectively. Restricted stock grants generally vest in equal proportions over three years.

### **1996 Stock Incentive Plan**

The Company's 1996 Stock Incentive Plan (the "1996 Plan") expired in accordance with its terms in November 2006. The exercise price of incentive options granted under the 1996 Plan to officers, employees, and non-employee directors of the Company was required by 1996 Plan provisions to be equal at least to the fair market value of the common stock at the date of grant. In general, options under this plan expire ten years after the date of grant and generally vest in equal proportions over three years. Unexercised options granted prior to 1996 Plan expiration remain outstanding until the earlier of exercise or option expiration. Under the 1996 Plan 30,000 fully vested common stock options are the only awards that remain outstanding and unexercised, all at exercise prices higher than the fair market value of the common stock at June 30, 2013.

**Forward Industries, Inc.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(UNAUDITED)****NOTE 6 SHARE-BASED COMPENSATION (CONTINUED)****Stock Option Awards**

Under the 2011 and 2007 Plans, the Compensation Committee has approved awards of stock options to purchase an aggregate of 1,737,500 shares of common stock to the Company's current and certain former non-employee directors, to certain key employees, to current and certain former Company officers, and to a consultant, of which awards covering 255,000 shares from the 2007 Plan and 530,500 shares from the 2011 Plan of common stock were forfeited, with such shares reverting to the respective plans and eligible for grant. The exercise prices of the awards granted was, in each case equal, to the closing market value of the Company's common stock on the Nasdaq Stock Market on the various grant dates.

The Company recognized approximately an expense of \$48,000 and a recovery of \$(81,000) of compensation in continuing operations for stock option awards in its consolidated statements of operations and comprehensive income (loss) for the three-month periods ended June 30, 2013 and 2012, respectively; and an expense of \$176,000 and a recovery of \$(142,000) for the nine-month periods ended June 30, 2013 and 2012, respectively

As of June 30, 2013, there was approximately \$193,000 of total unrecognized compensation cost related to 414,834 shares of unvested stock option awards granted under the 2007 and 2011 Plans, which is expected to be recognized over the remainder of the weighted average vesting period (extending to August 2016).

The following table summarizes stock option activity under the 2011 Plan and 2007 Plan, from September 30, 2012 through June 30, 2013 (there was no activity during such period with respect to the 1996 Plan grants):

	<b>Weighted Average Exercise Price</b>	<b>Weighted Average Remaining Contractual Term (Years)</b>	<b>Aggregate Intrinsic Value</b>
<b>Shares</b>			

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<b>Outstanding at September 30, 2012</b>	<b>1,142,000</b>	<b>\$3.31</b>	<b>4.2</b>	<b>\$ --</b>
Granted.....	120,000	1.14	9.3	--
Exercised.....	--	--	--	--
Forfeited.....	(365,000)	3.43	--	--
Expired.....	--	--	--	--
<b>Outstanding at June 30, 2013</b>	<b>897,000</b>	<b>\$2.98</b>	<b>6.5</b>	<b>\$ --</b>
			-	-
<b>Options expected to vest at</b>				
<b>June 30, 2013.....</b>	<b>375,151</b>	<b>\$2.88</b>	<b>8.4</b>	<b>--</b>
<b>Options vested and exercisable at</b>				
<b>June 30, 2013.....</b>	<b>482,166</b>	<b>\$3.03</b>	<b>4.9</b>	<b>--</b>

During the nine-month period ended June 30, 2013, the Company granted 120,000 stock options at a weighted average grant date fair value of \$0.61. During the nine-month period ended June 30, 2012 the Company granted 420,000 stock options at a weighted average grant date fair value of \$0.96.

**Forward Industries, Inc.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(UNAUDITED)****NOTE 6 SHARE-BASED COMPENSATION (CONTINUED)****Stock Option Awards (Continued)**

The fair value of each stock option on the date of grant was estimated using the Black-Scholes option-pricing formula applying the following assumptions for each respective period:

	<b>For the Nine-Month Periods Ended</b>	
	<b>June 30,</b>	
	<b>2013</b>	<b>2012</b>
Expected term (in years)	5.0	3.0 to 5.0
Risk-free interest rate.....	0.6%-0.7%	0.04% to 0.83%
Expected volatility.....	70.0%-70.4%	63% to 69%
Expected dividend yield.....	0%	0%
Forfeiture rate.....	5%	13%

The expected term represents the period over which the stock option awards are expected to be outstanding. The Company based the risk-free interest rate used in its assumptions on the implied yield currently available on U.S. Treasury zero-coupon issues with a remaining term equivalent to the award's expected term. The volatility factor used in the Company's assumptions is based on the historical price of its stock over the most recent period commensurate with the expected term of the award. The Company historically has not paid any dividends on its common stock and had no intention to do so on the date the share-based awards were granted. Accordingly, the Company used a dividend yield of zero in its assumptions. The Company estimates the expected term, volatility and forfeitures of share-based awards based upon historical data. The Company adjusted its estimated forfeiture rate effective October 1, 2011 and recognized a recovery of approximately \$46,000 during the three-month period ended December 31, 2011.

**Restricted Stock Awards**

Under the 2011 Plan and 2007 Plan, the Compensation Committee has approved and granted awards of 554,875 shares of restricted stock, in the aggregate, to certain key employees. Of these awards, 160,134 have vested and 23,366 shares of restricted stock were forfeited and reverted to, and are eligible for re-grant under, the 2007 Plan. Vesting of restricted stock awards is generally subject to a continued service condition with one-third of the awards vesting each year on the three successive anniversary dates of the grant date, typically commencing on the first such

anniversary date. The fair value of the awards granted was equal to the closing market value of the Company's common stock as quoted on the Nasdaq Stock Market on the grant date. During the three-month periods ended June 30, 2013 and 2012, the Company recognized approximately \$59,000 and \$1,000, respectively, of compensation expense in continuing operations in its consolidated statements of operations and comprehensive income (loss) related to restricted stock awards; and approximately \$157,000 and \$4,000 for the nine-month periods ended June 30, 2013 and 2012, respectively.

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**Forward Industries, Inc.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(UNAUDITED)****NOTE 6 SHARE-BASED COMPENSATION (CONTINUED)****Restricted Stock Awards (Continued)**

The following table summarizes restricted stock activity under the 2011 Plan and 2007 Plan from September 30, 2012, through June 30, 2013.

	<b>Shares</b>	<b>Weighted Average Grant Date Fair Value</b>
<b>Non-vested balance at September 30, 2012</b> .....	7,500	\$2.02
Changes during the period:		
Shares granted.....	371,375	1.16
Shares vested.....	(7,500)	2.02
Shares forfeited.....	--	--
<b>Non-vested balance at June 30, 2013</b> .....	<b>371,375</b>	<b>\$1.16</b>

As of June 30, 2013, there was approximately \$230,000 of total unrecognized compensation cost related shares of unvested restricted stock awards (reflected in the table above) granted under the 2011 Plan and 2007 Plan. That cost is expected to be recognized over the remainder of the requisite service (vesting) periods. The total grant date fair value of restricted stock that vested during the nine-month period ended June 30, 2013 was approximately \$15,000.

**Warrants**

As of June 30, 2013, warrants to purchase 75,000 shares of the Company's common stock at an exercise price of \$1.75 issued in fiscal year ended 1999 were outstanding. By their terms these warrants expire 90 days after a registration statement registering common stock (other than pursuant to employee benefit plans) is declared effective by the Securities and Exchange Commission. As of June 30, 2013, no such registration statement has been filed with the Securities and Exchange Commission.



In connection with the sale of the Convertible Preferred Stock, Warrants to purchase 381,674 shares of Common Stock were issued effective as of June 28, 2013.

## NOTE 7 INCOME TAXES

The Company's provision (benefit) for income taxes consists of the following United States Federal and State, and foreign components:

	For the Three-Month Periods Ended June 30,			For the Nine-Month Periods Ended June 30,		
	2013		2012	2013		2012
Current:						
Federal.....	\$--		\$--	\$--		\$--
State.....	--		--	75		--
Foreign.....	(8,977)		(130)	(5,570)		4,850
Deferred:						
Federal.....	(99,438)		367,299	82,082		(443,941)
State.....	(5,675)		20,966	4,683		(25,764)
Foreign.....	2,068		(144,343)	(10,682)		(188,495)
Change in valuation allowance....	103,045		(243,922)	(76,083)		658,200
<b>Income tax expense.....</b>	<b>\$(8,977)</b>		<b>\$ (130)</b>	<b>\$(5,495)</b>		<b>\$ 4,850</b>

**Forward Industries, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**NOTE 7 INCOME TAXES (CONTINUED)**

Income tax benefit from discontinued operations of approximately \$(9,000) and \$(100) recorded in the three-month periods ended June 30, 2013 and 2012, respectively, and income tax expense (benefit) from discontinued operations of \$(6,000) and \$5,000 recorded in the nine-month period ended June 30, 2013 and 2012, respectively, is attributable to Forward UK.

As of June 30, 2013, and September 30, 2012, the Company has no unrecognized income tax benefits. At June 30, 2013, the Company had available total net operating loss carryforwards for U.S. Federal and state income tax purposes of approximately \$8,154,000 and \$6,515,000, respectively, expiring through 2033, resulting in deferred tax assets in respect of U.S. Federal and state income taxes of approximately \$2,643,000 and \$224,000, respectively. In addition, at June 30, 2013, the Company had total available net operating loss carryforwards for foreign income tax purposes of approximately \$4,986,000 resulting in a deferred tax asset of \$439,000 approximately, expiring through 2020. Total net deferred tax assets, before valuation allowances, was \$3,742,000 at June 30, 2013 and \$3,818,000 at September 30, 2012, respectively. Undistributed earnings of the Company's foreign subsidiaries are considered to be permanently invested; therefore, in accordance with U.S. generally accepted accounting principles, no provision for U.S. Federal and state income taxes would result. As of June 30, 2013, there were no accumulated earnings of any of the Company's foreign subsidiaries.

As of June 30, 2013, as part of its periodic evaluation of the necessity to maintain a valuation allowance against its deferred tax assets, and after consideration of all factors, both positive and negative (including, among others, projections of future taxable income, current year net operating loss carryforward utilization and the extent of the Company's cumulative losses in recent years), the Company determined that, on a more likely than not basis, it would not be able to use its remaining deferred tax assets (except in respect of United States income taxes in the event the Company elects to effect the repatriation of certain foreign source income of its Swiss subsidiary, which income is currently considered to be permanently invested and for which no United States tax liability has been accrued). Accordingly, the Company has determined to maintain a full valuation allowance against its total deferred tax assets. As of June 30, 2013 and September 30, 2012, the valuation allowances were approximately \$3,742,000 and \$3,818,000, respectively. If the Company determines in a future reporting period that it will be able to use some or all of its deferred tax assets, the adjustment to reduce or eliminate the valuation allowance would reduce its tax expense and increase after-tax income. Changes in deferred tax assets and valuation allowance are reflected in the Income tax

expense (benefit) line item of the Company's consolidated statements of operations and comprehensive income (loss).

As of June 30, 2013 and September 30, 2012, the Company has not accrued any interest and penalties related to uncertain tax positions. It is the Company's policy to recognize interest and/or penalties, if any, related to income tax matters in income tax expense in the consolidated statements of operations and comprehensive income (loss). For the periods presented in the accompanying consolidated statements of operations and comprehensive income (loss), no income tax related interest or penalties were assessed or recorded. All fiscal years prior to the fiscal year ended September 30, 2009 are closed to Federal and State examination, except with respect to net operating losses generated in prior fiscal years.

**NOTE 8 INCOME (LOSS) PER SHARE**

Basic per share data for each period presented is computed using the weighted-average number of shares of common stock outstanding during each such period. Diluted per share data is computed using the weighted-average number of common and dilutive common-equivalent shares outstanding during each period. Dilutive common-equivalent shares consist of shares that would be issued upon the exercise of stock options and warrants, computed using the treasury stock method. Diluted loss per share data for the three-month periods ended June 30, 2013 and 2012, and the nine-month period ended June 30, 2012, excludes all outstanding common equivalent shares as inclusion of such shares would be anti-dilutive. Diluted income per share data for the nine-month period ended June 30, 2013 excludes 1,273,675 of common equivalent shares as inclusion of such shares would be anti-dilutive.

**Forward Industries, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**NOTE 9 COMMITMENTS AND CONTINGENCIES**

**Employment and Agreements**

*Robert Garrett Jr. Employment Agreement*

Under his employment agreement, which was effective as of March 1, 2012, Mr. Robert Garrett Jr. is currently employed as the Company's Chief Executive Officer at an annual salary of \$250,000. In executing his employment agreement, Mr. Garrett received a signing bonus of \$9,167. During Mr. Garrett's first year of employment he received a bonus of \$50,000. In addition, during each year of his employment, Mr. Garrett is eligible to receive an annual bonus at the discretion of the Compensation Committee in a combination of cash or equity-based compensation. Mr. Garrett's employment agreement also entitles him to awards of stock options to purchase an aggregate of 200,000 shares of the Company's common stock pursuant to the 2011 Plan, which have been granted in their entirety.

Mr. Garrett's employment agreement provides for successive one-year renewal terms, unless either party provides written notice of its intention not to renew the agreement not later than 90 days prior to the end of the term (or renewal period). In the event of the termination of Mr. Garrett's employment, depending on the circumstances, Mr. Garrett could be entitled to receive a severance payment which could be up to (12) twelve months of his salary, and under certain circumstances, the immediate vesting of any unvested options pursuant to applicable equity compensation plans, as well as any accrued discretionary bonus.

Mr. Garrett's employment agreement binds him to customary non-competition and non-solicitation covenants of up to one year following the expiration of the employment term.

*James O. McKenna Employment Agreement*

James O. McKenna serves as the Company's Chief Financial Officer, Treasurer and Assistant Secretary pursuant to an Amended Employment Agreement, dated as of April 1, 2011 (the "Employment Agreement"), between the Company and Mr. McKenna. On November 8, 2012, Mr. McKenna's Employment Agreement was further amended (the "Amendment") in connection with the logistical coordination, planning and implementation of the move of the Company's executive offices to West Palm Beach, Florida from Santa Monica, California, and his relocation from California to Florida at the Company's request. Among other things, the Amendment reduced his base salary to \$210,000 per annum from \$225,000 per annum, eliminated his housing allowance of \$90,000 per annum (paid pursuant to the Employment Agreement), and provided for a bonus payment in the amount of \$172,456, less applicable withholdings and deductions, all subject to the provisions provided in the Amendment. Approximately \$86,000 of such bonus payment is attributed as a bonus to Mr. McKenna in Fiscal 2012, with the remainder to be attributed to future periods. Up to one half of such bonus payment may be applied to reduce future bonuses due to Mr. McKenna, if any, on or prior to September 2014, pursuant to the terms and provisions of the Amendment. The term of the Employment Agreement expires on December 31, 2013, with automatic renewal for successive terms of one year each. Pursuant to the Employment Agreement, Mr. McKenna is entitled to a payment equal to one year of his salary as severance in the event of his termination "without cause" and termination for "good reason" (as such terms are defined in the Employment Agreement).

**Guarantee Obligation**

In February 2010, Forward Switzerland and its European logistics provider (freight forwarding and customs agent) entered into a Representation Agreement (the Representation Agreement ) whereby, among other things, the European logistics provider agreed to act as Forward Switzerland's Fiscal representative in The Netherlands for the purpose of providing services in connection with any value added tax matters. As part of this agreement, which succeeds a substantially similar agreement (except as to the amount and term of the undertaking) between the parties that expired June 30, 2009, Forward Switzerland agreed to provide an undertaking (in the form of a bank letter of guarantee) to the logistics provider with respect to any value added tax liability arising in The Netherlands that the logistics provider is required to pay to Dutch tax authorities on its behalf.

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**Forward Industries, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**NOTE 9 COMMITMENTS AND CONTINGENCIES (CONTINUED)**

**Guarantee Obligation (Continued)**

As of February 1, 2010, Forward Switzerland entered into a guarantee agreement with a Swiss bank relating to the repayment of any amount up to €75,000 (equal to approximately \$98,000 as of June 30, 2013) paid by such bank to the logistics provider in order to satisfy such undertaking pursuant to the bank letter of guarantee. Forward Switzerland would be required to perform under the guarantee agreement only in the event that: (i) a value added tax liability is imposed on the Company's sales in The Netherlands, (ii) the logistics provider asserts that it has been called upon in its capacity as surety by the Dutch Receiver of Taxes to pay such taxes, (iii) Forward Switzerland or the Company on its behalf fails or refuses to remit the amount of value added tax due to the logistics provider upon its demand, and (iv) the logistics provider makes a drawing under the bank letter of guarantee. Under the Representation Agreement, Forward Switzerland agreed that the letter of guarantee would remain available for drawing for three years following the date that its relationship terminates with the logistics provider to satisfy any value added tax liability arising prior to expiration of the Representation Agreement but asserted by The Netherlands after expiration.

The initial term of the bank letter of guarantee expired February 28, 2011, but renews automatically for one-year periods until February 28, 2014, unless Forward Switzerland provides the Swiss bank with written notice of termination at least 60 days prior to the renewal date. It is the intent of Forward Switzerland and the logistics provider that the bank letter of guarantee amount be adjusted annually. In consideration of the issuance of the letter of guarantee, Forward Switzerland has granted the Swiss bank a security interest in all of its assets on deposit with, held by, or credited to Forward Switzerland's accounts with, the Swiss bank (approximately \$1,245,000 at June 30, 2013). As of June 30, 2013, the Company had not incurred a liability in connection with this guarantee.

**NOTE 10 BUYING AGENCY AND SUPPLY AGREEMENT**

On March 12, 2012, the Company, entered into a Buying Agency and Supply Agreement (the Agreement) with Forward Industries Asia-Pacific Corporation (f/k/a Seaton Global Corporation), a British Virgin Islands corporation (Forward China), dated as of March 7, 2012. The Agreement provides that, upon the terms and subject to the conditions set forth therein, Forward China shall act as the Company's exclusive buying agent and supplier of Products (as defined in the Agreement) in the Asia Pacific region. The Company shall purchase products at Forward China's cost, and shall pay a service fee on the net purchase price. The Agreement shall terminate on March 11, 2014, subject to renewal. Terence Wise, a director of the Company, is a principal of Forward China. Jenny P. Yu, a Managing Director of Forward China, has filed a Schedule 13D disclosing that she beneficially owns 444,217 shares of the Company's common stock, representing approximately 5.48% of the Company's outstanding shares. The Company recognized approximately \$306,000 and \$270,000, respectively, during the three-month periods ended June 30, 2013 and 2012, and \$798,000 and \$332,000, respectively, during the nine-month periods ended June 30, 2013 and 2012, of Forward China service fees, which are included as a component of costs of goods sold in continuing operations in the accompanying consolidated statements of operations and comprehensive income (loss).

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**Forward Industries, Inc.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**NOTE 11 INVESTMENT MANAGEMENT AGREEMENT**

On April 16, 2013, the Company entered into an Investment Management Agreement (the Agreement) with LaGrange Capital Administration, L.L.C. (LCA), pursuant to which the Company retained LCA to manage certain investment accounts funded by the Company (collectively, the Account). Frank LaGrange Johnson, the Company's Chairman of the Board, serves as the Managing Member of LCA.

Pursuant to the Agreement, LCA is authorized, subject to supervision of the Investment Committee of the Board and the terms and conditions of the Agreement, to take all actions and make all decisions regarding the investment and reinvestment of the assets of the Account utilizing the Investment Strategy (as defined in the Agreement). As compensation for its services to the Company, LCA shall be entitled to advisory fees, comprised of an asset-based fee and a performance fee, as provided in the Agreement. The asset-based fee will equal 1% per annum of the average Account Net Asset Value (Account NAV). The performance fee will equal 20% of the increase (if any) in the Account NAV over an annual period. No performance fee will be payable for any annual period in which the Account NAV at the end of such annual period is below the highest Account NAV at the end of any previous annual period. In addition to such advisory fees, the Company will reimburse LCA for certain investment and operational expenses. Under the Agreement, the Company or its designees may make cash withdrawals from the Account on March 31, June 30, September 30 or December 31 of each year upon 45 days prior written notice to LCA; provided, that, in the event of a breach of certain terms of the Agreement, the Company may make a complete cash withdrawal from the Account immediately without LCA's consent. During the three and nine-month periods ended June 30, 2013, the Company recognized approximately \$6,000 of expense in continuing operations in its consolidated statements of operations and comprehensive income (loss) related to asset based advisory fees. The Company has not recorded any expense related to performance based advisory fees during the three and nine-month periods ended June 30, 2013.

The Agreement is effective as of February 1, 2013 and shall continue until the second anniversary of the effective date. Thereafter, the term of the Agreement shall automatically renew for additional one year terms unless terminated in accordance with the terms of the Agreement or if a party provides notice to the other party no less than 60 days prior to the end of a term of its decision to terminate the Agreement at the end of the then current term.

**NOTE 12 LEGAL PROCEEDINGS**

From time to time, the Company may become a party to other legal actions or proceedings in the ordinary course of its business. As of June 30, 2013, there were no such actions or proceedings, either individually or in the aggregate, that, if decided adversely to the Company's interests, the Company believes would be material to its business.

**NOTE 13 OPERATING SEGMENT INFORMATION**

As of June 30, 2013, the Company reported and managed its continuing operations based on a single operating segment: the design and distribution of carry and protective solutions, primarily for hand held electronic devices. Products designed and distributed by this segment include carrying cases and other accessories for medical monitoring and diagnostic kits, portable consumer electronic devices (such as smartphones, tablets, personnel computers, notebooks, and GPS devices), and a variety of other portable electronic and non-electronic products



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(such as firearms, sporting, and other recreational products). This segment operates in geographic regions that include primarily APAC, the Americas, and Europe. Geographic regions are defined by reference primarily to the location of the customer or its contract manufacturer.

On June 21, 2012, the Company determined to wind down its Retail segment, which commenced during the three-month period ended December 31, 2011, and focus solely on growing its OEM business. The decision to eliminate the Retail division was primarily driven by the longer than estimated path to bring it to profitability and the strong top line growth and cost rationalizations in the OEM business. The Company has substantially completed its exit of its Retail business as of March 31, 2013. The Company has not had, and does not expect to have, any continuing involvement in the Retail business after this date.

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**Forward Industries, Inc.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(UNAUDITED)****NOTE 13 OPERATING SEGMENT INFORMATION (CONTINUED)****Revenues from External Customers**

The following table presents net sales by geographic region.

	<i>(dollars in millions)</i>		<i>(dollars in millions)</i>	
	<b>For the Three-Month Periods Ended</b>		<b>For the Nine-Month Periods Ended</b>	
	<b>June 30,</b>		<b>June 30,</b>	
	<b>2013</b>	<b>2012</b>	<b>2013</b>	<b>2012</b>
<b>Americas:</b>				
United States.....	\$2.1	\$2.7	\$7.5	\$5.9
Other.....	0.8	0.5	1.2	1.1
<b>Total Americas.....</b>	<b>2.9</b>	<b>3.2</b>	<b>8.7</b>	<b>7.0</b>
<b>APAC:</b>				
Hong Kong.....	2.9	2.6	5.5	7.4
Other.....	0.9	0.7	2.6	1.5
<b>Total APAC.....</b>	<b>3.8</b>	<b>3.3</b>	<b>8.1</b>	<b>8.9</b>
<b>Europe:</b>				
Germany.....	1.1	0.4	4.7	2.6