FORWARD INDUSTRIES INC
Form 10KSB
November 20, 2006

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-KSB

(Mark One)

[X] ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended September 30, 2006

[ ] TRANSITION REPORT UNDER 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.

(Name of small business issuer in its charter)

New York	**13-1950672**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1801 Green Road, Suite E, Pompano Beach, FL	**33064**
(Address of principal executive offices)	(Zip Code)

(954) 419-9544
(Issuer's Telephone Number, including Area Code)
Securities registered under Section 12(b) of the Exchange Act:

(Title of class) Name of each exchange on which registered

Securities registered under Section 12(g) of the Exchange Act:

Common Stock, $.01 par value
(Title of class)

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.
Yes [ ] No [X]

Check whether the issuer: (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [**X**] No [ ]

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. [**X**]

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

The issuer's revenues for its most recent fiscal year: $30,607,843

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was sold, or the average bid and asked prices of such common equity, as of a specified date within the past 60 days:

Approximately $30,902,633 based on the average of the closing bid price ($5.05) and closing asked price ($5.08), as reported on the NASDAQ SmallCap Market on November 10, 2006.

As of November 10, 2006, 7,861,438 shares of the issuer's common stock, $.01 par value per share, were outstanding.

Transitional Small Business Disclosure Format: Yes [ ] No [**X**]

FORM 10-KSB ANNUAL REPORT
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 2006
FORWARD INDUSTRIES, INC.

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Note Regarding Use of Certain Terms

In this Annual Report on Form 10-KSB, unless the context otherwise requires, the terms "we", "our", and "the Company" refer to Forward Industries, Inc., a New York corporation, together with i consolidated subsidiaries; "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; "you" refers to holders of Forward's common stock who are not affiliates (as such term is defined in Rule 144(a)(1) under the Securities Act of 1933) of Forward; "Commission" refers to the United States Securities and Exchange Commission; "Securities Act" refers to the United States Securities Act of 1933; "Exchange Act" refers to the United States Securities Exchange Act of 1934; Fiscal 2006 refers to our fiscal year ended September 30, 2006; Fiscal 2005 refers to our fiscal year ended September 30, 2005; Fiscal 2004 refers to our fiscal year ended September 30, 2004; "EMEA Region" means the geographic area encompassing Europe, the Middle East and Africa; "APAC Region" means 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 "Americas" means the geographic area, encompassing North, Central, and South America.

Forward-Looking Statements

This Annual Report contains forward-looking statements that are not based on historical fact and that involve predictions of future events based on assessments of certain risks, developments, and uncertainties. These 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 or other variations 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 uncertainties, contingencies, and developments, including those discussed in Item 6 in "Management's Discussion and Analysis of Financial Condition and Results of Operations" and in "Risk Factors", could cause our future operating results to differ materially from those set forth in any forward looking statement. Such factors include, among others, the following: our success in winning new business from our customers and against competing vendors; whether replacement "in box" programs that we win will be as successful as those that are replaced; levels of demand generally for cellular handsets and blood glucose monitoring devices for which we supply carry solutions; general economic and business conditions, nationally and internationally in the countries in which we do business; demographic changes; changes in technology, including developments in cellular handsets or the control of diabetes; increased competition in the carrying case business; changes affecting, or the loss of, one or more of our principal OEM customers; the effective management of inventory including in connection with our OEM customers' hub arrangements to which we are subject; governmental regulations and changes in, or the failure to comply with, governmental regulations; and other factors included elsewhere in this Annual Report and our other reports filed with the Commission. Accordingly, there can be no assurance that any such forward looking statement, projection, forecast or estimate can be realized or that actual results will not be materially different than those contained in any such forward looking statement.

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.

Please consider carefully the Risk Factors disclosure contained in Item 6 of this Annual Report.

PART I

ITEM 1 - DESCRIPTION OF BUSINESS

General

We design, market, and distribute carry solutions for hand held consumer electronics products, including soft-sided carrying cases, bags, clips, hand straps, decorative face plates, and other accessories for cellular telephones, medical monitoring and diagnostic kits, cameras, and other consumer electronic products. We sell these products in two different customer markets. Our principal customer market is original equipment manufacturers, or "OEMs", of these consumer electronic products, who ship our carry solution products as accessories "in box" with their product offerings and to an increasing extent the contract manufacturing firms of these OEM customers. In Fiscal 2006, sales to OEM customers (or their contract manufacturers) accounted for 89% of our revenues.

Our second, and much smaller, customer market consists of wholesalers and retailers in the cell phone products aftermarket to whom we sell carry solutions under non-exclusive licenses from Motorola, Inc. and SAGEM S.A., a multi-national electronics manufacturer. Under the Motorola license, we have been granted the rights to market such carry solutions bearing Motorola's trademarks in the EMEA Region and in the APAC Region. Under the SAGEM license, we market such carry solutions bearing SAGEM's trademarks in the EMEA Region. In Fiscal 2006, sales of licensed products accounted for 11% of our revenues.

Our suppliers custom manufacture our carrying cases and related products to our order based on our designs and know-how and to our customers' specifications. Typically, we ship these products to our OEM customers, or to their contract manufacturers, to be packaged with their consumer products prior to distribution and sale. In the case of sale of carry solutions to our aftermarket customers under license, we ship these as stand alone stock units to wholesalers and retailers. We do not manufacture any of the products that we sell and distribute.

Background. Forward Industries, Inc. was incorporated in 1961 under the laws of the State of New York. Until 1989, our primary business was the manufacture and distribution of advertising specialty and promotional products. In 1989, we acquired Koszegi Industries, Inc., or "Koszegi", an Indiana corporation that manufactured soft-sided carrying cases at its South Bend, Indiana, facility. Our carrying case business progressively increased to the point where it became the predominant part of our business. In September 1997, we sold the assets relating to the production of advertising specialty and promotional products and ceased operating in that business segment.

In May 1994, we formed Koszegi Asia Ltd., or "Koszegi Asia", as a wholly owned, Hong Kong-based subsidiary of Forward Industries to facilitate a more nimble and robust carrying case procurement and quality control infrastructure and to further enhance our foreign sourcing capabilities. With Koszegi Asia's ability to source quality cases in China on short lead times, we determined that our domestic production capability was unnecessary, and we now source all our product supply from Chinese suppliers. See "Product Supply.

"In recent years we have focused on strengthening our sales and distribution network and commercial relationships with our key OEM customers. During Fiscal 2006, we began to modify our quality control infrastructure by contracting part of this function away from our Hong Kong distribution and quality control facility directly to a third party provider. We have been creative in addressing and responding to our OEM customers' needs to facilitate their distribution requirements. During Fiscal 2006 we entered into distribution hub agreements with two of our OEM customers at their request to improve their tracking and control of accessory products packaged "in box" with their consumer electronics. In addition, we have sought to strengthen our presence in secondary markets. In July 2005, our license agreement with Motorola, renewed in October 2004, was amended to expand the licensed territory to include the APAC Region as well as the EMEA Region, although this initiative has yet to impact our revenue. In February 2005 we entered into a license agreement with SAGEM, a French multinational electronics firm, for the distribution of cell phone carry solutions bearing the SAGEM trademarks throughout the EMEA Region. In May 2001, we formed Forward Innovations GmbH, a wholly owned Swiss subsidiary of Forward Industries, or "Forward Innovations", to facilitate distribution of licensed products as well as to further develop our OEM European business presence.

Forward Innovations has allowed us to better serve our European customers. See "Marketing and Distribution."

Products

Through our wholly owned subsidiaries, Koszegi and Forward Innovations, we design and market to our customers' orders carry solutions for hand held consumer electronics, including soft-sided carrying cases, bags, clips, hand straps, decorative faceplates, and other accessories made of leather, nylon, vinyl, plastic, PVC and other synthetic fabrics. Our products are used by consumers for carrying or transporting portable electronic products such as cellular telephones, blood glucose monitoring kits, cameras, and other consumer hand held electronic devices. Our carrying cases are designed to enable these devices to be stowed in a handbag, briefcase, or backpack, clipped to a belt, or carried in a pocket.

Cases for Cellular Handsets. We sell carrying cases and related accessory products for cellular telephone handsets to OEM handset suppliers and, under license, to retailers and wholesalers of cellular phone products and related accessories. These products include carry cases for cell phone handsets, cases for handset camera attachments, handset plastic belt clips, carrying case straps and bags, decorative faceplates, wrist straps, digital display cleaning cloths, and other accessory products. Our selling prices for these products vary widely, depending on the specific product, terms of the order, quantity ordered, and distribution channel, and generally range from $.20 or less to $13.00 per unit, with the higher prices in the range generally occurring in the case of licensed product sales. In the case of sales to OEM customers and their contract manufacturers, the manufacturer or its contract supplier packages the cases or other accessories "in box" as a custom accessory for the cellular handset. In the case of sales of licensed products, we sell and ship these products as separately packaged, aftermarket accessories to third party distributors under our license agreements with Motorola and SAGEM.

Cases for Medical Kits. We sell our medical monitoring and diagnostic kit carrying cases directly to OEMs (or their contract manufacturers) of electronic blood glucose monitoring kits for personal use by diabetics. We typically sell these cases at prices ranging from $0.50 to $9.00 per unit. The manufacturer or its contract supplier packages the cases "in box" as a custom accessory for its blood glucose testing and monitoring kits. The kits typically include a small, electronic blood glucose monitor, testing strips, lancets for drawing a drop of blood and our carrying case, customized with the manufacturer's logo and designed to fit and secure the glucose monitor, testing strips and lancets in separate straps, pouches, and holders. We believe that users of these monitoring kits may purchase new kits as frequently as every two years, depending on advances made in the blood glucose measurement technology and functionality. As the kits and technology change, our carrying case designs change to accommodate the changes in size, shape and layout of the electronic monitoring device, strips and lancet.

Other Carrying Case Products. We also sell carrying cases, belt clips, and other carry and storage solutions for a diverse array of other portable electronic and other products, including cases for cameras, MP3 players, retail bar code scanners, and a variety of other products. Our selling prices for these products also vary across a broad range, depending on the size and nature of the product for which we design the carry solution.

Product Development. In our OEM business, typically we receive product orders in connection with our customer's introduction and rollout to market of a new product which the customer has determined to accessorize and customize with our products. Our OEM customers provide us with the desired functionality, size and other basic specifications for the carrying case or other product, including the OEM's identifying logo imprint on the product. Our in-house design and production staff develops detailed design options and more detailed product specifications for our customer's evaluation, and in conjunction with our customer we then engage in the process of refinement of design and specifications. Working with our suppliers, we furnish our customer with product samples. Once our customer approves a product sample for commercial introduction and order, we work with our suppliers to ensure conformity to the definitive product samples and specifications. Manufacture and delivery of products in production quantities is then coordinated with our OEM customer's manufacturing and shipment schedules so our carry solutions can be boxed with the consumer electronic product.

In the case of sales of branded products pursuant to our license agreements, we market carrying cases and related accessory products for cell phone handsets based on our own designs or designs furnished by our licensor. Our in-house design staff develops detailed design options and more detailed product specifications for the licensor's evaluation. We work with our licensors to refine design specifications and subsequently submit production samples for approval. Upon approval, we offer such products to retailers and other distributors in the licensed territory. Licensed products have, to date, been manufactured for both inventory and customer order.

Research and development costs are not material to our business.

Marketing, Distribution, and Sales

Geographic Sales Distribution

We sell our products globally. The percentages of net sales to customers by their geographic location for the fiscal years ended September 30, 2006, 2005, and 2004 are as follows:

	Percentage of Net Sales by Geographic Location for the Fiscal Years Ended September 30,		
	2006	**2005**	**2004**
APAC	44%	36%	15%
Americas	34%	23%	40%
EMEA	22%	41%	45%
Total	**100%**	**100%**	**100%**

The variability of percentages of sales to customers by geographic location during these periods, and in particular the increasing importance of the Asia Pacific region, is attributable to fluctuations in order flow from, and the location of, our large OEM customers and, increasingly, the fact that, in certain cases, our OEM customers have outsourced product manufacture to contract manufacturers located in China or elsewhere in Asia. Where such outsourcing to Asian contract manufacturers is the case, we ship product to, and it is packaged in box at, such contract manufacturing facility. If payment to us is due from the contract manufacturer, we identify the sale to its geographic location rather than that of the OEM customer for whom the contract manufacturer is supplying product together with our cases. See Note 11 to the Consolidated Financial Statements included elsewhere in this Annual Report.

Sales Force

During the fiscal years ended September 30, 2006 and 2005, approximately 99% and 95%, respectively, of net sales were made directly by our employees, who work on a salaried (plus incentive bonuses) and not a commission basis. Depending on their customer accounts and whether sales are made to OEM customers or under license, such employees are based in our executive offices in Florida, in Switzerland, or in Hong Kong. The remaining sales were made through independent sales representative organizations, which receive a commission averaging 5% of the net sales amount.

Channels of Distribution

We have two channels of distribution for our products: first, direct to our OEM customers, which package our carry solutions products in box with their products, although increasingly, we may ship directly to the OEM customer's contract manufacturer, which similarly packages our products in box on behalf of the OEM customer. The second distribution channel is under our license agreements, where our carry solution product accessories bearing our licensor's trademarks are separately packaged and shipped to distributors and retailers for sale in the aftermarket. In

the three fiscal years ended September 30, 2006, 2005 and 2004, approximately 89%, 97%, and 89%, respectively, of our net sales were made to OEM customers (or their contract manufacturers), and sales of licensed products designed and developed by us under license accounted for approximately 11%, 3%, and 11%, respectively, of net sales.

OEM Product Sales. In the three fiscal years ended September 30, 2006, 2005, and 2004, OEM products sales for cellular phone handsets accounted for 40%, 67%, and 34%, respectively, of our net sales, and OEM product sales for blood glucose monitors accounted for approximately 37%, 23%, and 43%, respectively, of our net sales. In the three fiscal years ended September 30, 2006, 2005, and 2004, approximately 12%, 7%, and 11%, respectively, of net sales represented sales of carrying cases for products other than blood glucose monitoring kits or cellular phone handsets: these include custom cases for cameras, portable oxygen tanks, bar code scanners, MP3 players and other consumer electronic devices.

Of our approximately 200 active customers, four customers, including their subsidiaries, affiliates, or their contract manufacturers, accounted for approximately 73% of our net sales in Fiscal 2006. Our principal customers include Motorola for cellular telephone carrying cases and accessories, and Abbott Laboratories ("Abbott"), Bayer Healthcare LLC, ("Bayer") and Lifescan, Inc. ("Lifescan"), a subsidiary of Johnson and Johnson, for carrying cases for diabetic monitoring kits. These customers package our cases or other accessories "in box" with their branded products, or use them as promotional items. Our three largest customers in terms of our net sales are Motorola, Inc., Lifescan, and Abbott. Motorola, Inc. (together with its respective international affiliates, "Motorola"), is our largest OEM customer, accounting for approximately 37% and 56%, respectively, of net sales in the fiscal years ended September 30, 2006 and 2005 (excluding sales of Motorola-branded products to third parties under our license agreement). In the fiscal years ended September 30, 2006 and 2005, sales of cases for Lifescan diabetic monitoring kits accounted for approximately 19% and 12%, respectively, of our net sales. Sales of cases for diabetic monitoring kits to Abbott accounted for approximately 9% and 4%, respectively, of our net sales in the fiscal years ended September 30, 2006 and 2005. The loss of any of the above named customers would have a material adverse effect on our business, results of operations and financial condition. See "Item 6. Management's Discussion and Analysis-Variability of Revenues and Results of Operations;-Risk Factors-*Our business is characterized by a high degree of customer concentration. Two significant customers accounted for 56% of revenues in Fiscal 2006; the loss of, or material reduction in orders from, any of these customers would materially and adversely affect our results of operations and financial condition.*"

During Fiscal 2006, sales to Nokia declined to approximately 3% of net sales compared to Fiscal 2005, when such revenue, primarily contributed by one major program, accounted for approximately 11% of net sales This program substantially terminated during Fiscal 2006. We currently have no material in-box programs in active promotion with Nokia but have no reason to believe we won't be considered for future business from this customer. Similarly, sales to Roche diminished each quarter during the course of Fiscal 2006, and it is currently not considered a major customer.

Licensed Product Sales. We have entered into non-exclusive licenses with Motorola and SAGEM, each of which grants us the right to sell cell phone carry cases and other accessories branded with their respective trademarks in designated territories. The SAGEM license is not material to our revenue or expenses.

Sales to third parties of licensed products under the Motorola agreement accounted for approximately 10% and 3% of our net sales in the fiscal years ended September 30, 2006, and 2005, respectively.

Motorola License. Effective October 1, 2004, we entered into a new license agreement with Motorola pursuant to which we are granted the non-exclusive right to sell cellular telephone handset carry cases and other carry solutions bearing Motorola trademarks in the EMEA Region. The license permits us to sell and distribute such licensed products based on our proprietary designs or Motorola designs directly to third party distributors, including wholesalers and retailers in the EMEA Region. This license agreement, which expires on December 31, 2007, unless earlier terminated in accordance with its terms, modifies and continues the arrangements to sell licensed products bearing Motorola trademarks in the EMEA Region under the initial license agreement that we entered into with Motorola effective January 2001 and which expired September 30, 2004. In July 2005 the current license was amended to expand the licensed territory to include the APAC Region in consideration of payment of additional royalties on actual sales in that territory.

Under the current agreement we are required to pay royalties to Motorola based on specified percentages of the revenue derived from the sale of licensed products to third parties, depending upon the terms of the sale, and we have guaranteed to pay Motorola minimum royalty payments over the following three contract periods relating to the EMEA Region (the discussion below does not include the minimum royalties payable in respect of sales in the APAC Region, which are calculated separate and apart from the royalties in respect of EMEA Region sales):

- Contract Period 1: October 1, 2004 to December 31, 2005
- Contract Period 2: January 1, 2006 to December 31, 2006
- Contract Period 3: January 1, 2007 to December 31, 2007

The minimum royalty payment to Motorola for Contract Period 1 is $375,000, or $300,000 annualized. Prior to the end of Contract Period 1 and Contract Period 2, the Company and Motorola have agreed that, at such times, they will establish new minimum royalty amounts for Contract Period 2 and Contract Period 3, respectively. If the Company is unable to reach agreement at either such time with Motorola on the minimum royalty payment for Contract Period 2 or Contract Period 3, as the case may be, then the parties have agreed that the minimum royalty payment for the ensuing relevant period may not be less than seventy-five per cent (75%) of the annualized royalties payable in respect of actual sales for the prior contract period, provided, however, that in no event shall 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 the prior period's annualized minimum royalty. Pursuant to this formula, and in the absence of any agreement to the contrary, the minimum royalty amount for Contract Period 2 was fixed at $225,000, and is expected to be fixed in the amount of $281,000 for Contract Period 3.

As to APAC Region sales and royalties, which we do not believe will be material during the fiscal year ending September 30, 2007, we are currently exploring various distribution channels in the Asian market. In addition, we are required to pay Motorola minimum royalty payments of $75,000 for the contract period of January 1, 2007 to December 31, 2007 related to the APAC Region.

In addition to other customary terms and conditions typical of agreements of this kind, we may be required to indemnify Motorola in respect of damage to its intellectual property, to cause our designated manufacturers to comply with certain terms of the manufacturing agreement to which they are a party pursuant to the license, or to incur costs and expenses in other respects. See "Item 6. Management's Discussion and Analysis-Risk Factors--*Under our license agreement with Motorola we may become liable for certain indemnification or other liabilities and become exposed to certain risks*" for a discussion of indemnification obligations, manufacturing compliance and certain other risks under the license agreement.

OEM Distribution Hubs. During Fiscal 2006 we entered into distribution hub agreements with two of our OEM customers that obligate us to supply carrying case accessory products to the customer's distribution hub at multiple locations where its consumer electronics product is manufactured and/or warehoused pending sale and where our products are packaged with the OEM customer's electronics. These arrangements require us to supply product to their distribution hubs based on our OEM customer's forecasts. We have no means of determining the accuracy of such forecasts. Additionally, due to visibility constraints associated with such forecasts, combined with the long lead-times for some of our products covered under these hub agreements, we may, from time to time, be required to stock inventory at levels exceeding those forecasted by our customers. Whether this will result in a one-time lag between inventory stocking of the hubs and a re-adjustment of timing of product procurement from our suppliers remains to be seen, and inventory levels, liquidity, and results of operations may be adversely affected. We ship product to the hub but do not recognize revenue until we have been advised by our customer that product has been withdrawn from the distribution hub to be placed "in box". By historical standards in our business, these arrangements have had the

general effect of financing our customers' inventory by extending the time between placement of our orders to our suppliers in order to supply the hubs and the time that revenue is recognized. The corollary effect is an increase in our inventory levels.

Computer Carrying Case Initiative

In addition to marketing carry solutions to OEM customers in the cellular phone and blood glucose monitoring kit markets, we began an initiative in October 2003 to target OEM manufacturers and distributors of laptop, handheld, and notebook computers, a market for our independent product line of cases that we previously exited in fiscal 2001. Our evolved strategy in this market is similar to that in our cellular phone and blood glucose kit markets-the distribution and sale of carrying cases to OEMs, as well as distributors, to their specifications. We believe that the laptop, handheld, and notebook computer market constitutes a natural complement for our existing markets and involves similar design, manufacturing, execution, and distribution competencies and characteristics. As a key part of this initiative, in October 2003 we hired a senior sales executive with extensive experience in the market for laptop, handheld, and notebook computer carrying cases to lead our development efforts in this regard. This carrying case market is characterized by longstanding relationships between the OEM and the carrying case supplier. To date, we have been unable to generate any material revenue from this initiative and have shifted our focus to carrying cases for other OEM markets that we believe are more easily penetrable, such as satellite radios, PDAs, and other consumer handheld electronic devices.

Credit Risk

We sell our products on credit terms customary in the industry. Historically, we have not had significant credit problems with our customers. Our significant OEM customers are large, multi-national companies with good credit histories. None of these customers is or has been in default to us, and payments are generally received from them on a timely basis. Two customers, including their international affiliates, accounted for approximately 75% of the Company's accounts receivable at September 30, 2006. As part of an ongoing trend, certain of our OEM customers have requested that we ship product to their designated contract manufacturer and invoice such manufacturers for the products to be included in box with the cellular handsets or blood glucose monitors manufactured, assembled and packaged by such contract manufacturers. In these cases, even though our order flows originate with and depend on our relationship with the OEM, our credit risk lies with the contract manufacturer. Our OEM customer does not guarantee the credit of the contract manufacturer to whom the OEM requests us to ship our carrying case products, and such orders may be significant in volume from time to time. In most cases, these contract manufacturers are themselves major multinational enterprises with good credit histories. Any failure of any such customer (or its contract manufacturer) to pay part or all the sums owed to us when due could have a material adverse effect on our liquidity, business prospects, and results of operations. See "Item 6. Management's Discussion and Analysis-Results of Operations-Trends in Results of Operations- Product manufacture is increasingly being outsourced by our OEM customers to contract manufacturing firms in China and in Southeast Asia;--Risk Factors."

Foreign Exchange Risk

Certain of our OEM customers have established sales and manufacturing operations in China. In addition, as noted above, certain of these or other OEM customers may outsource manufacturing and packaging of the products with which our carrying case solutions are packaged "in box" to contract manufacturers that are located in China or in Southeast Asia. Accordingly, our payment and remittance arrangements with such customers may subject these arrangements to Chinese or other local currency regulations. We may be required to invoice in local currency and take payment in local currency or U.S. dollars, in some cases through intermediaries that possess foreign exchange licenses. In the event that any foreign government were to impose regulatory restrictions on the ability to effect conversion of local currency into U.S. dollars, repatriation of U.S. dollars or other currencies to the United States, or payment in any form to foreign business entities, or were to impose or enforce tighter restrictions on foreign exchange license holders, our receipt or recognition of U.S. dollars in payment, directly or indirectly, of invoices for sales of our products could be delayed or otherwise affected. If this were to affect receipt or recognition of material amounts of revenues, our liquidity or results of operations could be materially and adversely affected. See "Item 6. Management's Discussion and Analysis-Risk Factors-Payment by or on behalf of our customers of accounts receivable originated in China or other Asian nations may be subject to local regulations or moratorium that restrict the right to convert foreign currencies into U.S. dollars, that prevent, delay, or restrict the ability to repatriate foreign exchange to the United States or other countries, or that impose costs or intermediaries in order to effect foreign exchange and its repatriation to the United States."

Product Supply

Manufacturing. The manufacture of custom carrying cases and other carry solution products generally consists of die cutting fabrics, principally vinyl, nylon, and leather, heat sealing, gluing, sewing and decorating (affixing logos) by means of silk screening, hot-stamping, embroidering or embossing. The principal materials used in the manufacture of our products are vinyl, nylon, leather, metal and plastic parts (such as clips, buckles, loops, and hinges and other hardware), foam padding and cardboard, all of which are obtained according to our specifications from Chinese suppliers. We do not believe that any of the component materials or parts used by our suppliers in the manufacture of our products is supply constrained. We believe that there are adequate available alternative sources of supply for all of the materials used to manufacture, package, and ship our products.

Suppliers. We procure all our supply of carrying solutions products from independent suppliers, each of which is a Chinese business entity located in China. We purchased approximately 80% and 82% of our products from five such suppliers in Fiscal 2006 and Fiscal 2005, respectively. One supplier accounted for approximately 36% of our product purchases in both Fiscal 2006 and Fiscal 2005. See Note 1 to the Consolidated Financial Statements set forth in Item 7 of this Annual Report.

We place orders with one or more suppliers at the times we receive firm orders from our OEM customers for a particular product. Depending on the product, we may require several different suppliers to furnish component parts or pieces. Accordingly, we do not have minimum supply requirement agreements with these or other suppliers to guarantee us supply of finished product, nor have we made purchase commitments to purchase minimum amounts from any of these suppliers. However, from time to time, we may order products from our suppliers in anticipation of receiving a customer order to meet required delivery times and, if our customer cancels the order or we fail to receive the customer order, we may be required to comply with the supply order, which would result in a loss to us as these are generally custom manufactured products unfit for sale to other customers.

With respect to licensed products, we estimate the product sell through rates of our distributor and retail customers in order to gauge the timing and size of inventory stocking orders to our suppliers.

We believe that other suppliers could provide us similar products on comparable terms. However, a switch to a different supplier could delay shipment of product resulting in a loss of sales that could affect our operating results and adversely influence our relationship with the affected customer. In addition, under our license agreement with Motorola our selection of a new supplier to manufacture licensed products is subject to Motorola's approval.

Product Sampling and Quality Control. Upon award of an OEM order, our design and production staff works closely with our customer to finalize product designs and specifications and with our suppliers to coordinate production schedules, conformity to design specifications, and quality control. Depending on the customer's requirements, the product involved, and time from sampling to commercial order, our production staff, working in conjunction with our marketing department, may submit samples and refinements thereof to the customer between one and three times per product before approval for production is granted. Once the sampling process is completed for a specific product, which may range from weeks to many months, commercial orders may be received and accepted.

To ensure that product manufacturing by foreign contractors meets our standards, products are currently either inspected by contracted third-parties in China or by our employees in Hong Kong. In Fiscal 2005, in an effort to reduce our inspection, handling, and local freight costs for China-based shipments, we entered into an arrangement with one of our China-based suppliers to reimburse it for expenses incurred in performing in-factory inspection of our products under our supervision at their factory. Beginning in Fiscal 2006, we expanded and altered this in-factory inspection initiative by contracting with a third-party logistics provider to conduct in-factory inspection services at the aforementioned supplier's factory and at additional supplier factories, and to operate a separate quality assurance facility in China. These inspections are overseen by Koszegi Asia employees. Currently, the vast majority of our quality assurance function is performed by this third-party logistics provider rather than by our own employees at Koszegi Asia, which historically has been the case. In the course of transition of responsibility for the inspection function from our Koszegi Asia facility to the third-party logistics company, certain problems in quality control consistency and standards have from time to time surfaced, and we are working to improve the quality and frequency of the oversight by Koszegi Asia employees in order to bring quality assurance operations to our standards on a consistent basis. See "Risk Factors-*Our dependence on foreign manufacturers creates product cost, pricing, availability, quality control, and delivery risks."*

Quality assurance and sourcing related expenses are reflected in cost of goods sold in our results of operations. In January 2004, our Hong Kong inspection facility renewed its ISO 9001:2000 quality certification.

Once Koszegi Asia's Hong Kong inspection and quality control facility approves carry solutions products for shipment, the products are typically shipped on container carrier vessels. In certain cases, at the customer's request, we will ship by air freight or transfer products to a customer's location in Hong Kong. Most ocean-going shipments bound for the Untied States are off-loaded at the port of Los Angeles or San Francisco, but certain customers arrange for shipments to East coast ports, such as Miami or Philadelphia. European shipments generally are routed via Rotterdam, Frankfurt, or London. Disruptions or delays in off-loading cargo at any of these domestic or foreign ports as a result of labor disputes, physical damage to port facilities or otherwise, or other delays may delay shipments to our customers and cause re-routing of containers to ports with open facilities or shipment via air freight. Depending on the cause of delay and trade terms with our customer, we may be required in certain cases to bear the additional expense of such alternate routing or reliance on air freight. See "Item 6. Management's Discussion and Analysis-Risk Factors-Our shipments of products via container freight to customers in the United States and Europe are subject to delays or cancellation at port facilities due to work stoppages or slowdowns, damage caused by weather or terrorism and congestion due to inadequacy of equipment and other causes."

We ship our products to our customers by common carrier.

Insurance

We maintain commercial loss and liability, business interruption, and general claims and other insurance customary for our business. We do not maintain credit insurance for our trade accounts receivable.

Competition

The business in which we engage is highly competitive in terms of product pricing, design, delivery terms, and customer service. In the production of carrying cases and related carry solutions for OEM products, we estimate that we compete with approximately 1,500 United States and foreign producers and distributors. Some of our competitors are substantially larger than we are and have greater financial and other resources. We believe that we sustain our competitive position through maintenance of an effective product design capability, rapid response time to customer requests for proposals and product shipment, competitive pricing, reliable product delivery, and product quality. We believe that our ability to compete based on product quality assurance considerations is enhanced by the local presence of our Hong Kong and outsourced Chinese quality control and shipment facilities.

Employees

At September 30, 2006, we had 49 full-time employees, of whom 3 are employed in executive capacities, 7 are employed in administrative and clerical capacities, 15 are employed in sales and sales support capacities, and 24 are employed in sourcing, quality control, and warehouse capacities. In addition, we employed one part-time sales person. We consider our employee relations to be satisfactory. None of our employees is covered by a collective bargaining agreement.

Since June 2003, we have employed our U.S. employees through a co-employment agreement with ADP TotalSource, a Professional Employer Organization. As a co-employer, the objective is that ADP TotalSource assume many of the legal and administrative responsibilities of human resources management, health benefits, workers' compensation, payroll, payroll tax compliance, 401(K) plan administration and unemployment insurance.

Regulation and Environmental Protection

Our business is subject to various regulations in various jurisdictions, including the United States and member states of the European Community, that restrict the use or importation of products manufactured with compounds deemed to be hazardous. We work with our suppliers to ensure compliance with such regulations. In addition, from time to time one or more customers may require testing of our products to ensure compliance with applicable consumer safety rules and regulations. Because we do not engage in the manufacture of products that we sell and distribute, compliance with federal, state and local laws and regulations pertaining to the discharge of materials into the environment, or otherwise relating to the protection of the environment, has not had, and is not anticipated to have, any direct material effect upon our capital expenditures, earnings, or competitive position. However, compliance with such laws and regulations on the part of our suppliers may result in increased costs of supply to us, particularly if domestic environmental regulation in China becomes more prevalent and effective. In addition, under our license agreement with Motorola, we may be responsible for ensuring our Chinese suppliers' compliance with applicable regulations, including, among others, those relating to worker safety, child labor laws, and environmental protection. This may require us to incur administrative and/or legal expense in working with our suppliers to achieve such compliance.

We have not been engaged in any environmental litigation or incurred any material costs related to compliance with environmental or other regulations.

ITEM 2 - DESCRIPTION OF PROPERTY

We lease approximately 10,000 square feet of office and warehouse space at 1801 Green Road, Pompano Beach, Florida, through Koszegi Industries Inc., our wholly owned subsidiary. Under the terms of the lease, which expires in May 2012, the monthly rent is approximately $11,000. We use this office space as our executive office and our United

States sales office.

We lease approximately 9,000 square feet of warehouse and office space in Hong Kong, at a monthly rental of approximately $9,000 through Koszegi Asia Ltd., our wholly owned subsidiary, under a lease that expires in May 2007. We use this space as our quality control inspection facilities for products purchased from our China suppliers.

Forward Innovations, our Swiss subsidiary, leases approximately 2,000 square feet of office space in Cham, Switzerland, at a monthly rental of approximately $2,000. This lease is on a month-to-month basis and can be cancelled by us with a six-months' notice. Our landlord cannot cancel the lease prior to October 2008. We use this facility as our EMEA sales and administrative office.

We believe that each of the foregoing leased properties is adequate for the purposes for which it is used. All leases are with independent third parties. We believe that the loss of any lease would not have a material adverse effect on our operations as we believe that we could identify and lease comparable facilities upon approximately equivalent terms.

ITEM 3 - LEGAL PROCEEDINGS

From time to time, the Company may become a party to legal actions or proceedings in the ordinary course of its business. Except as described below, as of September 30, 2006, 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.

On October 3, 2006, the Company was served with a summons and purported class action complaint that had been filed July 31, 2006 in a matter captioned Lynn Finkelstein & Company, Inc., on behalf of certain of its clients as attorney-in-fact and all others similarly situated, Plaintiff, vs. Forward Industries, Inc. and each of the named executive officers in Item 10 of this Annual Report, in their individual capacities, Defendants, brought in the United States District Court for the Southern District of Florida. The complaint alleges that the Company during a purported class period July 25, 2005 to February 2, 2006 made certain misrepresentations of fact, or failed to disclose certain material facts, and violated certain generally accepted accounting principles in the presentation of its financial statements included in its periodic reports filed with the Commission pursuant to the Exchange Act.

The Company, as well as each of the individual defendants, believes that the complaint is wholly without merit and intends to vigorously contest this lawsuit. The Company has directors and officers' liability insurance, including entity coverage. The Company believes that in the course of defending the complaint it will incur legal and other expenses which may exceed the retention amount of $250,000 in its directors and officers liability insurance policy and that incurring expenses not covered by this policy may adversely affect its reported results of operations in future periods. While the Company believes that the complaint is without merit and the plaintiff has yet to assert an amount of damages claimed, the outcome of this lawsuit cannot be predicted and the Company's ultimate liability if this lawsuit is adversely determined cannot currently be ascertained and could be material.

ITEM 4 - SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matter was submitted to a vote of our security holders in the fourth quarter of our fiscal year ended September 30, 2006. We anticipate that the annual meeting of shareholders in respect of the fiscal year ended September 30, 2006, will be held in May 2007.

PART II

ITEM 5 - MARKET FOR COMMON STOCK, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market for common stock. The principal market for our common stock is the NASDAQ SmallCap Market. Our common stock is traded under the symbol "FORD". The following table sets forth the high and low closing bid quotations for our common stock on the NASDAQ SmallCap Market for each quarter in the last two fiscal years.

Bid Price Information for Common Stock*

	Fiscal 2006		Fiscal 2005	
	High Bid	Low Bid	High Bid	Low Bid
First Quarter	$ 26.35	$ 8.90	$ 4.57	$ 2.02
Second Quarter	$ 11.83	$ 8.05	$13.45	$ 3.42
Third Quarter	$ 11.45	$ 4.00	$23.37	$10.27
Fourth Quarter	$ 7.27	$ 4.01	$29.81	$15.91

*High and low bid price information as furnished by The NASDAQ Stock Market Inc.

On November 10, 2006, the closing bid quotation for our common stock was $5.05.

See "Item 6. Management's Discussion and Analysis-Risk Factors-*If our common stock were to be de-listed from the NASDAQ SmallCap Market, the existing market prices for and liquidity of our common stock may decline*."

Holders of common stock. As of November 1, 2006, there were approximately 120 holders of record of our common stock, excluding approximately 9,500 beneficial holders whose shares are held in street name.

Dividends. We have not paid any cash dividends on our common stock since 1987 and do not plan to pay cash dividends in the foreseeable future. The payment of dividends in the future, if any, will depend upon our results of operations, as well as our short-term and long-term cash availability, working capital, working capital needs, and other factors, as determined by our Board of Directors. Currently, except as may be provided by applicable laws, there are no contractual or other restrictions on our ability to pay dividends if we were to decide to declare and pay them.

Recent sales of unregistered securities. During Fiscal 2006, we did not issue and sell any shares of common stock, or securities exercisable for or exchangeable into common stock, or any other securities that were not registered under the Securities Act of 1933.

Securities authorized for issuance under equity compensation plans. For information relating to this topic, see Item 11 of this Annual Report.

Purchase of Equity Securities

During the fourth quarter of Fiscal 2006, neither the Company nor any "affiliated purchaser" (within the meaning of Rule 10b-18(a)(3) under the Exchange Act) on the Company's behalf made any purchase of any of our common stock, the only equity security of the Company. In September 2002, the Company announced a corporate stock buyback program and authorized the repurchase of up to 400,000 shares of our common stock. The program was amended in January 2004 to increase the amount of shares authorized for repurchase to 486,200 shares. No repurchases of common stock were made in the open market under the program or otherwise during Fiscal 2006. We repurchased 36,400 shares of our common stock in the open market during the first three quarters of Fiscal 2004 and since the inception of the program we have purchased a total of 102,600 shares at an aggregate cost of approximately $171,000.

ITEM 6 - MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis should be read in conjunction with our Financial Statements and the notes thereto appearing elsewhere in this Annual Report as Item 7. This Annual Report on Form 10-KSB contains statements that constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. We caution you that forward-looking statements are not guarantees of future performance, developments or events; such statements identify important risks and uncertainties; and actual results, developments and events may differ materially from those in the forward-looking statements as a result of various factors, including those set forth under the caption "Risk Factors." We disclaim any responsibility to update the forward looking statements contained herein. Please refer to "Forward Looking Statements" on page 3 of this Annual Report.

Critical Accounting Policies and Estimates

Management's discussion and analysis of our financial condition and results of operations are based upon our audited consolidated financial statements, or the "Financial Statements", included in Item 7 of this Annual Report, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires that we make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, and expenses and the related disclosure of contingent assets and liabilities. At each balance sheet date, management evaluates its estimates, including, but not limited to, those related to accounts receivable, inventories, and income taxes. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances at the time the estimates are made. Actual results may differ from these estimates under different assumptions or conditions. The estimates and critical accounting policies that are most important in fully understanding and evaluating our financial condition and results of operations are discussed below.

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: Specifically, we analyze 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 September 30, 2006, our allowance for doubtful accounts was approximately $47,000 compared to $51,000 at September 30, 2005. Increases to this account are reflected in the general and administrative expense line of our statement of income and amounted to approximately $8,000 in Fiscal 2006. Decreases to this account are the result of bad debt write-offs against the allowance and not the result of a change in accounting estimate. 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 required allowance.

Inventory Valuation

We use certain 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 do, however, 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 agreements. At the end of each fiscal quarter, we evaluate our ending inventories for obsolescence, excess quantities, and otherwise unsaleable product. This evaluation includes among other factors analyses of inventory levels, historical loss trends, sales history, and projections of future sales demand. We establish an allowance for inventory that is considered obsolete, slow moving or otherwise un-saleable and

physically dispose of inventory once its marketability has been determined to be zero. Inventory allowances were approximately $0.2 million and $0.1 million at September 30, 2006 and September 30, 2005, respectively. The cost of obsolete inventory is included in cost of goods sold on our statement of income and was approximately $0.3 million and $0.1 million in Fiscal 2006 and Fiscal 2005, respectively.

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, 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 operate. 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 $83,000 and $0.2 million of deferred tax assets at September 30, 2006, and September 30, 2005, 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 expense (benefit) line of our consolidated statements of income. See Note 5 to the Financial Statements in Item 7 of this Annual Report.

Variability of Revenues and Results of Operations

Because the predominant percentage of our sales revenues is highly concentrated in a few large customers, and because typically the timing and volumes of these customers' order flow to us are highly variable, with short lead times, our quarterly revenues, and consequently our results of operations, are highly variable and subject to significant changes over a relatively short period of time.

We depend for the predominant proportion of our sales revenues on OEM orders from our four largest customers (or their contract manufacturers), 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 for "in box" and promotional programs. When we are selected to supply a carry solution for a specific product and launch, we may not know or be able to predict the frequency or volumes of our customers' orders, or the duration of such orders (which will depend on the product's life cycle, or acceptance in the market, as well as the determination to sell the product with accessories "in box"), 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. As the customer's product life and the related "in box" program mature, we may be forced to accept significant price reductions for our carry solutions, which will affect the level of our revenue. Short product life cycles 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.

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Demand for our products depends on demand for our OEM customers' products as well as our customers' decisions to continue to bundle our "in-box" carry solution with their products. In Fiscal 2005, our results of operations were driven to higher than historical levels by the success of three "in box" programs containing our carry solutions. During Fiscal 2006, two of these three "in-box" programs substantially terminated. But, in the most striking development, while the OEM customer for the third and largest program continued marketing the cell phone with our carrying case solutions "in box" in Fiscal 2006, the declines in the volumes of orders and the prices we received for our products in this one program alone accounted for approximately $19 million of the revenue decline of $21 million that we experienced in Fiscal 2006 compared to Fiscal 2005, and the predominant percentage of the related decline in net income. The introduction of new cell phone models for which our products have been selected as an accessory "in-box", have not resulted in a comparable level of demand for our products compared with the three programs in Fiscal 2005, and the level of our OEM cell phone product sales and margins has declined significantly and rapidly from levels achieved in Fiscal 2005. It is generally difficult to assess the sustainability of the success of any in box program, and thus of any trend in revenues and results of operations, more than one quarter forward.

The fluctuation of our quarterly revenue levels between Fiscal 2005 and 2006 reflects this susceptibility to a high degree of variability. 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.

RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with our Audited Consolidated Financial Statements and the notes thereto and other financial information appearing elsewhere in this Annual Report on Form 10-KSB for the fiscal year ended September 30, 2006. The following discussion and analysis compares our consolidated results of operations for the fiscal year ended September 30, 2006 ("Fiscal 2006"), with those for the fiscal year ended September 30, 2005 ("Fiscal 2005"), and our consolidated results of operations for Fiscal 2005 with those for the fiscal year ended September 30, 2004 ("Fiscal 2004"), and is based on or derived from such Audited Consolidated Financial Statements, or "financial statements", included elsewhere in this Annual Report. 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. There have been no material changes in critical accounting estimates since September 30, 2005.

Trends in Results of Operations

- *We anticipate that aggregate "in box" business will continue in the first fiscal quarter of 2007 at somewhat below the levels of quarterly revenues experienced in Fiscal 2006.* New and continuing "in-box" programs appear to have stabilized at that level and are not expected to perform to the exceptional level of the major programs that drove our results of operations in Fiscal 2005, one of which continues to contribute to current net sales. We continue to experience pressure from our OEM customers to reduce prices for carry solutions in our cell phone and diabetic case markets and shifts in product mix to lower priced items. These trends continue to exert downward pressure on our revenues.

- *Gross profit percentage deteriorated significantly in Fiscal 2006 to 25.6% compared to 35.8% in Fiscal 2005 and is difficult to predict for Fiscal 2007.* The erosion in gross profit percentage in Fiscal 2006 was and continues to be attributable to pricing pressures from our largest OEM cell phone and diabetic case customers with respect to certain programs in combination with lower unit volumes and revenues. Although we have been successful in certain cases in reducing our costs of materials/supply in an attempt to mitigate the reduction in prices we receive from our OEM customers, this has not been true across all product sales. In addition, we remain vulnerable to rapid shifts in our product mix, which may further impact our gross profit. Finally, our Hong Kong costs (quality assurance and sourcing expenses incurred in Hong Kong and China), which constitutes part of cost of goods sold on our income statement, tend to be relatively fixed and, on a lower revenue base, will act as a drag on gross profit percentage, as was the case in Fiscal 2006.
- *Our inventory increased during Fiscal 2006 primarily as a result of supporting our hub agreements recently entered into with two of our largest OEM customers. Our inventory may remain at this higher level in future periods.* 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.
- *Our General and Administrative Expenses may increase in future quarters as a result of pending litigation.* We may incur substantial expenses for legal fees in these periods in order to defend a purported class action litigation that was served on us on October 3, 2006. We maintain directors and officers liability insurance, including entity coverage. We believe that in the course of defending the complaint we will incur legal and other expenses up to the retention amount of $250,000, above which it is our expectation that it is the insurance carrier's responsibility to assume under such policy.
- *Product manufacture is increasingly being outsourced by our OEM customers to contract manufacturing firms in China and in Southeast Asia*. Such firms are performing manufacturing, assembly and product packaging functions, including the bundling of product accessories such as ours with the OEM customer's product. As a consequence of this trend, we are increasingly selling our carry solution products to the contract manufacturing firm. In these cases, we invoice the contract manufacturing firm and not the OEM customer. Therefore, it is the contract manufacturing firm's credit to which we must look for payment in such cases and not that of our OEM "customer". A second result of this trend toward origination of orders from contract manufacturers is that APAC has in recent periods accounted for, and may continue to account for, an increasing percentage of our sales revenues, as seen in the tables below. In addition, we believe that the increasing reliance on contract manufacturers by our OEM customers is an effort to reduce their costs of supply that may also be increasing pressure generally to compress margins in respect of accessory products packaged "in-box" with various consumer electronics.

Results of Operations for Fiscal 2006 Compared to Fiscal 2005

Net Income

Net income in Fiscal 2006 was $1.5 million compared to net income of $9.4 million in Fiscal 2005, a decrease of $7.9 million or 84%. The decrease was due to significantly lower gross profit in Fiscal 2006, as a result of the decrease in OEM cell phone carrying case revenue and sharply reduced margins on such reduced revenue. Other income increased $0.6 million in Fiscal 2006, which offset, in small part, the decline in operating income. Basic and diluted earnings per share were $0.20 and $0.19, respectively, for Fiscal 2006, compared to basic and diluted earnings per share of $1.37 and $1.26 respectively, for Fiscal 2005.

Net Sales

Net sales decreased $21.3 million or 41% to $30.6 million in Fiscal 2006 compared to $51.9 million in Fiscal 2005. As described in greater detail under "Cell Phone Product Sales" below, the decrease in net sales was due to lower sales volumes of cell phone carrying case solutions products, which decreased $21.0 million or 57%, and, to a much lesser extent, lower sales of carrying cases for blood glucose monitoring kits for diabetics, which decreased $0.4 million or 3%. The tables below set forth approximate sales by product line and geographic locations of our customers for the periods indicated.

Net Sales for Fiscal 2006
(millions of dollars)

	APAC	**Americas**	**EMEA**	Total
Cell Phone Products	$6.7	$3.7	$5.2	$15.6
Diabetic Products	5.7	4.1	1.6	11.4
Other Product Sales	0.9	2.6	0.1	3.6
Total*	**$13.3**	**$10.4**	**$6.9**	**$ 30.6**

Net Sales for Fiscal 2005
(millions of dollars)

	APAC	**Americas**	**EMEA**	Total
Cell Phone Products	$12.7	$5.0	$18.9	$ 36.6
Diabetic Products	5.7	3.7	2.4	11.8
Other Product Sales	0.5	3.0	--	3.5
Total*	**$18.9**	**$11.7**	**$21.3**	**$ 51.9**

* Tables may not total due to rounding.

Cell Phone Product Sales:

Our cell phone carry solutions products include carrying cases for handsets and camera attachments, plastic belt clips, carrying case straps and bags, screen cleaners, decorative faceplates, and other attachments used to carry or enhance the appearance of cellular telephone handsets.

We design to the order of and sell these products directly to cell phone handset original equipment manufacturers including Motorola. Our cases are packaged as an accessory "in-box" with the handsets that are sold by our OEM customers. In addition, under our license agreements with Motorola and SAGEM, we distribute our products as separately packaged accessories directly to third party wholesalers and retailers in the EMEA Region and, under the Motorola license, the APAC Region. Cell phone product sales consisted of OEM "in-box" sales to Motorola and Nokia and sales under our license agreements.

Total sales of cell phone products decreased $21.0 million or 57%, to $15.6 million in Fiscal 2006 from $36.6 million in Fiscal 2005. OEM cell phone product sales decreased $22.5 million or 65% in Fiscal 2006 from $34.8 million in Fiscal 2005. Sales to Motorola (excluding sales under license) declined $17.7 million to $11.3 million in Fiscal 2006 from $29.0 million in Fiscal 2005. Nokia revenues declined $4.7 million to $1.0 million in Fiscal 2006 from $5.7 million in Fiscal 2005. In general, the decline in OEM cell phone sales was the result of reduced volumes in demand from Motorola and Nokia for products included "in-box" for three major programs that drove sales to exceptional levels during Fiscal 2005 (two of which substantially terminated in Fiscal 2006), sharply reduced margins on such reduced volumes as a result of pricing pressure experienced from these OEM customers, and the absence of robust, new "in box" business from these customers to compensate for the impact of the declines in such three programs.

With respect to the largest of those programs, consisting of cases and cleaning cloths sold "in box" with a popular Motorola cell phone (the V3 Razr) and which alone accounted for 47% of all net sales in Fiscal 2005, sales from this program declined $19.3 million, or 79%, to $5.0 million in Fiscal 2006 from $24.3 million in Fiscal 2005.

To a much lesser extent, our OEM cell phone revenue was adversely affected by adoption of a sourcing, billing, and payment arrangement in China in place during Fiscal 2006 for one OEM customer's products in which, due to the terms of the arrangement and accounting principles generally accepted in the United States we were required to recognize revenue only to the extent of the related gross profit on sales to this customer. This arrangement was in place during latter part of Fiscal 2005. Had we not implemented this arrangement, our OEM cell phone revenues would have been approximately $1.1 million higher in Fiscal 2006.

Sales to third parties under our license agreement with Motorola totaled $3.2 million in Fiscal 2006 compared to $1.5 million in the Fiscal 2005, an increase of $1.7 million, or 113%, which we believe is inversely related to the sales of carry accessories included "in-box" by our OEM customers.

Diabetic Product Sales:

We design to the order of and sell directly to OEMs carrying cases used by diabetics to carry their personal electronic, blood glucose monitoring kits. OEM customers for these carrying cases include Abbott Labs, Bayer, Lifescan (a subsidiary of Johnson & Johnson) and Roche Diagnostics. Our carrying cases are packaged as an accessory "in-box" with the monitoring kits that are sold by our OEM customers.

Sales of cases for blood glucose monitoring kits decreased $0.4 million or 3%, to $11.4 million in Fiscal 2006 from $11.8 million in Fiscal 2005. The decrease was due primarily to $0.5 million in lower sales to Roche, a 78% decrease from Fiscal 2005, and decreases in sales to Lifescan, our largest OEM customer for these cases, and Bayer, of $0.2 million and $0.3 million, or 3% and 13%, respectively. These decreases more than offset a $0.8 million increase in sales to Abbot and other customers. OEM sales of carrying cases for blood glucose monitoring kits represented 37% of our net sales in Fiscal 2006 compared to 23% of net sales in Fiscal 2005, the result of the decline in cell phone product sales revenues in Fiscal 2006.

Other Product Sales:

We design and sell a number of other carrying solutions for items such as cameras, portable oxygen tanks, bar code scanners, MP3 players, and other carrying solutions for a wide assortment of products on a made-to-order basis that are customized to meet the individual needs of our smaller OEM customers. By the nature of our distribution in this market composed of many niche products, sales of these customized products to order in their product category vary from period to period without necessarily reflecting a significant trend in overall demand for these items. Sales of other products increased $0.1 million or 3% to $3.6 million in Fiscal 2006 from $3.5 million in Fiscal 2005.

Gross Profit

Gross profit decreased $10.8 million, or 58%, to $7.8 million in Fiscal 2006 from $18.6 million in Fiscal 2005 primarily as a result of lower sales revenues due to lower sales volumes and pricing pressures from OEM customers with respect to certain programs. In addition, we experienced a rapid shift in our product mix to lower margin items, which further adversely affected our gross profit. Gross profit as a percentage of net sales decreased to 25.6% in Fiscal 2006 from 35.8% in Fiscal 2005. Although we have been successful in certain cases in reducing our costs of materials/supply to mitigate pricing pressure, this was not true across all product sales. Additionally, the cost of operating our Hong Kong facility, which constitutes part of cost of goods sold on our income statement, was relatively fixed a lower revenue base, acted as a drag on our gross profit percentage. Finally, our shipping costs increased in Fiscal 2006 as a result of increased reliance on air freight to meet product shipping deadlines, and this further eroded our gross profit percentage.

Selling, General, and Administrative Expenses

Selling, general, and administrative expenses decreased $0.1 million, or 2%, to $6.1 million in Fiscal 2006 from $6.2 million in Fiscal 2005 due primarily to lower personnel expenses and professional fees, offset in part by higher expenses in other categories. Personnel expenses decreased $0.5 million, or 13%, to $3.5 million from $4.0 million primarily as a result of lower performance-based bonuses paid to executive officers and lower payroll taxes associated with the exercise of fewer stock options. Professional fees decreased $0.1 million to $0.3 million due primarily to lower legal fees. These decreases were offset in part by increases of $0.2 million in "other" general and administrative expense, which consists primarily of directors and officers liability insurance, general liability insurance, and directors fees, and royalty expenses, which increased $0.1 million, or 35%, to $0.5 million in Fiscal 2006 from Fiscal 2005 on higher sales of licensed products, as well as increases in other categories of expense. Changes in other selling, general, and administrative accounts were not material. See "Item 10. Executive Compensation".

Other Income

Other income increased $0.6 million or 300% to $0.8 million in Fiscal 2006 compared to $0.2 million in Fiscal 2005 as a result of increased interest income on higher cash balances. In Fiscal 2006 we incurred a small loss in foreign exchange transactions compared to a gain in Fiscal 2005, when we also recorded a gain on property disposal.

Pretax Income

Pretax income decreased $10.0 million or 80% to $2.5 million in Fiscal 2006 from $12.5 million in Fiscal 2005 as a result of the decrease in gross profit as described above, offset in small part by the increase in other income.

Income Taxes

Our effective income tax rate was 38% in Fiscal 2006 versus 25% in Fiscal 2005. Notwithstanding significantly reduced revenues and gross profit in Fiscal 2006 compared to Fiscal 2005, our effective tax rate increased in Fiscal 2006 because the relative contribution of revenues from the EMEA Region, which are taxed at a lower rate than United States revenues, was significantly lower in Fiscal 2006 compared to Fiscal 2005. This had a disproportionate impact on an overall smaller revenue base. Our effective tax rate does not approximate the United States statutory federal income tax rate primarily due to tax rate differentials in respect of United States state and foreign taxes, to which income recorded by Forward Innovations is subject. Provision for income taxes decreased $2.1 million in Fiscal 2006 to $1.0 million compared to $3.1 million in Fiscal 2005 due to lower taxable income. The provision in Fiscal 2006 consists primarily of estimated U.S. federal income taxes, and to a lesser extent, current state and foreign income taxes. See Note 5 to the Financial Statements.

We have in the past considered the earnings of our foreign subsidiaries indefinitely invested and, accordingly, have not recorded a provision for U.S. income taxes on their un-repatriated earnings. At September 30, 2006, those cumulative earnings were approximately $5 million. On October 22, 2004, the American Jobs Creation Act of 2004, or the "Act", became law. The Act creates a one-time tax incentive for United States corporations to repatriate accumulated income earned abroad by providing a tax deduction equal to 85% of the dividends received for certain foreign earnings that are repatriated. The Company has evaluated the effects of the repatriation provision and has elected not to avail itself of the Act's repatriation incentives.

Results of Operations for Fiscal 2005 compared to Fiscal 2004

Net Income

Net income in Fiscal 2005 was $9.4 million compared to net income of $1.9 million in Fiscal 2004, an increase of $7.5 million or 395%. The increase was due to higher gross profit, predominantly as a result of the increase in sales of cell phone carrying case products, offset in part by a significant increase in provision for income taxes. Basic and diluted earnings per share were $1.37 and $1.26, respectively, for Fiscal 2005, compared to basic and diluted earnings per share of $0.32 and $0.30 respectively, for Fiscal 2004.

Net Sales

Net sales increased $31.8 million or 158% to $51.9 million in Fiscal 2005 compared to $20.1 million in Fiscal 2004. The increase in net sales was due to higher sales of cell phone carrying case solutions products, which increased $27.3 million or 294%, and, to a much lesser extent, higher sales of carrying cases for blood glucose monitoring kits for diabetics, which increased $3.2 million or 37%, as well as higher sales of other products. The tables below set forth approximate sales by product line and geographic locations of our customers for the periods indicated.

Net Sales for Fiscal 2005
(millions of dollars)

	APAC	Americas	EMEA	Total
Cell Phone Products	$12.7	$5.0	$18.9	$ 36.6
Diabetic Products	5.7	3.7	2.4	11.8
Other Product Sales	0.5	3.0	--	3.5
Total*	**$18.9**	**$11.7**	**$21.3**	**$ 51.9**

Net Sales for Fiscal 2004
(millions of dollars)

	APAC	Americas	EMEA	Total
Cell Phone Products	$1.3	$2.7	$5.3	$ 9.3
Diabetic Products	1.5	3.3	3.7	8.6
Other Product Sales	0.2	2.0	0.1	2.3
Total*	**$3.0**	**$8.0**	**$9.1**	**$ 20.1**

* Tables may not total due to rounding.

Cell Phone Product Sales:

Total sales of cell phone products increased $27.3 million or 294%, to $36.6 million Fiscal 2005 from $9.3 million in Fiscal 2004. Cell phone product sales include OEM "in-box" sales to Motorola and Nokia, as well as sales under our license agreements. OEM cell phone product sales were unusually strong in Fiscal 2005, with the full year revenues reflecting a trend of sharp, sequential quarterly revenue increases established in the first quarter of Fiscal 2005 and continuing throughout all four quarters. OEM cell phone product sales for Fiscal 2005 totaled $34.8 million compared to $6.9 million in Fiscal 2004, an increase of $27.9 million or 404%.

The trend of revenue increases to higher than historical levels in each quarter of Fiscal 2005 has been driven by three "in-box" programs for cellular handsets: the Motorola "Razr"® and "Triplets" handsets, and the Nokia "Troubadix" (7650) handset, which contributed approximately 47%, 4%, and 9%, respectively, of net sales to Fiscal 2005 results. Combined, these three "in-box" programs accounted for $31.1 million or 85%, of our cell phone product net sales and 60% of our net sales in Fiscal 2005.

Sales to third parties under our license agreements totaled $1.5 million in Fiscal 2005 compared to $2.1 million in Fiscal 2004, a decrease of $0.6 million or 29%, which we believe, in part, is a function of the strong take-up of new OEM handset models in the broad market generally (including carry accessories "in-box" from numerous vendors), which tends to undercut demand for carry solutions sold through distributors and retailers in the ar market.

Diabetic Product Sales:

Sales of cases for blood glucose monitoring kits increased $3.2 million or 37%, to $11.8 million in Fiscal 2005 from $8.6 million in Fiscal 2004. The increase was due primarily to higher sales to Lifescan, our largest OEM customer for these cases, and Bayer, sales to whom increased $3.0 million and $0.8 million, or 100% and 44%, respectively. These increases more than offset a $0.5 million decline in sales to other customers. OEM sales of carrying cases for blood glucose monitoring kits represented 23% of our net sales in Fiscal 2005 compared to 43% net sales in Fiscal 2004, the result of the increase in cell phone product sales revenues in Fiscal 2005.

Other Product Sales:

Sales of other products increased $1.2 million or 52% to $3.5 million in Fiscal 2005 from $2.3 million in Fiscal 2004.

Gross Profit

Gross profit increased $11.8 million, or 174%, to $18.6 million in Fiscal 2005 from $6.8 million in Fiscal 2004 primarily as a result of higher sales volumes and, to a lesser extent, higher gross profit percentage. Gross profit as a percentage of net sales increased to 35.8% in Fiscal 2005 from 33.8% in Fiscal 2004 due to lower freight, duties, and customs costs and Hong Kong inspection costs as percentages of net sales, which more than offset higher materials costs, which increased 4.4% as a percentage of sales. Our freight costs depend in large part on the distance between our shipping points and our customers' facilities and on our sales terms to them. In recent periods, an increasing percentage of our shipments have been routed within or to China directly from our Chinese suppliers' facilities or from our Hong Kong distribution facility as certain of our customers have relocated manufacturing facilities to China or have outsourced their manufacturing to manufacturing firms with facilities in China, where "in box" packaging of products with associated accessories is performed. This has had the effect of reducing freight, duties, and customs costs as a percentage of sales. Despite the significant increase in sales in Fiscal 2005, freight, duties, and customs costs increased only 17.5% in Fiscal 2005 from Fiscal 2004 and represented 1.9% and 4.3% of net sales, respectively. We include the cost of operating our Hong Kong procurement and quality assurance facility as a component of our cost of goods sold. The costs of operating the Hong Kong facility were $2.3 million and $1.4 million or 4.5% and 7.2 % of net sales, for Fiscal 2005 and Fiscal 2004, respectively. Other components of cost of goods sold also contributed to the improvement in margins.

Selling, General, and Administrative Expenses

Selling, general, and administrative expenses increased $1.1 million, or 22%, to $6.2 million in Fiscal 2005 from $5.1 million in Fiscal 2004 due primarily to higher personnel expenses and professional fees. Personnel expenses increased $0.8 million, or 25%, to $4.0 million from $3.2 million primarily as a result of higher performance-based bonuses paid to executive officers, additional payroll taxes associated with the exercise of stock options, and increased benefit costs. Professional fees increased $0.2 million to $0.4 million due primarily to higher legal fees and accounting fees associated with the company's regulatory and tax filings. Changes in other selling, general, and administrative accounts were not material.

Pretax Income

Pretax income increased $10.8 million or 635% to $12.5 million in Fiscal 2005 from $1.7 million in Fiscal 2004 as a result of the increase in gross profit as described above, offset in small part by the increase in operating expense.

Income Taxes

Our effective income tax rate was 25% in Fiscal 2005 versus a tax benefit in Fiscal 2004. The rate does not approximate the statutory federal income tax rate primarily due to tax rate differentials in respect of United States state and foreign taxes, to which income recorded by Forward Innovations and Koszegi Asia is subject. Provision for income taxes increased $3.3 million in Fiscal 2005 to $3.1 million of expense compared to a tax benefit of $0.2 million in Fiscal 2004. The provision in Fiscal 2005 consists primarily of estimated U.S. federal income taxes, and to a lesser extent, current state and foreign income taxes. The benefit recorded in Fiscal 2004 resulted from removing a valuation allowance we previously established with respect to our deferred tax assets.

Liquidity and Capital Resources

During Fiscal 2006, we generated $3.2 million of cash from operations compared to $7.1 million of cash generated in Fiscal 2005. Our operating cash flows in Fiscal 2006 consisted of net income of $1.5 million, adjusted for non-cash items by $0.5 million, including $0.1 million of deferred income taxes, a $0.1 million provision for depreciation, and a $0.3 million provision for obsolete inventory. These cash flows were supplemented by net changes in working capital items of $1.2 million, consisting primarily of decreases in accounts receivable, accounts payable and accrued expenses of $6.6 million, $3.0 million, and $0.7 million, respectively, and increases in inventory of $1.6 million and prepaid and other current assets of $0.1 million, respectively. The lower level of accounts receivable and accounts payable in Fiscal 2006 is a result of the lower sales and production levels in Fiscal 2006. The decrease in accrued expenses is primarily a result of lower accrued performance-based bonuses and salaries. The higher level of inventory in Fiscal 2006 is in support of our OEM customers' distribution hubs pursuant to the customers' stated objectives and requirements.

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Operating cash flows in Fiscal 2005 resulted primarily from net income of $9.4 million, adjusted for non-cash items including deferred taxes of $0.5 million, depreciation expense of $0.1 million, a provision for obsolete inventory of $0.1 million, plus changes in our working capital accounts. The accounts receivable balance and accounts payable balance increased $9.1 million and $3.3 million, respectively, in Fiscal 2005, which were attributable to the higher level of sales in Fiscal 2005. The increased level of accrued expenses of $3.2 million in Fiscal 2005 was primarily the result of higher payroll and income taxes payable, plus accrued personnel expenses, including performance-based bonuses and salaries, offset in part by a tax benefit from the exercise of stock options.

Net investing activities generated $26,000 in Fiscal 2006, consisting of $75,000 of cash from the sale of marketable equity securities arising from the liquidation of and distribution of assets from a pension fund, offset, in part, by $49,000 for purchases of property, plant and equipment, primarily computer and telecommunications hardware and software. In Fiscal 2005, net investing activities used $0.1 million primarily for purchases of property, plant and equipment.

Net financing activities generated $88,000 and $3.8 million in cash during Fiscal 2006 and Fiscal 2005, respectively, primarily from the issuance of common stock upon the exercise of stock options to purchase approximately 27,900 and 1.6 million shares, respectively, of common stock under our 1996 Stock Incentive Plan.

At September 30, 2006, our current ratio (current assets divided by current liabilities) was 9.7; our quick ratio (current assets less inventories divided by current liabilities) was 8.9; and our working capital (current assets less current liabilities) was $24.7 million. As of such date, we had no short- or long-term debt balances outstanding.

Our primary sources of liquidity are cash on hand, our operating cash flow, and our bank credit facilities. The primary demands on our working capital are: our accounts payable arising in the ordinary course of business, the most significant of which arise when our customers place orders and we order from our suppliers; and our commitments under our license agreement with Motorola. Historically, our sources of liquidity have been adequate to satisfy working capital requirements arising in the ordinary course of business. We anticipate that our liquidity and financial resources for the ensuing fiscal year will be adequate to manage our financial requirements.

In March 2006, Forward and Koszegi 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. The line expires in March 2007 and is renewable annually, at the discretion of the bank, subject to our submission of satisfactory financial information and other documentation. Forward and Koszegi are required to eliminate borrowings for thirty consecutive days during the term of the facility and are required to maintain 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 Industries. At September 30, 2006, there were no outstanding borrowings or letter of credit obligations under this facility. See Note 3 to the audited consolidated Financial Statements set forth in Item 7.

In February 2003, 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, 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 loan outstanding under the facility. Amounts borrowed other than as a term loan must be settled quarterly or converted into term loans. In connection with this facility, Forward Innovations has agreed to certain financial covenants. Amounts drawn under this credit facility bear interest at variable rates established by the bank (5.5% as of September 30, 2006). At September 30, 2006 Forward Innovations is contingently liable to the bank under a letter of credit issued on its behalf in the amount of €224,000 (approximately $284,000 as of September 30, 2006) 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. See Note 3 to the audited consolidated Financial Statements set forth in Item 7.

On September 27, 2002, our Board of Directors authorized the repurchase of up to 400,000 shares of our outstanding common stock, or approximately 7% of the number of shares then outstanding. On January 21, 2004, our Board increased the amount of shares authorized for repurchase to 486,200. Under that authorization, as of September 30, 2006, we had repurchased an aggregate of 102,600 shares at a cost of approximately $0.2 million, but none during Fiscal 2006,

Contractual Obligations and Commercial Commitments

The Company has entered into various contractual obligations and commercial commitments that, under accounting principles generally accepted in the United States, are not recorded as a liability on our balance sheet. The following is a summary of such contractual cash obligations as of September 30, 2006.

Effective October 1, 2004, we entered into a new license agreement with Motorola for the use of certain trademarks of Motorola in connection with the sale and distribution of cell phone carry solutions products to be sold throughout the EMEA Region. Under the terms of the license agreement, we are required to pay Motorola a royalty based upon a percentage of our net sales to third parties of licensed products within the EMEA Region. The license requires us to make minimum guaranteed royalty payments to Motorola over the following three contract periods:

- Contract Period 1: October 1, 2004 to December 31, 2005
- Contract Period 2: January 1, 2006 to December 31, 2006
- Contract Period 3: January 1, 2007 to December 31, 2007

The minimum royalty payment to Motorola for Contract Period 1 was $375,000, or $300,000 annualized. Prior to the end of Contract Period 1 and Contract Period 2, the Company and Motorola have agreed that, at such times, they will establish new minimum royalty amounts for Contract Period 2 and Contract Period 3, respectively. If the Company is unable to reach agreement at such time with Motorola on the minimum royalty payment for Contract Period 2 or Contract Period 3, as the case may be, then the parties have agreed that the minimum royalty payment for the ensuing relevant period may not be less than seventy-five per cent (75%) of the annualized royalties payable in respect of actual sales for the prior contract period, provided, however, that in no event shall 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 the prior period's annualized minimum royalty. Pursuant to this formula, and in the absence of any agreement to the contrary, the minimum royalty amount for Contract Period 2 was fixed at $225,000, and is expected to be fixed in the amount of $281,000 for Contract Period 3.

If we elect to terminate the license before December 31, 2007, we would be required to pay the balance, if any, of the minimum royalty for the contract period in effect at the date of cancellation. Motorola has not guaranteed us a minimum amount of revenues we will receive from the sale of the licensed products, and there can be no assurance that we will generate sufficient revenues from the sale of licensed products to recoup the minimum royalty payments that we are obligated to pay to Motorola. In Fiscal 2006, we recognized approximately $3.2 million in sales of licensed products to third parties pursuant to the license.

The foregoing discussion does not reflect the July 2005 amendment to the license agreement that extends the licensed territory to include the APAC Region. Sales and minimum royalties payable in respect of the APAC Region, which are calculated separate and apart from the royalties in respect of EMEA Region sales, are not expected to be material in the fiscal year ending September 30, 2007. In addition, we are required to pay Motorola minimum royalty payments of $75,000 for the contract period of January 1, 2007 to December 31, 2007 related to the APAC Region.

Effective October 1, 2005, we 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 the agreements, each of which expires on December 31, 2007, except Mr. Sabra's agreement expires December 31, 2008.   Each 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. These agreements provide for minimum salary levels, incentive bonuses that become payable if specified management goals are attained, and other benefits. Under certain conditions, as defined in the agreements, any or all of such executives may terminate their respective agreements and receive a lump sum payment equivalent to six months of their base salary plus the ratable portion of any bonus to which the Executive would have been entitled in the year of termination. The aggregate commitments for future payments under these agreements excluding bonuses and other benefits, is reflected in the table below. See "Item 10. Executive Compensation - Employment Agreements."

Contractual Obligation or Commitment	**October 2006 - September 2007**	**October 2007- September2009**	**October 2009 - September 2011**	**Thereafter**
Employment Agreements*	$ 835,000	$ 347,000	$ 0	$ 0
Operating Leases	216,000	290,000	315,000	112,000
License Agreements**	336,000	89,000	0	0
Totals	$ 1,387,000	$ 726,000	$ 315,000	$ 112,000

* Reflects commitments for future payments to Mr. Ball under his employment agreement until the expiration of the term thereof on December 31, 2007. The Company had announced in July 2006 that Mr. Ball intended to resign as Chief Executive Officer effective December 31, 2006. As reported in a Current Report on Form 8-K filed on November 16, 2006, Mr. Ball has determined to serve out his term of office under his employment agreement, which decision the Board of Directors has unanimously accepted.

**The amounts shown as license agreement obligations represent the minimum amounts the Company will incur as a royalty expense under the terms of its Motorola license agreement.

Off-balance sheet arrangements

The Company has not guaranteed the debt of any unconsolidated entity and does not engage in derivative transactions or maintain any off-balance sheet special purpose entities.

Risk Factors

Please read the note regarding "Forward Looking Statements" that appears on page 3 of this Annual Report.

We experienced severe erosion in our OEM product sales margins during Fiscal 2006, and it is not clear when these margins will begin to improve

During Fiscal 2006, we experienced significant pricing pressure from our OEM customers in both cell phone product sales and blood glucose monitor carrying case sales. We have been unable to extract comparable pricing concessions from our product suppliers across all product lines, which has resulted in the erosion of product sales margins. In addition, our OEM cell phone customers have weighted their purchasing toward lower price, lower margin items. We anticipate that pressures on our pricing power and shift in our product mix to lower price items will continue to exert downward pressure on gross profit percentage in the fiscal year ending September 30, 2007. Certain other components of cost of goods sold, such as our Hong Kong inspection costs, are relatively fixed in nature, and on a reduced sales volumes, this also contributes to reduced gross profit percentage. We cannot predict when, if at all, our overall product sales margins will begin to improve.

Our business is characterized by a high degree of customer concentration. Two significant customers accounted for 56% of net sales in Fiscal 2006, and three customers accounted for 79% of net sales in Fiscal 2005; the loss of, or material reduction in orders from, any of these customers would materially and adversely affect our results of operations and financial condition

The predominant percentage of our sales revenues is concentrated in two large OEM customers. In Fiscal 2006, direct sales to Motorola, together with its international affiliates, accounted for approximately 37% of our net sales, or approximately $11.5 million (which amount excludes approximately 11% of our net sales, or $3.2 million, of products under our license agreement with Motorola). Lifescan, a Johnson and Johnson subsidiary, accounted for approximately 19% of our net sales, or approximately $5.8 million. The loss of any of these two key customers or any of two other OEM customers who accounted for 9%, and 7% of net sales in fiscal 2006 (whether as a result of such customers purchasing their carry solution requirements from another vendor, deciding to manufacture their own carrying cases or eliminating the inclusion of our carrying cases with their products) would have a material adverse effect on our financial condition, liquidity and results of operations.

At any time, a significant percentage of our accounts receivable risk may be concentrated in a small number of customers

Two customers accounted for approximately 75% of our accounts receivable at September 30, 2006. The failure to receive or collect such amounts when, and as, due could have a material adverse effect on our financial condition, liquidity, and results of operations.

Future revenues are difficult to predict and are likely to show significant variability as a consequence of customer concentration

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, and can fluctuate markedly in a short period of time, our quarterly revenues, and consequently our results of operations, are highly variable and subject to significant changes over a relatively short period of time.

Each of these customers launches many different products and may purchase products accessories, such as carrying cases, from many different competing vendors. When we are selected to supply a carry solution for a specific product and launch, we may not be in a position to know the frequency or volumes of our customers' orders, the duration of such orders (which will depend on the product's life cycle), or the pricing of such orders, 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, new product introductions, and our customers' competitors' product offerings. As the customer's product life and the related "in box" program mature, we may be forced to accept significant price reductions for our carry solutions, which will affect the level of our revenue. Short product life cycles 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.

All of this makes our quarterly revenue levels susceptible to a high degree of variability and difficult to predict more than a quarter into the future. Significant, rapid shifts in our operating results may occur if and when one or more of these customers increase or decrease the size(s) of, or eliminate, their orders from us by amounts that are material to our business. These factors make the fluctuations in revenues and net income experienced between Fiscal 2005 and Fiscal 2006 representative of the volatility we can experience in our results of operations, leading to large and rapid changes in levels of revenue.

Our gross margins, and therefore our profitability, vary considerably by customer and therefore across our product lines, and if the relative revenue contribution from one or more OEM customers changes materially, relative to total revenues, our gross profit percentage may decline

Our gross profit margins vary widely depending on the customer, order size, market in which the customer's products are sold and the types of carrying cases sold. In addition, there is a broad range of selling prices within our soft-sided carrying cases product line, and there is also a broad range of selling prices between, for example, soft-sided carrying cases and other carry solutions such as straps, clips, and camera attachment cases. Because of the broad variability in price ranges and product types, we anticipate that gross margins, and accordingly net income, will continue to fluctuate depending on the relative revenue contribution by customer of carrying cases for cellular handsets and those for blood glucose monitors, as well as our OEM customers' order patterns and preferences for more or less expensive cases to be included as accessories "in box". Such fluctuations may have the effect of masking the impact of fluctuations in unit volume sale trends.

The purported class action lawsuit filed against the Company is likely to result in the incurrence of substantial legal fees, and the ultimate liability of the action is not predictable but may be material

We may incur substantial expenses for legal fees in future periods in order to defend a purported class action litigation that has been filed against us. On October 3, 2006, the Company was served with a summons and purported class action complaint, as described above under Item 3. of this Annual Report, "Legal Proceedings." We maintain directors and officers' liability insurance, including entity coverage. We believe that in the course of defending the complaint we will incur legal and other expenses up to the retention amount of $250,000, above which it is our expectation that it is the insurance carrier's responsibility to assume under such policy and that incurring expenses not covered by this policy may adversely affect our reported results of operations in future periods. While we believe that the complaint is without merit and will vigorously contest this action, and the plaintiff has yet to assert a specific amount in its claim for damages, the outcome of this lawsuit cannot be predicted and the Company's ultimate liability if this lawsuit is adversely determined cannot currently be ascertained and could be material.

Product manufacture is increasingly being outsourced by our OEM customers to contract manufacturing firms in China and in Southeast Asia.

Such firms are performing manufacturing, assembly and product packaging functions, including the bundling of product accessories such as ours with the OEM customer's product. As a consequence of this trend, we are increasingly selling our carry solution products to the contract manufacturing firm. In these cases, we invoice the contract manufacturing firm and not the OEM customer. Therefore, it is the contract manufacturing firm's credit to which we must look for payment in such cases and not that of our OEM "customer". This may alter the credit profile of our customer base and may involve significant purchase order volumes. In some, but not all cases, the manufacturing firm is itself a large, multinational entity with significant financial resources.

Under our license agreement with Motorola we may become liable for certain indemnification or other liabilities and become exposed to certain risks.

Each manufacturer selected by us to manufacture products for sale pursuant to our license agreement with Motorola is subject to Motorola's approval, and we are responsible for ensuring such manufacturer's compliance with the terms of the Manufacturer's Agreement (as defined in the License Agreement), in particular the proper use of the Motorola trademarks and compliance with applicable laws in the jurisdiction where the manufacturer is located. Failure of the manufacturer to comply with its obligations under such manufacturing agreement could result in termination of the license agreement, Motorola's demand that we enforce the terms of the Manufacturing Agreement against the manufacturer, at our cost and expense, or a claim for damages by Motorola against us, or a combination of the foregoing.

The License Agreement expires on December 31, 2007, but both parties have certain rights of termination customary for such agreements prior to such date, including, for example, in the case of violation of the agreement, insolvency or bankruptcy of one party, or breach of representations or covenants. We are required to pay a penalty of an amount equal to up to one year's minimum guaranteed royalty if we terminate the License Agreement under certain conditions as specified in the agreement. In addition, Motorola and we have agreed to certain cross-indemnification provisions, which, as applicable to us, obligate us to indemnify Motorola in respect of all third party suits, actions, claims, damages and liabilities and expense against, or incurred by, Motorola arising out of or connected with the licensed products, their method of manufacture, sale or distribution, the promotional or packaging of the products, or any breach by us of the License Agreement. The occurrence of any of the foregoing events, claims, obligations, or demands could subject us to make payment or incur expense, which could be material and adversely affect our results of operations and financial condition.

Our inventory levels increased during Fiscal 2006 and may remain at historically high levels in future periods, primarily as a result of the support of hub agreements recently entered into with several large OEM customers.

In Fiscal 2006 we entered into hub agreements with two of our principal OEM customers. These arrangements require us to supply product to their distribution hubs based on our OEM customer's forecasts. We have no means of determining the accuracy of such forecasts. Additionally, due to visibility constraints associated with such forecasts, combined with the long lead-times for some of our products covered under these hub agreements, we may, from time to time, be required to stock inventory at levels exceeding those forecasted by our customers. Whether this will result in a one-time lag between inventory stocking of the hubs and a re-adjustment of timing of product procurement from our suppliers remains to be seen, and inventory levels, liquidity, and results of operations may be adversely affected.

Payment by or on behalf of our customers of accounts receivable originated in China or other Asian nations may be subject to local regulations or moratorium that restrict the right to convert foreign currencies into U.S. dollars, that prevent, delay, or restrict the ability to repatriate foreign exchange to the United States or other countries, or that impose costs or intermediaries in order to effect foreign exchange and its repatriation to the United States

Our payment and remittance arrangements with certain customers may subject these arrangements to Chinese or other local currency regulations. We may be required to invoice in local currency and take payment in local currency or in U.S. dollars, in some cases through intermediaries that possess foreign exchange licenses. In the event that any foreign government were to impose regulatory restrictions on the ability to effect conversion of local currency into U.S. dollars, repatriation of U.S. dollars or other currencies to the United States, or payment in any form to foreign business entities, or were to impose or enforce tighter restrictions on foreign exchange license holders, or that impose fees, expenses, or other payments on such accounts receivable or foreign exchange holders, our receipt or recognition of U.S. dollars in payment, directly or indirectly, of invoices for sales of our products could be delayed or otherwise affected, including, for example, by a reduction in effective exchange rate to our detriment, imposition of fees or expenses, a discounting of the amount of the account receivable, or a deferral of such accounts receivable into a future reporting period. If this were to affect receipt or recognition of material amounts of revenues, our liquidity or results of operations could be materially and adversely affected.

Our results of operations are subject to the risks of fluctuations in the values of foreign currencies relative to the U.S. Dollar

Our results of operations are expressed in U.S. Dollars. When the U.S. Dollar appreciates or depreciates in value against a currency, such as the Euro, in which customer accounts receivable to us may be denominated, our results will be adversely affected or benefited, respectively. The opposite relationship would apply to purchases or other accounts payable denominated in a foreign currency. If, for example, China were to permit the renminbi to float to a free market rate of exchange, it is widely anticipated that the U.S. Dollar would depreciate in value relative to the renminbi, which could materially increase our costs of goods sold (in U.S. dollar terms) and our results of operations if we cannot pass those costs along to our customers or if we cannot enter into financial arrangements that hedge or otherwise mitigate this risk. When the U.S. Dollar appreciates or depreciates in value against a currency, such as the Euro, in which a significant part of our revenues is denominated, our results of operations can be adversely affected or benefited, respectively. For example, the significant appreciation of the Euro against the U.S. Dollar since the beginning of 2003 has had the effect of increasing, in U.S. dollar denominated sales on our statement of income in proportion to Euro-denominated sales revenues. A reversal of this trend could adversely affect our results of operations.

Our dependence on foreign manufacturers creates product cost, pricing, availability, quality control, and delivery risks

All of our products are manufactured by Chinese manufacturers in China. We do not have any written agreements with any such supplier to guarantee supply to us of finished product, nor do we have any arrangements for minimum purchase requirements with any such supplier. Our supply arrangements with these manufacturers are subject to various commercial, economic, foreign exchange, political, and other risks and uncertainties. Among other risks, our supply arrangements with these manufacturers are subject to the risks of cost increases; restrictions on transfer of funds; export duties, quotas, and embargoes; domestic and international customs and tariffs; foreign exchange risk; changing taxation policies; foreign exchange restrictions; and political instability, domestic political considerations, and governmental regulations. Our reliance on foreign suppliers, manufacturers, and other contractors involves significant risks, including reduced control over delivery schedules, quality assurance, manufacturing yields, and costs, the potential lack of adequate capacity, and potential misappropriation of our designs.

In the course of transition of responsibility for quality assurance inspection of products from our Koszegi Asia facility to a third-party logistics company, certain problems in quality control consistency and standards have from time to time surfaced during Fiscal 2006. We are working to improve the quality and frequency of the oversight by Koszegi Asia employees of the quality control activities of this logistics company in order to bring quality assurance operations to our standards on a consistent basis, but there can be no assurance that our efforts will be effective in order to improve to a consistently high standard the work of this logistics firm. Failures on the part thereof, or on the part of Koszegi Asia to improve the standards of this work, may adversely affect customer relationships and could result in the loss of a key customer, which would have an adverse effect on our results of operations and our business reputation.

Our shipments of products via container freight to customers in the United States and Europe are subject to delays or cancellation due to work stoppages or slowdowns, damage to port facilities caused by weather or terrorism, and congestion due to inadequacy of port terminal equipment and other causes.

Since all of our carrying solutions products are sourced from China, the carrying cases and other products we distribute and sell must be brought to our customers' markets. To the extent that there are disruptions or delays in loading cargo in Hong Kong or Chinese ports or off-loading cargo at ports of destination as a result of labor disputes, work-rules related slowdowns, tariff or World Trade Organization-related disputes, physical damage to port terminal facilities or equipment caused by severe weather or terrorist incidents, congestion in port terminal facilities, inadequate equipment to load, dock and offload container vessels or energy-related tie-ups or otherwise, or for other reasons, product shipments to our customers will be delayed. In any such case, our customer may cancel or change the terms of its purchase order, resulting in a cancellation or delay of payments to us. A closure or partial closure of Hong Kong, Chinese, United States or European port facilities or other causes of delays in the loading, importation, offloading or movement of our products could result in increased expenses, as we try to avoid such delays, delayed shipments or cancelled orders, or all of the above. Depending on the severity of such consequences, this may have an adverse effect on our financial condition and results of operations.

The carrying solutions business is highly competitive and does not pose significant barriers to entry

There is intense competition in the sale of carry solutions products to original equipment manufacturers. Since little or no significant proprietary technology is involved in the design, production, or distribution of products similar to our products, others may enter the business with relative ease and compete against us. Such competition may result in the diminution of our market share, the loss of one or more major OEM customers, and adversely affect our net sales, results of operations, and financial condition. Many of our competitors are larger, better capitalized, and more diversified than we are and may be better able to withstand a downturn in the general economy or in the product areas in which we specialize. These competitors may also have less sales concentration than we do and be better able to withstand the loss of a key customer or diminution of a large customer's orders.

Our business could suffer if the services of any of the key personnel we rely on were lost to us

We are highly dependent on the efforts and services of Jerome E. Ball, Chairman and Chief Executive Officer, and Michael Schiffman, President and Chief Operating Officer, as well as certain key sales representatives. We have entered into employment agreements with each of Jerome E. Ball and Michael Schiffman, respectively, that expire December 31, 2007, and which are renewable for successive one-year terms, subject to certain conditions. Our business could be materially and adversely affected if we lost the services of either of these individuals. We do not maintain key person life insurance as to these individuals. If we lost the services of a key sales representative upon whom our relationships with a major OEM customer is in part dependent, we might experience a reduction in orders from such customer, resulting in a loss of revenues, which could adversely affect our results of operations and financial condition.

We do not pay dividends on our common stock

We have not paid any cash dividends on our common stock since 1987. The payment in the future of cash dividends by us, if any, will depend upon our results of operations, short-term and long-term cash availability, working capital, working capital needs, and other factors, as determined by our Board of Directors. Applicable laws may also restrict the ability of a corporation to pay dividends, for example when such payment would render the corporation insolvent. We do not anticipate that cash dividends will be paid in the foreseeable future. The absence of dividend payments on a common stock might make such stock susceptible to greater market price swings.

Because of the control by insiders of a significant percentage of our common stock, your ability to influence actions taken by us may be limited

As of November 10, 2006, our executive officers and members of our Board of Directors, directly or indirectly, beneficially owned 820,627 shares of common stock, including 245,000 shares of common stock subject to currently exercisable stock options, aggregating approximately 10% of our issued and outstanding common stock on such date. By virtue of their ownership of such common stock and their positions as executive officers, such executive officers and directors or their affiliates may, collectively, be deemed to control Forward Industries through the exercise of sufficient voting power to effectively control (or, at least, exercise a significant influence upon) the election of our Board, direct the appointment of our officers and, in general, significantly influence the outcome of any corporate transaction or other matter submitted to our shareholders for approval, including mergers, consolidations and the sale of all or substantially all of our assets, and to prevent or cause a change in the control of Forward.

We have in place anti takeover measures that may prevent a hostile or unwanted effort to acquire Forward

Our Board of Directors is authorized to issue up to 4,000,000 shares of "blank check" preferred stock. Our Board of Directors has the authority, without shareholder approval, to issue such preferred stock in one or more series and to fix the relative rights and preferences thereof including their redemption, dividend and conversion rights. Our ability to issue the authorized but unissued shares of preferred stock could be used to impede takeovers of our company. Under certain circumstance, the issuance of the preferred stock would make it more difficult for a third party to gain control of Forward, discourage bids for the common stock at a premium, or otherwise adversely affect the market price of our common stock. Such provisions may discourage attempts to acquire Forward. Applicable laws that impose restrictions on, or regulate the manner of, a takeover attempt may also have the effect of deterring any such transaction. We are not aware of any attempt to acquire Forward.

Under our license agreement with Motorola we are obligated to pay substantial minimum royalties but are not guaranteed minimum sales

Under the terms of our license agreement with Motorola, we have committed to pay Motorola minimum royalties for the sale of Motorola trademarked products. Motorola has not guaranteed to us a minimum amount of sales or revenues from the sale of those trademarked products. There can be no assurance that we will generate sufficient revenues to recoup the minimum royalty payments that we are obligated to pay to Motorola. The failure to do so could have a material adverse affect on our results of operations.

If our common stock were to be de-listed from the NASDAQ SmallCap Market, the existing market prices for and liquidity of our common stock may decline

The National Association of Securities Dealers' listing requirements require, among other things, that all issuers of securities listed on the NASDAQ SmallCap Market maintain a continued minimum bid price per share of such securities of $1.00. In October 2002, NASDAQ advised us that our common stock did not meet the requirements for continued listing on the NASDAQ SmallCap Market under the NASDAQ Marketplace Rules and that our common stock would be delisted for failing to maintain a minimum bid price of $1.00 in accordance with Marketplace Rule 4310(c)(4). After a hearing in December 2002 requested by us to review NASDAQ's determination, NASDAQ reversed its delisting determination, and we maintained our NASDAQ listing without interruption. As of November 16, 2006, we believe that the Company complies with the NASDAQ Marketplace Rules in all material respects.

ITEM 7 - FINANCIAL STATEMENTS

Our financial statements and notes thereto can be found beginning at page F-1, following Part III of this Annual Report on Form 10-KSB.

ITEM 8 - CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

As previously reported on Form 8-K filed with the Commission on December 22, 2004, on December 20, 2004, Forward dismissed Ernst & Young LLP ("E&Y"), its independent registered public accounting firm. On December 22, 2004, the Company engaged Kaufman, Rossin & Co., P.A. ("Kaufman, Rossin") as its new independent registered public accounting firm for the fiscal year ending September 30, 2005. Reference is made to the disclosures in such filing on Form 8-K.

ITEM 8 A-CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Our management is responsible for establishing and maintaining a system of disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) that is designed to ensure that information required to be disclosed by the Company in the reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported, within the time periods specified in the Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management, including its principal executive officer or officers and principal financial officer or officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

In accordance with Exchange Act Rule 13a-15(b), our management, with the participation of our Chief Executive Officer and Chief Financial Officer, performed an evaluation of the effectiveness of the Company's disclosure controls and procedures as of the end of the period covered by this Annual Report (our fourth fiscal quarter). Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective, as of the end of the period covered by this Annual Report, to provide reasonable assurance that information required to be disclosed in the Company's reports filed or submitted under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the Commission's rules and forms.

Internal Control Over Financial Reporting

Our management, with the participation our Chief Executive Officer and Chief Financial Officer, performed an evaluation required by Rule 13a-15(d) as to whether any change in our internal controls over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the fiscal fourth quarter of Fiscal 2006. Based on that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that no change occurred in the Company's internal controls over financial reporting during the last fiscal quarter (the fourth quarter of the fiscal year ended September 30, 2006) that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

ITEM 8B. OTHER INFORMATION

During the fourth quarter of the fiscal year ended September 30, 2006, there was no information required to be disclosed in a Current Report on Form 8-K that was not reported.

PART III

ITEM 9 - DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS; COMPLIANCE WITH SECTION 16(a) OF THE EXCHANGE ACT

Directors and Executive Officers

Our directors and executive officers are as follows:

Name	Age	Position with the Company	Held Office Since
Jerome E. Ball	71	Chief Executive Officer and Chairman of the Board	1998
Michael Schiffman	41	President, Chief Operating Officer and Director	1998
Norman Ricken	70	Director and Chairman of the Audit and Compensation Committees, and a member of the Nominating Committee	2000
Bruce Galloway	49	Director and member of the Audit, Compensation, and Nominating Committees	2002
Edwin A. Levy	69	Director and member of the Audit and Compensation Committees and Chairman of the Nominating Committee	2003
Louis Lipschitz	61	Director and member of the Audit, Compensation, and Nominating Committees	2005
Douglas W. Sabra	47	Director, Vice President and Chief Financial Officer	2000
Steven A. Malsin	59	Secretary	2005

Each of our directors was elected for a one-year term at our most recent annual meeting, held on April 27, 2006, in respect of the fiscal year ended September 30, 2005. All directors are expected to stand for election at our Annual Meeting of Shareholders in May 2007.

JEROME E. BALL became Chief Executive Officer and Vice Chairman of the Board effective October 1998 and became Chairman of the Board in April 1999. Before joining Forward, from 1996 until October 1998 Mr. Ball served as Chairman and Chief Executive Officer of George Arzt Communications, a full service public relations firm. Prior to that time, Mr. Ball had been president of Balson-Hercules Group, a textile manufacturing company, which was sold to a Canadian Stock Exchange listed company, Consoltex Group, Inc., Ltd., where he served until 1996.

MICHAEL SCHIFFMAN has been employed by Forward in various capacities since 1985 and became a director in April 1992. Mr. Schiffman was employed as a salesman for our advertising specialties products in 1985. He became marketing manager for such products in 1987 and, following the acquisition of the custom carrying case business in 1989, was appointed General Manager of that division. From 1995 through June 1998, Mr. Schiffman was assigned to our Hong Kong operations. Executive Vice-President from 1992 to 1998, Mr. Schiffman was appointed our President and Chief Operating Officer in June 1998.

NORMAN RICKEN has been a director since March 2000. During the past five years Mr. Ricken has served as an independent consultant; between 1971 and his retirement in 1989, Mr. Ricken held senior positions at Toys R Us Inc., including Chief Financial Officer, President and Chief Operating Officer.

BRUCE GALLOWAY has been a director since April 2002. Mr. Galloway has been Chairman and Chief Executive of Galloway Capital Management, a private investment firm, since August 2005, and was a Managing Director of Burnham Securities from 1993 until August 2005; Non-executive Chairman and member of the Compensation Committee of Broadcaster Inc., a new media and software company, since August 2001; Chairman of Command Security Corporation, a security guard and aviation screening services provider, since August 2004; and was a Director of Datametrics, a manufacturer of ruggedized computer equipment, from August 2000 to October 2006 and was a director of GVI Security Solutions Inc., a video surveillance equipment provider, from February 2004 until June 2006.

EDWIN A. LEVY has been a director since April 2003. Mr. Levy is Chairman, founder, and principal of Levy, Harkins & Co., a New York City investment advisory firm; General Partner in Gracy Fund, a private investment partnership; Director of Traffix, a publicly held online database direct marketing company, since 1995; Director of Bear, Stearns Financial Products, a wholly owned subsidiary of the Bear, Stearns Companies, since 1997; and Director of World Point Terminals, a maritime port facilities provider of liquid bulk storage, since 1998, Director of Coastcast Corporation, a publicly held golf club head manufacturer from 1994 to 2004.

LOUIS LIPSCHITZ has been a director since June 2005. From February 1, 1996, to March 2004, Mr. Lipschitz served as Executive Vice President and Chief Financial Officer of Toys "R" Us, Inc. Mr. Lipschitz has served as a director of Majesco Entertainment, a publicly held software and digital content provider for electronic games, since April 2004 where he is the Audit Committee Chairman and member of the Compensation Committee. Since October 2005, he has been a director of New York & Company, Inc., a publicly held specialty clothing chain, where he is Chairman of the Audit Committee.

DOUGLAS W. SABRA has been a director since April 2006, and became Vice President and Chief Financial Officer of Forward in September 2000. Prior to joining Forward, Mr. Sabra was a Controller for Tyco Submarine Systems (now Tycom Ltd.), where he worked from 1998 to June 2000. Mr. Sabra retired from the Coast Guard in 1998 after 22 years of service where he held a variety of financial management positions. Mr. Sabra received an MBA from the University of South Florida and a Bachelors Degree in accounting from Florida International University. Mr. Sabra was appointed Assistant Secretary in January 2005.

STEVEN A. MALSIN was appointed Secretary of Forward in January 2005. He is, and has for more than the past five years, been engaged in private legal practice. He serves on the Board of Directors of two not-for-profit organizations.

Audit Committee

Our board of directors has established a separately designated, standing audit committee (as defined in and established in accordance with Section 3(a)(58)(A) of the Exchange Act) to oversee the accounting and financial reporting processes of the Company and the audits of our financial statements. The members of the audit committee are Messrs. Galloway, Levy, Lipschitz, and Ricken.

Audit Committee Financial Expert

Our board of directors has determined that Mr. Ricken, who is a member and the chairman of the Audit Committee of our Board of Directors, is an audit committee financial expert, as defined in Item 401 of Regulation SB. The Company considers Mr. Ricken to be independent of the Company, as the term "independent" is used in Item 7(d)(3)(iv) of Schedule 14A under the Exchange Act and under NASDAQ Marketplace Rules 4200(a)(15), 4350(c)(1), and 4350(d)(2).

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Exchange Act requires our directors and executive officers and persons who beneficially own more than ten percent of each class of our equity securities that is registered under the Exchange Act to file with the Commission Form 3 initial reports of ownership and Form 4 reports of changes in ownership of common stock and other equity securities of the Company. Officers, directors, and persons who beneficially own more than ten percent of a registered class of our equity securities are required by the regulations of the Commission to furnish the Company with copies of all Section 16(a) forms they file. To our knowledge, based solely on review of the copies of such reports and amendments thereto furnished to us and written representations that no other reports were required, during the fiscal year ended September 30, 2006, all Section 16(a) filing requirements applicable to our officers and directors and beneficial owners of more than ten percent of our common stock were complied with on a timely basis. See "Item 11. Security Ownership of Certain Beneficial Holders and Management and Related Shareholder Matters."

Code of Ethics

The Company has adopted a code of ethics within the meaning of Item 406 of Regulation S-B that applies to our officers (including our principal executive officer and our principal financial and accounting officer), employees and directors. A copy of our Code of Business Conduct and Ethics is posted and available for viewing on our web site, www.forwardindustries.com/corp-gov.htm and will be provided without charge to any person who requests a copy by sending a written request to:

Forward Industries Inc.
1801 Green Road, Suite E.
Pompano Beach, FL 33064
Att'n: CFO/Code of Ethics

We intend to satisfy the disclosure requirements under Item 5.05 of Form 8-K regarding an amendment to, or a waiver from, a provision of our code of ethics that applies to our principal executive officer, principal financial officer, principal accounting officer, or controller, or persons performing similar functions, and that relates to the designated elements of the Code of Ethics specified in Item 406(b) of Regulation S-B by positing such information in our web site, the address of which is set forth above.

ITEM 10 - EXECUTIVE COMPENSATION

The following table sets forth certain summary information regarding all cash and non-cash compensation earned by our chief executive officer and each of our executive officers who earned more than $100,000 during Fiscal 2006, Fiscal 2005 or Fiscal 2004. For further information concerning compensation arrangements with the executive officers named below, see "-Employment Agreements."

SUMMARY COMPENSATION TABLE

Annual Compensation

Name and Principal Position	Year	Salary	Bonus	Other Annual Comp. $	All Other Comp ($) (a)
Jerome E. Ball					
Chairman and	2006	$325,000	$ 0		$8,000
Chief Executive	2005	$230,000	$214,000		$7,200
Officer (b)	2004	$230,000	$139,800		$7,375
Michael Schiffman					
President and					