FORWARD INDUSTRIES INC
Form 10-Q
February 13, 2008

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended December 31 , 2007.

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

FORWARD INDUSTRIES, INC.

(Exact name of registrant as specified in its charter)

New York	**13-1950672**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1801 Green Rd., Suite E, Pompano Beach, FL 33064

(Address of principal executive offices, including zip code)

(954) 419-9544

(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. [**X**] Yes [ ] No

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

[ ] Large accelerated filer [ ] Accelerated filer [**X**] Non-accelerated filer

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

The number of shares outstanding of the registrant s common stock, par value $0.01 per share, at December 31, 2007, was 7,855,439 shares.

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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 terms "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.; "Koszegi" refers to Forward Industries wholly owned subsidiary Koszegi Industries, Inc., an Indiana corporation; Koszegi Asia refers to Forward Industries wholly owned subsidiary Koszegi Asia Ltd., a Hong Kong corporation; Forward Innovations refers to Forward Industries wholly owned subsidiary Forward Innovations GmbH, a Swiss corporation; 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; the 2008 Quarter refers to the three months ended December 31, 2007; the 2007 Quarter refers to the three months ended December 31, 2006; Fiscal 2008 refers to our fiscal year ending September 30, 2008; Fiscal 2007 refers to our fiscal year ended September 30, 2007; EMEA Region means the geographic area encompassing Europe, the Middle East and Africa; APAC Region means 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; and Americas refers to the geographic area encompassing North, Central, and South America.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Forward Industries, Inc.

CONSOLIDATED BALANCE SHEETS

	December 31, 2007 (Unaudited)	**September 30, 2007**
Assets		
Current assets:		
Cash and cash equivalents	$21,298,124	$20,267,791
Accounts receivable, net	3,925,324	4,135,117
Inventories, net	1,355,400	1,072,360
Prepaid expenses and other current assets	626,604	628,786
Deferred tax asset	309,461	279,741
Total current assets	27,514,913	26,383,795
Property, plant, and equipment, net	162,956	160,644
Deferred tax asset	--	29,898
Other assets	77,409	57,538
Total Assets	$27,755,278	$26,631,875
Liabilities and shareholders equity		
Current liabilities:		
Accounts payable	$ 3,176,938	$1,904,946
Accrued expenses and other current liabilities	427,264	303,185
Total current liabilities	3,604,202	2,208,131
Commitments and contingencies		
Shareholders equity:		
Preferred stock, par value $0.01 per share; 4,000,000 shares authorized; no shares issued	--	--
Common stock, par value $0.01 per share; 40,000,000 shares authorized,		

8,488,932 shares issued (including 633,493 held in treasury)	84,889	84,889
Capital in excess of par value	15,560,442	15,546,046
Treasury stock, 633,493 shares at cost	(1,085,057)	(1,085,057)
Retained earnings	9,590,802	9,877,866
Total shareholders' equity	24,151,076	24,423,744
Total liabilities and shareholders equity	$27,755,278	$26,631,875

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

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Forward Industries, Inc.

CONSOLIDATED STATEMENTS OF OPERATIONS

	(UNAUDITED)	
	Three Months Ended December 31,	
	2007	**2006**
Net sales	$4,953,090	$7,434,422
Cost of goods sold	3,835,270	5,477,712
Gross profit	1,117,820	1,956,710
Operating expenses:		
Selling	779,705	850,911
General and administrative	934,924	895,114
Total operating expenses	1,714,629	1,746,025
(Loss) income from operations	(596,809)	210,685
Other income:		
Interest income	239,619	241,290
Other income, net	13,497	10,733
Total other income	253,116	252,023
(Loss) income before provision (benefit) for income taxes	(343,693)	462,708
(Benefit) provision for income taxes	(56,629)	90,000
Net (loss) income	$ (287,064)	$ 372,708
Net (loss) income per common and common equivalent share		
Basic	$(0.04)	$0.05
Diluted	$(0.04)	$0.05
Weighted average number of common and common equivalent shares outstanding		
Basic	7,855,439	7,861,438
Diluted	7,855,439	7,978,869

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

Forward Industries, Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	(Unaudited) Three Months Ended December 31,	
	2007	**2006**
Operating activities:		
Net (loss) income	$(287,064)	$372,708
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Provision for obsolete inventory	129,524	54,000
Depreciation and amortization	16,580	22,210
Share-based compensation	14,396	--
Deferred income taxes	178	(5,000)
Provision for bad debt expense	(20,033)	--
Changes in operating assets and liabilities:		
Accounts receivable	229,826	917,221
Inventories	(412,564)	(70,994)
Prepaid expenses and other current assets	2,182	(54,257)
Other assets	(19,871)	1,520
Accounts payable	1,271,992	1,610,809
Accrued expenses and other current liabilities	124,079	(299,102)
Net cash provided by operating activities	1,049,225	2,549,115
Investing activities:		
Purchases of property, plant, and equipment	(18,892)	(5,190)
Net cash used by investing activities	(18,892)	(5,190)
Net cash (used) provided by financing activities	**--**	--
Net increase in cash and cash equivalents	1,030,333	2,543,925
Cash and cash equivalents at beginning of period	20,267,791	18,609,371
Cash and cash equivalents at end of period	$21,298,124	$21,153,296

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. was incorporated under the laws of the State of New York and began operations in 1961. The Company is engaged in the design, marketing, and distribution of custom-designed, soft-sided carrying cases and other carry solutions products made from leather, nylon, vinyl, and other synthetic fabrics. The cases and other products are used primarily for the protection and transport of portable electronic devices such as cellular phones and medical devices. The Company markets products as a direct seller to original-equipment-manufacturers in the EMEA Region (meaning the geographic area encompassing Europe, the Middle East and Africa), the APAC Region (meaning the Asia Pacific Region, encompassing Australia, New Zealand, Hong Kong, Taiwan, China, South Korea, Japan, Singapore, Malaysia, Thailand, Indonesia, India, the Philippines and Vietnam) and the Americas (meaning the geographic area, encompassing North, Central, and South America) and as a seller to retailers and wholesalers in Europe, the Middle East and Africa under non-exclusive licenses for certain trademarks. This license expired December 31, 2007. See Note 9.

In the opinion of management, the accompanying consolidated financial statements 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 full fiscal year ending September 30, 2008. 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, 2007, and with the disclosures and risk factors presented therein.

NOTE 2 ACCOUNTING POLICIES

Accounting estimates

Preparing the Company's financial statements in conformity with accounting principles generally accepted in the United States 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 and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Basis of presentation

The accompanying consolidated financial statements include the accounts of Forward Industries, Inc. ("Forward") and its wholly owned subsidiaries (together, the "Company"). All significant intercompany transactions and balances have been eliminated in consolidation.

Revenue Recognition

In accordance with the requirements of Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition in Financial Statements, the Company recognizes revenue from product sales to customers when: products that do not require further services by the Company are shipped, there are no uncertainties surrounding customer acceptance, and collectibility is reasonably assured.

Supplier Rebates

Emerging Issues Task Force (EITF) Issue No. 02-16, Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor, permits recognition of a rebate or refund of a specified amount of cash consideration that is payable if the customer completes a specified cumulative level of purchases. The Company has entered into agreements with several of its suppliers that grant the Company a rebate based on its level of purchases made during each quarter. In lieu of a cash payment from these suppliers the Company generally receives a credit memo. The Company reduces accounts payable to the supplier and cost of goods sold each quarter as the Company earns the rebates. For the three-month periods ended December 31, 2007 and 2006, the cumulative amounts of such quarterly rebates were approximately $102,000 and $193,000, respectively. The quarterly rebates are net of amounts allocated to unsold inventories and are reflected in the accompanying consolidated statements of operations as a reduction of cost of goods sold.

Forward Industries, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

NOTE 2 ACCOUNTING POLICIES (CONTINUED)

Foreign Currency Transactions

The functional currency of the Company's wholly owned foreign subsidiaries is the U.S. dollar. 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 the functional currency and the currency in which a transaction is denominated increases or decreases 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, net in the accompanying unaudited consolidated statements of operations. The net gains from foreign currency transactions were approximately \$10,000 and \$11,000 for the three-month periods ended December 31, 2007 and 2006, respectively.

Comprehensive (Loss) Income

For the three-month periods ended December 31, 2007 and 2006, the Company did not have any components of comprehensive (loss) income other than net (loss) income.

Recent Accounting Pronouncements

On July 13, 2006 the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, as amended by FASB Interpretation No. 48-1, Definition of Settlement in FASB Interpretation No. 48 on May 2, 2007 (FIN 48). FIN 48, clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. It also provides guidance on de-recognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition, and clarifies that income taxes are outside the scope of FASB Statement No. 5, Accounting for Contingencies.

FIN 48 applies to all tax positions related to income taxes subject to FASB Statement No. 109, Accounting for Income Taxes, (FAS 109). This includes tax positions considered to be routine as well as those with a high degree of uncertainty.

The Company adopted FIN 48 effective October 1, 2007. The adoption of FIN 48 did not have a material impact on its consolidated financial statements.

NOTE 3 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. Provision has been made to reduce excess, obsolete, or otherwise un-saleable inventories to net realizable value. Changes in this provision are reflected in the cost of goods sold line of the Company s consolidated statements of operations.

NOTE 4 DEBT

In February 2007, Forward and its wholly-owned U.S. subsidiary, Koszegi Industries, Inc. renewed their credit facility with a U.S. bank that provides for a committed line of credit in the maximum amount of $3.0 million, including a $1.5 million sub-limit for letters of credit. This credit facility expires March 30, 2008. Forward and Koszegi are required to eliminate borrowings for thirty consecutive days during the term of the facility and are required to comply with certain financial covenants, including the maintenance of current and tangible net worth ratios, as defined. Amounts drawn under the credit facility bear interest at LIBOR plus 2.5% and are secured by substantially all of Koszegi s assets and certain assets of Forward. There were no borrowings or letter of credit obligations outstanding under this facility during the three-month period ended December 31, 2007.

Forward Industries, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

NOTE 4 DEBT (CONTINUED)

In 2003, Forward s wholly-owned Swiss subsidiary, Forward Innovations GmbH (Forward Innovations), established a credit facility with a Swiss bank that provides for an uncommitted line of credit in the maximum amount of $400,000. Amounts borrowed under the facility may be structured as a term loan or loans, with a maximum repayment period of 12 months, as a letter of credit facility, or as a guarantee facility, or any combination of the foregoing. Either party may terminate the facility at any time; however, such termination would not affect the stated maturity of any term loans outstanding. Amounts borrowed other than as a term loan must be settled quarterly or converted into term loans. In connection with this facility, Forward Innovations agreed to certain covenants. Amounts drawn under this credit facility bear interest at variable rates established by the bank (5.5% as December 31, 2007). At December 31, 2007, Forward Innovations is contingently liable to the bank in respect of a letter of credit issued on its behalf in the amount of €224,000 (equal to approximately $327,000 as at December 31, 2007) in favor of Forward Innovations freight forwarder and customs agent in connection with its logistics operations in The Netherlands. The effect of the issuance of the letter of credit is to reduce the availability of the credit line in an amount equal to the face amount of the letter of credit.

NOTE 5 OPERATING SEGMENT INFORMATION

The Company operates in a single segment that provides carrying solutions for portable electronic devices. This carrying-solution segment designs, markets, and distributes products to its customers that include manufacturers of consumer hand held wireless telecommunications and medical monitoring devices. The carrying solution segment operates in geographic regions that include primarily the Americas, EMEA, and APAC regions. Geographic regions are defined based primarily on the location of the customer. The following table presents net sales related to these geographic segments:

	(all amounts in thousands of dollars)		
	Three Months Ended December 31,		
	2007		**2006**
APAC	$2,295		$3,356

Americas	1,524		2,462
EMEA	1,134		1,617
Total net sales	**$4,953**		**$7,435**

Forward Industries, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

NOTE 6 INCOME TAXES

The Company s income tax (benefit) provision consists of the following United States and foreign components.

	Three Months Ended December 31,		
U.S. Federal and State	**2007**		**2006**
Current	$ --		$68,000
Deferred	(50,229)		5,000
Foreign:			
Current	--		17,000
Deferred	(6,400)		--
Income tax (benefit) provision	**$(56,629)**		**$90,000**

For the three-month periods ended December 31, 2007 and 2006, the Company recorded a (benefit) provision for income taxes of approximately $(57,000) and $90,000, respectively. The Company s effective tax rate does not approximate the statutory United States federal income tax rate primarily due to tax rate differentials in respect of United States state and foreign taxes.

Effective June 2001, undistributed earnings of the Company s Swiss subsidiary are considered to be permanently invested; therefore, in accordance with SFAS No. 109, no provision for U.S. Federal and state income taxes on those earnings has been provided. At December 31, 2007, the Company s Swiss subsidiary had approximately $4,708,000 of accumulated undistributed earnings.

NOTE 7 (LOSS) EARNINGS 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 period. Diluted per share data is computed using the weighted-average number of common and dilutive common-equivalent shares outstanding during the period. Dilutive common-equivalent shares consist of shares that would be issued upon the exercise of stock options, computed using the treasury stock method. For this purpose, the average quoted market prices on the NASDAQ SmallCap Market for the Company's common stock for the three-month periods ended December 31, 2007 and 2006, were $2.66 and $4.88, respectively.

Loss per share data for the three-month period ended December 31, 2007, excludes all outstanding options as inclusion of such shares would be anti-dilutive. Income per share data for the three-month period ended December 31, 2006, excludes options to purchase a total of 70,000 shares of common stock from the computation of diluted earnings per share because the exercise prices were greater than the average quoted market price of the Company s common stock, and therefore, their effect would be anti-dilutive as calculated under the treasury method promulgated by the Statement of Financial Accounting Standard No. 128, Earnings per Share (SFAS 128).

In accordance with the contingently issuable shares provision of SFAS 128, 21,999 shares of service-based common stock awards (restricted stock) were excluded from the calculation of diluted loss per share for the three-month period ended December 31, 2007.

Forward Industries, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

NOTE 8 STOCK BASED COMPENSATION

In May 2007, shareholders of the Company approved the 2007 Equity Incentive Plan (the 2007 Plan), pursuant to which up to 400,000 shares of common stock can be issued to officers, employees and non-employee directors of the Company upon the grant of restricted common stock and the exercise of stock options granted to such persons. This plan was adopted by the Board of Directors in February 2007. The price 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 at the date of grant. The Company s Compensation Committee administers the plan. Options generally expire ten years after the date of grant and restricted stock grants generally vest in equal proportions over three years.

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 were required by its provisions to be equal at least to the fair market value of the common stock at the date of grant. Options expire ten years after the date of grant and generally vest in equal proportions over three years. Unexercised options granted pursuant to the 1996 Plan prior to expiration remain outstanding in accordance with the original terms of the grants.

Stock Option Awards

All stock option awards granted under the 1996 Plan and the 2007 plan are fully vested. During the three-month period ended December 31, 2007, the Company did not grant any stock option awards under the 2007 Plan. Accordingly, the Company did not recognize any compensation cost related to stock option awards in its consolidated statements of operations for the three-month period ended December 31, 2007.

A summary of the stock option activity under the 2007 Plan and the 1996 Plan during the three-month period ended December 31, 2007 is presented below:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual	

			Term (Years)	
				Aggregate Intrinsic Value
Outstanding at September 30, 2007	**232,000**	**$4.51**	**4.68**	**$233,000**
Granted	--	--		
Exercised	--	--		
Forfeited	--	--		
Expired	--	--		
Outstanding at December 31, 2007	**232,000**	**$4.51**	**4.17**	**$76,000**
			-	-
Options vested at December 31, 2007.	232,000	$4.51	4.17	$76,000
Options exercisable at December 31 , 2007				
	232,000	$4.51	4.17	$76,000

Forward Industries, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

NOTE 8 STOCK BASED COMPENSATION (CONTINUED)

Stock Option Awards (Continued)

The table below provides additional information regarding stock option awards that were outstanding and exercisable at December 31, 2007.

	Stock Options Outstanding and Exercisable		
Range of Exercise Prices	Outstanding at December 31, 2007	Weighted Average Remaining Contractual Term (Years)	Weighted Average Exercise Price
$1.75 to $2.85	162,000	2.56	$2.02
$6.02	40,000	8.34	$6.02
$15.91	30,000	7.31	$15.91
	232,000		

Restricted Stock Awards

Under the 2007 Plan as of December 31, 2007, the Compensation Committee had approved awards of 56,000 shares of restricted stock (including 23,000 shares of restricted stock the grant date for which is January 2, 2008), in the aggregate, to certain key employees, one of whom also serves as a director, pursuant to the 2007 Plan. Vesting of the restricted stock is generally subject to a continued service condition with one-third of the awards vesting each year on the anniversary date the awards were granted commencing on the first such anniversary date. The fair value of the awards was equal to the market value of the Company s common stock on the grant date. During the three-month period ended December 31, 2007 the Company recognized approximately $14,000 of compensation cost in its consolidated statements of operations related to restricted stock awards vesting under the 2007 Equity Plan.

The following table summarizes restricted stock activity from September 30, 2007 through December 31, 2007 (restricted stock grants approved during this period but having a grant date of January 2, 2008, are not reflected in the table).

	Weighted Average Grant Date Fair Value

	Shares	
Nonvested balance at September 30, 2007	21,999	$3.49
Changes during the period:		
Shares granted	--	--
Shares vested	--	--
Shares forfeited	--	--
Nonvested balance at December 31 , 2007	21,999	$3.49

As of December 31, 2007, there was approximately $34,000 of total unrecognized compensation cost related to 21,999 of restricted stock awards (reflected in the table above) granted under the 2007 Equity Incentive Plan. That cost is expected to be recognized over the remainder of the requisite service period.

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Forward Industries, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

NOTE 8 STOCK BASED COMPENSATION (CONTINUED)

Warrants

As of December 31, 2007, warrants to purchase 75,000 shares of the Company s common stock at an exercise price of $1.75 were outstanding. These warrants are scheduled to expire 90 days after a registration statement is declared effective by the Securities and Exchange Commission. As of December 31, 2007, no such registration statement has been filed with the Securities and Exchange Commission.

NOTE 9 COMMITMENTS AND CONTINGENCIES

Royalty Commitments

The Company was granted a license for the use of certain trademarks by Motorola, Inc. ("Motorola") for the distribution and sale of carry solution products throughout the EMEA Region under a non-exclusive license agreement effective October 1, 2004. The license agreement expired by its terms on December 31, 2007, with the Company being obligated to pay a royalty on sales effected through the expiration date. The Company and licensor are in negotiations to extend or renew the license. Subject to successful conclusion of such negotiations, as to which there can be no assurance, the Company has limited sell-through rights with respect to unsold inventory on hand as of December 31, 2007, as to which it is also obligated to pay royalties.

Under the terms of the license agreement, the Company is required to pay Motorola a royalty based upon a percentage of the Company's net sales to third parties of licensed products within the EMEA Region, subject to payment of minimum royalties (irrespective of actual net sales) to Motorola over three contract periods, the last two of which were calendar 2006 (Contract Period 2) and calendar 2007 (Contract Period 3).

The license terms provided that, prior to commencement of the latter two contract periods, the parties would attempt to negotiate a new minimum royalty amount for the ensuing contract period, in the absence of which a default formula would apply. The default formula provided that the minimum royalty payment for the ensuing Contract Period may not be less than seventy-five per cent (75%) of the annualized royalties payable in respect of actual sales for the previous Contract Period, provided, however, that in no event may the minimum royalty in such ensuing Contract Period be less than seventy-five percent (75%) nor more than one-hundred-twenty-five percent (125%) of the amount of such prior Contract Period s annual minimum royalty. The Company and Motorola were unable to negotiate new agreed minimum royalty payment amounts for Contract Period 2 and Contract Period 3. Consequently, application of the default formula resulted in fixing the minimum royalty amounts at $225,000 for Contract Period 2 and $281,000 for Contract Period 3.

In July 2005, the license agreement with Motorola was amended to expand the licensed territory to include the APAC Region as well as the EMEA Region in consideration for payment of additional royalties on sales in such licensed territory, subject to payment of minimum royalties, separate and apart from royalties payable in respect of sales in the EMEA Region.

Under the license the Company recorded royalty expense of approximately $89,000 and $137,000 for the three-month periods ended December 31, 2007 and 2006, respectively. These amounts are included in selling expenses in the accompanying consolidated statements of operations. These amounts represent minimum royalty in respect of the 2008 Quarter and royalties paid in respect of actual sales in respect of the 2007 Quarter. The minimum royalties for the three-month periods ended December 31, 2007 and 2006 were $89,000 and $69,000, respectively.

Forward Industries, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

NOTE 9 COMMITMENTS AND CONTINGENCIES (CONTINUED)

Bank Guarantee

In July 2002, Forward Innovations and its European logistics provider (freight forwarding and customs agent) entered into a Representation Agreement whereby, among other things, the European logistics provider agreed to act as such subsidiary'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, the subsidiary agreed to provide an undertaking to the logistics provider with respect to any value added tax liability arising in The Netherlands that the logistics provider paid on the subsidiary's behalf. In February 2004, such subsidiary entered into a guarantee agreement with a Swiss bank relating to the repayment of any amount up to €224,000 (equal to approximately $327,000 as of December 31, 2007) paid by such bank to the logistics provider pursuant to a letter of credit that was issued by the bank in favor of the logistics provider in order to satisfy such undertaking. The subsidiary would be required to perform under the guarantee 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) the subsidiary or the Company on its behalf fails or refuses to remit the amount of value added tax due to the logistics provider, and (iv) the logistics provider makes a drawing under the letter of credit. Commencing December 31, 2004, and on each anniversary thereafter until December 31, 2009, it is intended that the bank letter of credit will be renewed automatically for one-year periods. The subsidiary has agreed to keep a letter of credit guarantee in place for five years following the date its relationship terminates with the logistics provider. As of December 31, 2007, the Company has not incurred a liability in connection with this guarantee.

Employment Agreements

Effective October 1, 2005, the Company entered into an employment agreement with each of Jerome E. Ball, Michael M. Schiffman, and Douglas W. Sabra in order to secure their services to Forward during the terms of their respective agreements. Mr. Ball s and Mr. Schiffman s agreement expired December 31, 2007 (see Note 11 Subsequent Events, below, with respect to Mr. Schiffman s separation arrangements). Mr. Sabra s agreement expires December 31, 2008. Mr. Sabra s 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). If Forward gives such notice, subject to certain conditions, the executive would be entitled to receive six months salary, at the rate then in effect, as severance. No stock options or other equity compensation is granted to any such executive pursuant to these agreements.

Under his employment agreement, which was amended in connection with his appointment to succeed Mr. Ball as Chief Executive Officer, Mr. Sabra is employed as President and Chief Executive Officer at an annual salary of $250,000, increased from $225,000. At the time of this appointment and salary increase the Compensation Committee of the Company s Board of Directors also determined to grant Mr. Sabra 20,000 shares of restricted stock under the 2007 Plan, with a grant date of January 2, 2008, vesting in equal proportions over three years from the grant date.

In addition, under his agreement Mr. Sabra is eligible to receive bonus compensation in each year of the term of his agreement based on financial incentives. The formula, as amended, that determines the amount of bonus that may be earned in each year during the term of the agreement is based on a percentage of, Forward s Pre-Tax Income (defined to exclude other income).

Mr. Sabra is entitled to receive customary benefits including health, life and disability insurance, auto allowances and participation in the Company's 401K retirement plan.

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Forward Industries, Inc.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

NOTE 9 COMMITMENTS AND CONTINGENCIES (CONTINUED)

Consulting Arrangement

The Company entered into a two-year consulting agreement with its Chairman of its Board of Directors, Jerome E. Ball, effective upon his retirement as Chief Executive Officer on January 1, 2008. Under this consulting agreement the Company has retained him to advise the Company as to its principal customer relationships, development and strategies under its business plan, and potential acquisitions and/or business combinations. In exchange for such services, the Company has agreed to pay Mr. Ball $10,000 per month during the term of the consulting agreement, which commenced January 1, 2008 and is scheduled to expire on December 31, 2009. If the agreement is terminated due to Mr. Ball s permanent disability or death during the term of the agreement, the Company has agreed to pay Mr. Ball or his estate, as the case may be, one half the payments remaining under the agreement as a termination benefit. In addition, if during the term of the agreement Mr. Ball is re-elected to the Board of Directors and serves as its Chairman, he will be entitled to a fee of $25,000 per annum, payable in monthly installments.

NOTE 10 LEGAL PROCEDINGS

From time to time, the Company may become a party to legal actions or proceedings in the ordinary course of its business. As of December 31, 2007, 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 11 SUBSEQUENT EVENTS

On January 28, 2008, the Company entered into severance arrangements with Mr. Michael M. Schiffman, whose employment as President and Chief Operating Officer expired December 31, 2007. Under these arrangements, in addition to other customary terms and conditions, Mr. Schiffman was granted a severance package consisting of $162,500, or six months salary at the annual rate under his employment agreement at expiration, vested benefits under the Company s health and retirement plans in accordance with plan terms, and a release by the Company of potential claims, Mr. Schiffman released the Company from potential claims and agreed to certain modifications of the non-competition and non-solicitation covenants contained in the employment agreement.

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

The following discussion and analysis should be read in conjunction with our unaudited Consolidated Financial Statements and the notes thereto and other financial information appearing elsewhere in this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K for the fiscal year ended September 30, 2007. The following discussion and analysis compares our consolidated results of operations for the three months ended December 31, 2007 (the 2008 Quarter), with the three months ended December 31, 2006 (the 2007 Quarter), and is based on or derived from the Unaudited Consolidated Financial Statements included elsewhere in this Quarterly Report. There have been no material changes in critical accounting estimates since September 30, 2007. All figures in the following discussion are presented on a consolidated basis. All dollar amounts and percentages presented herein have been rounded to approximate values.

CAUTIONARY STATEMENT FOR PURPOSES OF THE SAFE HARBOR PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This quarterly report contains forward-looking statements that are not based on historical fact and that involve assessments of certain risks, developments, and uncertainties. Such forward looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995, can be identified by the use of forward-looking terminology such as may , will , should , expect , anticipate , estimate , intend , continue , or believe , or the negatives o of these terms or comparable terminology. Forward looking statements may include projections, forecasts, or estimates of future performance. Forward looking statements are based upon assumptions that we believe to be reasonable at the time such forward looking statements are made. Whether those assumptions will be realized will be determined by future factors, developments, and events, which are difficult to predict and may be beyond our control. Actual factors, developments, and events may differ materially from those assumed. Such risk factors, developments, uncertainties, and contingencies developments, including those discussed in this Management s Discussion and Analysis of Financial Condition and Results of Operations and those identified in Risk Factors in Item 1A of Part II of this Quarterly Report on Form 10-Q and in our annual report on Form 10-K for the fiscal year ended September 30, 2007, could cause our future operating results to differ materially from those set forth in any forward looking statement. Such factors include, among other, the following: our success in winning new business from our customers and against competing vendors; whether replacement programs that we win will be as successful as those that are replaced; the loss of a key salesman who has significant influence on our relationships with certain Original Equipment Manufacturer (OEM) diabetic customers; levels of demand and pricing generally for cellular handsets and blood glucose monitoring devices sold by our customers for which we supply carry solutions; variability in order flow from our OEM customers; general economic and business conditions, nationally and internationally in the countries in which we do business; the expiration of our license agreement with Motorola by its terms on December 31, 2007, and the uncertainty as to whether such agreement will be renewed or extended on terms acceptable to us; the need to add materially to our inventory allowance, including the impact on inventory levels or saleability of inventory arising out of hub agreements we have entered into with two of our OEM customers; demographic changes; changes in technology, including developments affecting cellular handsets; developments in the treatment or control of diabetes that affect the incidence of use of handheld blood glucose monitors by diabetics; increased competition in the business of distribution of carry solutions for handheld electronic devices generally or increased competition to include carry solutions with products manufactured by our OEM customers in particular; changes affecting the business or business prospects of one or more of our principal OEM customers; governmental regulations and changes in, or the failure to comply with, governmental regulations; and other factors included elsewhere in this report and our other reports filed with the Commission, including without limitation, those described under the caption Risk Factors contained in our Annual Report on Form 10-K for the year ended September 30, 2007. Accordingly, there can be no assurance that any such forward looking statement, projection, forecast or estimate can be realized or that actual returns or results will not differ materially from those set forth in any forward looking statement.

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Given these uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements. The Company disclaims any obligation to update any such factors or to publicly announce the results of any revisions to any of the forward-looking statements contained herein to reflect future results, events or developments.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

This management s discussion and analysis of financial condition and results of operations is based upon our unaudited consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent liabilities. We base these estimates on our historical experience and on various other assumptions that we believe to be reasonable under the circumstances, and these estimates form the basis for our judgments concerning the carrying values of assets and liabilities that are not readily apparent from other sources. We periodically evaluate these estimates and judgments based on available information and experience. Actual results could differ from our estimates under different assumptions and conditions. If actual results significantly differ from our estimates, our financial condition and results of operations could be materially impacted. Please refer to Management s Discussion and Analysis Critical Accounting Policies and Estimates included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2007, for further information regarding our critical accounting policies and estimates.

The notes to our audited consolidated financial statements and Management s Discussion and Analysis included in our Annual Report on Form 10-K for the year ended September 30, 2007 (including the information under Risk Factors therein), the notes to our consolidated financial statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q, the factors and events described elsewhere in the Management s Discussion and Analysis of Financial Condition and Results of Operations that follows below, as well as the information contained under the caption Risk Factors in Item 1A of Part II of this Quarterly Report on Form 10-Q contain additional information related to our accounting policies and should be read in conjunction with the following discussion and analysis relating to our overall financial performance, operations and financial position.

Revenue Recognition

In accordance with the requirements of Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition in Financial Statements, the Company recognizes revenue from product sales to customers when: products that do not require further services by the Company are shipped; there are no uncertainties surrounding customer acceptance; and collectibility is reasonably assured.

Accounts Receivable

We record an allowance for doubtful accounts for all receivables judged by us to be unlikely to be collected. The effect of the allowance is to reduce the accounts receivable reported on our balance sheet to an amount that we believe will actually be collected. Significant management judgments and estimates must be made and used in connection with establishing this valuation account, based on a combination of factors: Our analysis includes, among other factors, of the age of receivable balances, our historical bad debts write-off experience, and our respective customer s creditworthiness to determine the appropriate allowance for doubtful accounts. At December 31, 2007 and September 30, 2007, our allowance for doubtful accounts was approximately $27,000 and $47,000, respectively. Changes to this account are reflected in the general and administrative expense line of our consolidated statements of operations. Although we consider our allowance for doubtful accounts to be adequate and proper, changes in economic conditions, the assessments of new customers creditworthiness, changes in customer circumstances, or other factors could have a material effect on the recorded allowance.

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Inventory Valuation

We make estimates and judgments to value our inventory. Our inventory is recorded at the lower of cost or market. The majority of our inventory consists of finished goods that are custom made by our suppliers based on firm orders from our OEM customers and held for our account. We also supply custom manufactured inventory to our OEM customers   distribution hubs in anticipation of their draw-downs to fulfill orders; we also periodically stock inventory in anticipation of orders from our OEM customers when it appears to us commercially advantageous to do so. We also hold inventory in support of our license agreement. At the end of each fiscal quarter, we evaluate our ending inventories, and we establish an allowance for inventory that is considered obsolete, slow moving, or otherwise un-saleable. This evaluation includes, among other factors, analyses of inventory levels, historical loss trends, sales history, and projections of future sales demand. We physically dispose of inventory once its marketability has been determined to be zero. Inventory allowances were approximately $0.7 and $0.6 million at December 31, 2007 and September 30, 2007, respectively. Changes to this account are reflected in the cost of goods sold line of our consolidated statements of operations.

The vast majority of our production is made to customer specifications. If a customer elects not to accept delivery, or defaults on a purchase order or commitment, or returns inventory from its hub without payment in violation of the hub arrangements, additional inventory write-downs or reserves may be required and would be reflected in cost of goods sold in the period the revision is made. Historically, actual inventory valuation results have not deviated significantly from those previously estimated by us.

Deferred Income Taxes

In the preparation of our consolidated financial statements, we are required to estimate income taxes in each of the jurisdictions in which we are subject to taxation. This process involves estimating actual current income tax expense together with assessing temporary differences resulting from differing treatment of revenue and expense items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included in our consolidated balance sheet. We had approximately $0.3 million of deferred tax assets at December 31, 2007, and September 30, 2007, respectively. No valuation allowances were recorded in respect of these deferred tax assets as of such dates.

Management evaluates our deferred tax assets on a quarterly basis and assesses the need for valuation allowances. Our deferred tax assets are evaluated by considering historical levels of income, estimates of future taxable income, and the impact of our tax planning strategies. We record a valuation allowance to reduce deferred tax assets when it is determined, on a more likely than not basis, that we will not be able to use all or part of our deferred tax assets.

In the event that it should be subsequently determined that we can not, on a more likely than not basis, realize all or part of our deferred tax assets, if any, in the future, an adjustment to establish (or record an increase in) the deferred tax asset valuation allowance would be charged to income in the period in which such determination is made. Changes in our deferred tax assets are reflected in the tax (benefit) expense line of our consolidated statements of operations.

Variability of Revenues and Results of Operation

Because our sales revenues are highly concentrated in a few large customers, and because the volumes of these customers order flows to us are highly variable, with short lead times, our quarterly revenues, and consequently our results of operations, are susceptible to significant variability over a relatively short period of time.

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We depend for the predominant proportion of our sales revenues on OEM orders from our three largest customers, each of which is a large, multinational corporation. Each of these customers launches many different products and purchases products accessories, such as carrying cases, from many different vendors. When we are selected to supply a carry solution in-box for a specific product and launch, we may not be in a position to know the frequency or volumes of our customers orders, or the duration of such orders (which will depend on the OEM customer product s life cycle), all of which depend on our customers ongoing assessments of the product s relative contribution to their businesses, as well as other factors. Our OEM customers may keep products for which our carry solutions have been selected to be packaged in-box in active promotion for many months, or for a very short period of time, depending on the popularity of the product, product development cycles and new product introductions, and our customers competitors product offerings. Short product life cycles and/or significant variability in product pricing are particularly characteristic of the cellular handset market, where new functionality is constantly introduced, competition among vendors is high, and industry technical standards are subject to continuing change. When in-box programs end, and to the extent that the introduction of new programs does not include our products as an accessory in-box , or such new programs do include our products as an accessory in-box but do not result in a comparable level of demand for our products, the level of our OEM product sales is susceptible to significant and rapid change.

All of this makes our quarterly revenue levels susceptible to a high degree of variability and difficult to predict. Significant, rapid shifts in our operating results may occur if and when one or more of these customers increases or decreases the size(s) of, or eliminates, its orders from us by amounts that are material to our business.

TRENDS IN RESULTS OF OPERATIONS

- *We foresee a continuation of weak results from our major cell phone OEM customer*. Revenue from Motorola, historically our largest customer, has trended down on a comparable quarter basis since the first quarter of Fiscal 2007. This downtrend accelerated in the third and fourth quarters of Fiscal 2007, and in the 2008 Quarter, revenue from Motorola fell precipitously from the lower levels of Fiscal 2007. We believe as part of the economics accompanying our customer s cell phone launch cycle that Motorola has reduced and/or eliminated the inclusion of accessories in-box for formerly high-price handset models that have transitioned to mid- and lower-price handsets, with consequent revenue loss for us. We have not received awards of significant new in-box programs to make up for higher revenue programs in previous reporting periods. Currently, we foresee no imminent new in-box programs or developments to reverse this trend in the immediate future. The uncertainties relating to a reversal of this trend toward more positive developments have increased with Motorola s disclosures that it is evaluating strategic alternatives for its wireless handset business unit. Absent a reversal of this trend, which we do not foresee in the immediate future, and absent a material increase in sales revenues from other product markets, we will continue to incur operating losses, and possibly net losses, throughout Fiscal 2008. See Risk Factors in Part II, Item 1A, for a discussion of recent developments relating to our relationship with Motorola.
- *We anticipate that gross profit and gross profit percentage will continue to be impacted by several factors.* First, reduction in volume demand (particularly with respect to our cell phone products) in the 2008 Quarter

was, and we anticipate for Fiscal 2008 likely will be, the most significant factor in the level of gross profit. Second, we anticipate that our gross profit will continue to be pressured by a difficult pricing environment for our cell phone and blood glucose carry solution product lines, combined with inflationary cost pressures on our cost of goods sold, as described below. Third, while revenues from Lifescan, our largest customer, and certain other OEM customers in this product line have trended higher, gross margin on these sales is relatively narrow. As revenue from these programs accounts for an overall higher percentage of our revenue mix, we expect gross profit percentage may further decline. Finally, aftermarket sales under the Motorola license have tended to carry higher profit margins than OEM sales on certain products. If we are not successful in renewing or extending the license agreement, and if net sales under any such license are not material, gross profit percentage will be further pressured.

- *Our customer base is becoming more concentrated.* Four customers, accounted for 78% of our net sales in the 2008 Quarter. In Fiscal 2007, three customers, including their subsidiaries, affiliates, or their contract manufacturers, accounted for 72% of our net sales. We continue to pursue opportunities with several new OEM suppliers of handheld devices.

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- *We believe that recent, macro-economic developments in or affecting China s economy will continue to contribute to rising costs of goods sold, which will pressure gross profit.* We source 100% of the products we sell and distribute from vendors located in China. We continue to face rising labor costs (particularly in South China, where we source the majority of our products), higher fuel costs, and the rising value of the Renminbi in comparison to the U.S. dollar in Fiscal 2008. The appreciation of the Renminbi versus the US dollar may accelerate in Fiscal 2008. While our cost of goods sold is denominated in US dollars, higher labor costs and Chinese currency appreciation are reflected in our vendors prices to us. We believe that currently we have relatively little ability to pass these higher costs on to our larger customers.
- *Our 2008 Quarter and Fiscal 2007 operating results led to a pre-tax net loss that would have been significantly larger but for the substantial level of other income , which consists primarily of interest income on cash balances.* We anticipate that these conditions will likely persist in the foreseeable future absent any significant reductions in selling, general, and administrative expense or improvements to our gross profit.
- *Our inventory remains at historically high levels primarily as a result of supporting hub agreements entered into with two of our largest OEM customers. We expect inventory to remain at higher levels in the foreseeable future in large part because of the recent entry into additional hub agreements with these customers.* Under these agreements, we are required to source and ship our products to our OEM customers distribution hubs at multiple locations, but do not invoice the OEM customers until they withdraw our product from the hub for sale through their chain of distribution. The implementation of these arrangements negatively affects our liquidity.

RESULTS OF OPERATIONS FOR THE 2008 QUARTER COMPARED TO THE 2007 QUARTER

Net (loss) income

We incurred a net loss of $0.3 million in the 2008 Quarter compared to net income of $0.4 million in the 2007 Quarter, a decrease of $0.7 million. This decrease was due to a 43% decline in gross profit resulting from a significant decline in sales of cell phone products, as detailed below. Our operating expenses (higher general and administrative expense offset by lower selling expense) and other income remained essentially flat. Income taxes swung $150,000 to a benefit in the 2008 Quarter from a provision in the 2007 Quarter, which had the effect of reducing the net loss. Basic and diluted per share data was ($0.04) for the 2008 Quarter, compared to $0.05 for the 2007 Quarter. The decrease in earnings per share in the 2008 Quarter was due to the decrease in net income.

Net Sales

Net sales decreased $2.5 million or 33% to $5.0 million in the 2008 Quarter compared to $7.4 million in the 2007 Quarter due to a decline in sales of cell phone products of $3.7 million, or 87%. This decline was offset in part by increases in sales of diabetic products of $1.0 million, or 42%, and sales of other products of $0.2 million, or 22%. The tables below set forth sales by product line and geographic location of our customers for the periods indicated.

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Net Sales for 2008 Quarter 3 Months ended December 31, 2007 (millions of dollars)			
	APAC	Americas	EMEA