



**AIRBOSS OF AMERICA CORP.** SECOND QUARTER INTERIM REPORT 2006

**TRUST. COMMITMENT.  
PERFORMANCE.**

# AIRBOSS OF AMERICA CORP.

AirBoss of America Corp. is one of today's most respected and trusted global manufacturers of high performance proprietary rubber-based products. We develop, manufacture, and sell high quality proprietary rubber-based products offering enhanced performance and productivity to transportation, defense and industrial markets. With a capacity to supply over 250 million pounds of rubber annually to a diverse group of rubber manufacturers, AirBoss is one of North America's largest custom compounding companies.

<b>Business Segments</b>		<b>Q2 2006</b>	<b>Markets</b>
Rubber Compounding	Manufactures custom compounds from natural and synthetic rubber gum, binding agents, and chemicals. Uses state of the art equipment, technical staff, and strong customer focus to achieve consistent on-time service customers can depend on.	\$45 million	<ul style="list-style-type: none"><li>• 52% sales to US</li><li>• Conveyor belts, tires and retreading automotive parts</li></ul>
Military and Industrial Products	Manufacturer of protective wear for military and first response applications. Manufactures extruded, calendared, cushion gum, and compression moulded rubber products.	\$9 million	<ul style="list-style-type: none"><li>• 75% sales to US</li><li>• CBRN footwear, gloves and masks for defense and firefighter</li></ul>
Railway Products	One of two companies to design, market, and service a complete line of railway fastening products to major North American rail lines to support heavy haulage requirements.	\$6 million	<ul style="list-style-type: none"><li>• 100% sales to US</li><li>• Plastic pads and insulators, and metal rail fastening clips</li></ul>

## CONTENTS

Financial Highlights	1
Letter to Shareholders	2
Management's Discussion and Analysis of Financial Condition and Results of Operations	4
Consolidated Financial Statements	10
Notes to Consolidated Financial Statements	13

## SECOND QUARTER 2006 RESULTS

(unaudited, in thousands of Canadian dollars, except per share and share amounts)	Three months ended June 30		Six months ended June 30	
	2006	2005	2006	2005
Net sales	\$ 60,884	\$ 61,210	\$ 121,999	\$ 120,778
Gross margin	9,115	7,750	17,401	14,965
Earnings before interest, taxes & amortization (EBITDA) (Note 1)	5,746	4,678	10,462	8,681
Interest expense	796	754	1,626	1,581
Net income from continuing operations	3,402	1,696	5,230	3,014
Net income (loss) from discontinued operations	(280)	(99)	(331)	103
Net income	3,122	1,597	4,899	3,117
Net income per share, from continuing operations				
- Basic	\$ 0.14	\$ 0.07	\$ 0.22	\$ 0.13
- Diluted	0.14	0.07	0.22	0.13
Net income per share				
- Basic	\$ 0.13	\$ 0.07	\$ 0.21	\$ 0.14
- Diluted	0.13	0.07	0.21	0.13
Cash flow before changes in non-cash working capital	3,475	2,963	6,209	6,040
Common shares outstanding (millions):				
- Basic	23.7	22.8	23.3	22.7
- Diluted	24.2	24.0	23.8	23.9

### Note 1

The Company discloses EBITDA, a financial measurement used by interested parties. EBITDA does not have a standardized meaning prescribed by GAAP and is not necessarily comparable to similar measures presented by other issuers. EBITDA is not a measure of performance under GAAP and should not be considered in isolation or as a substitute for net income under GAAP.

(in thousands of Canadian dollars)	Three months ended June 30		Six months ended June 30	
	2006	2005	2006	2005
Income from continuing operations before income taxes	\$ 3,685	\$ 2,618	\$ 6,333	\$ 4,537
Interest expense	796	754	1,626	1,581
Amortization from continuing operations	1,265	1,306	2,503	2,563
EBITDA - continuing operations	\$ 5,746	\$ 4,678	\$ 10,462	\$ 8,681

## TO OUR SHAREHOLDERS

Sales for the six month period ended June 30, 2006 increased by 1% compared to the same period in 2005 while pre-tax income from continuing operations increased by \$1.8 million or 40% and net income from continuing operations increased by 73.5% to \$5.2 million. Net income per share from continuing operations for the six month period increased by 69% to \$0.22 per share.

### **AirBoss Rubber Compounding**

Sales volumes for the six month period ended June 30, 2006 increased by 7% while sales dollars increased by 18% over the same period a year ago. This reflects the continued inflationary pressure of rising raw material prices. Sales volumes were again led by strong demand for rubber compounds for products which service the energy generation and mining industries. AirBoss is the leading manufacturer of compounds for products servicing these sectors.

Margin increases experienced in the first quarter as a result of operational improvements continued. Reduced manufacturing cycle times, limiting of overtime costs and the reduction of start-up costs in Scotland Neck all contributed to obtaining an improvement in the return on capital employed. We are pleased with the progress that has been made in these areas and look for further improvements in the coming periods.

The increase in world prices of certain raw materials continues to be a short term concern. Natural rubber has increased by over 25% in the last few months and carbon black by in excess of 10%. Whether these trends will continue is difficult to predict as they are tied to many interrelated factors including exchange rates, oil prices and speculative pressures.

Rubber compound manufacturing capacity has also been affected in North America by a downturn in sales of domestically produced pneumatic tires. Most of the major tire producers have reduced the purchase of outside compounds and this has created some temporary excess capacity in North America.

### **AirBoss-Defense**

Sales of CBRN protective wear were lower than expected due to delays in receiving releases under existing military supply contracts. The uncertainty of various military budget allocations and other timing issues may negatively impact sales of CBRN gloves and gas masks over the next few quarters although the long range forecasts remain substantially the same. As a result we will delay the installation of injection molding equipment in North Carolina until the end of the year. CBRN overshoe orders have begun to be released and we anticipate ending the year with a greater order backlog than in 2005.

### **AirBoss-Railway Products**

This Division contributed slightly higher profits from operations for the six months ended June 30, 2006 compared to last year despite the lower exchange rate on the US dollar. Sales included shipments of track fastening clips for both US rapid transit and South American heavy haulage installations. We anticipate this strong performance to continue through the remainder of the year.

### **Outlook**

The strong second quarter performances of the Rubber Compounding and Railway Products Divisions and favourable income tax changes have the Company on target to achieve earnings goals for the year.

The softening demand for rubber compound, rising commodity prices, and uncertainty of the requirements for military protective wear are cause for a more conservative earnings outlook in the second half of the year.



**P.G. Schoch**  
Chairman



**Robert L. Hagerman**  
President and CEO

## **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following Management's Discussion and Analysis ("MD&A") of the financial position of AirBoss of America Corp. (the "Company") and results of operations for the three and six month periods ended June 30, 2006 prepared as of August 1, 2006 should be read in conjunction with the audited consolidated financial statements and notes thereto, as well as the MD&A and audited consolidated financial statements for the year ended December 31, 2005 contained in the 2005 Annual Report to Shareholders. All tabular dollar amounts are shown in thousands of Canadian dollars unless otherwise specified. Additional information relating to the Company, including the Company's Annual Information Form, can be obtained from SEDAR at [www.sedar.com](http://www.sedar.com) and at the Company's website at [www.airbossofamerica.com](http://www.airbossofamerica.com)

### **FORWARD-LOOKING STATEMENT**

Certain statements included herein, including those that express management's expectations or estimates of future developments or AirBoss's future performance, constitute "forward-looking statements" within the meaning of applicable securities laws. Words such as "may", "could", "expects", "anticipates", "forecasts", "plans", "intends" or similar expressions are intended to identify forward-looking statements.

Forward-looking statements are necessarily based upon a number of estimates and assumptions that, while considered reasonable by management at the time the statements are made, are inherently subject to significant business, economic and competitive uncertainties and contingencies. AirBoss cautions that such forward-looking statements involve known and unknown risks, uncertainties and other risks that may cause AirBoss's actual financial results, performance, or achievements to be materially different from its estimated future results, performance or achievements expressed or implied by those forward-looking statements. Numerous factors could cause actual results to differ materially from those in the forward-looking statements, including without limitation: changes in accounting policies and methods including uncertainties associated with critical accounting assumptions and estimates; AirBoss's ability to maintain existing customers or develop new customers in light of increased competition; cyclical trends in the tire and automotive, construction, mining, retail and rail transportation industries; sufficient availability of raw materials at economical costs; weather conditions affecting raw materials, production and sales; potential product liability and warranty claims; its dependence on key customers; equipment malfunction; changes in the value of the Canadian dollar relative to the US dollar; ability to obtain financing on acceptable terms; environmental damage caused by it and non-compliance with environmental laws and regulations; changes in tax laws, and potential litigation.

This list is not exhaustive of the factors that may affect any of AirBoss's forward-looking statements. Investors are cautioned not to put undue reliance on forward-looking statements. All subsequent written and oral forward-looking statements attributable to AirBoss or persons acting on its behalf are expressly qualified in their entirety by this notice. Whether as a result of new information, future events or otherwise, AirBoss disclaims any intent or obligation to update publicly these forward-looking statements. Risks and uncertainties about AirBoss's business are more fully discussed in the Management's Discussion and Analysis of Financial Condition and Results of Operations in the 2005 Annual Report to Shareholders under the heading "Risk Factors".

### **SIGNIFICANT EVENTS**

The Rubber Compounding US operation in Scotland Neck, North Carolina commenced commercial production in the first six months of 2006.

### **SUBSEQUENT EVENT**

Subsequent to quarter end, the Company received \$2.0 million of the funds held in escrow and took delivery of injection molding equipment in Scotland Neck worth \$0.4 million. As well, the Company had drawn the final amount against its US term loan.

### **OUTSTANDING COMMON SHARES**

The number of common shares outstanding at August 1, 2006 was 23,755,423.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND  
RESULTS OF OPERATIONS (CONT'D)

### CHANGES IN ACCOUNTING POLICIES

No new accounting policies were adopted in the first six months of 2006.

### Selected Financial Information

(\$ thousands, except per share amounts)	Three months ended June 30		Six months ended June 30	
	2006	2005	2006	2005
Net sales	\$ 60,884	\$ 61,210	\$ 121,999	\$ 120,778
Net income from continuing operations	3,402	1,696	5,230	3,014
Net income	3,122	1,597	4,899	3,117
Net income per share (continuing)				
- Basic	\$ 0.14	\$ 0.07	\$ 0.22	\$ 0.13
- Diluted	0.14	0.07	0.22	0.13
Cash flow before changes in non-cash working capital	3,475	2,963	6,209	6,040
Capital expenditures	1,718	1,354	3,191	3,547
(\$ thousands)		June 30, 2006		December 31, 2005
Total assets		\$ 138,427		\$ 124,679
Demand loan		17,079		11,763
Current portion of term loan and other debt		22,305		22,429

### RESULTS OF OPERATIONS

Three and six month periods ended June 30, 2006 compared to the same period in 2005.

### SALES FROM CONTINUING OPERATIONS

Sales revenue for the second quarter ended June 30, 2006 was \$60.9 million and \$122 million for the six month year-to-date period.

Three month periods ended June 30 (\$ thousands)	ENGINEERED PRODUCTS			
	RUBBER COMPOUNDING	AEP AND OTHER	RAILWAY PRODUCTS	TOTAL
Net sales <b>2006</b>	45,313	9,310	6,261	60,884
2005	38,464	15,273	7,473	61,210
Increase(decrease) \$	6,849	(5,963)	(1,212)	(326)
Increase(decrease) %	17.8%	-39.0%	-16.2%	-0.5%

Six month periods ended June 30 (\$ thousands)	ENGINEERED PRODUCTS			
	RUBBER COMPOUNDING	AEP AND OTHER	RAILWAY PRODUCTS	TOTAL
Net sales <b>2006</b>	92,564	18,387	11,048	121,999
2005	78,615	27,944	14,219	120,778
Increase(decrease) \$	13,949	(9,557)	(3,171)	1,221
Increase(decrease) %	17.7%	-34.2%	-22.3%	1.0%

### Rubber Compounding

Net sales revenue for the quarter ended June 30, 2006 increased by 17.8 % or \$6.8 million. The increased volume came mainly from existing customers who are manufacturers of off-road tires, belting and other products servicing the industrial and mining sectors. Compounds produced for the automotive part sectors accounted for 27% of the volume increase.

Net sales for the six months year-to-date increased by 17.7% consistent with the quarter.

### AirBoss Engineered Products & Other

Net sales decreased \$6.0 million or 39.0% for the quarter. Sales of CBRN Military protective wear decreased by \$3.3 million. This was primarily due to delays in receiving order releases on existing contracts from the US military. The first significant overshoe order was not received until mid-way through the second quarter and the first shipments were not made until after the second quarter end.

The majority of the remaining decline was due to reduced demand for calendared rubber products utilized in the manufacture of snowmobile tracks.

### Railway Products

Net sales for the quarter ended June 30, 2006 decreased \$1.2 million compared with the same period in 2005. The translation of US dollar sales at a lower exchange rate accounted for approximately one-half of the decline with the remainder being a reduction in sales of low margin cast tie plates for the domestic market.

## GROSS MARGINS

Gross margin for the three month period ended June 30, 2006 increased by \$1.4 million from \$7.7 million to \$9.1 million compared to 2005, representing a 17.6% increase.

Three month periods ended June 30 (\$ thousands)	RUBBER COMPOUNDING	ENGINEERED PRODUCTS		TOTAL
		AEP AND OTHER	RAILWAY PRODUCTS	
Gross Margin <b>2006</b>	<b>5,427</b>	<b>2,549</b>	<b>1,139</b>	<b>9,115</b>
2005	2,914	4,001	835	7,750
Increase(decrease) \$	2,513	(1,452)	304	1,365
% net of sales <b>2006</b>	<b>12.0</b>	<b>27.4</b>	<b>18.2</b>	<b>15.0</b>
2005	7.6	26.2	11.2	12.7

Six month periods ended June 30 (\$ thousands)	RUBBER COMPOUNDING	ENGINEERED PRODUCTS		TOTAL
		AEP AND OTHER	RAILWAY PRODUCTS	
Gross Margin <b>2006</b>	<b>10,758</b>	<b>4,697</b>	<b>1,946</b>	<b>17,401</b>
2005	6,140	6,897	1,928	14,965
Increase(decrease) \$	4,618	(2,200)	18	2,436
% net of sales <b>2006</b>	<b>11.6</b>	<b>25.5</b>	<b>17.6</b>	<b>14.3</b>
2005	7.8	24.7	13.6	12.4

### Rubber Compounding

Gross margin increased \$2.5 million due to higher volumes, more effective controls over production costs and the elimination of low and negative margin compounds. The 2005 comparatives include some significant losses at the temporary Waynesville NC mixing facility.

Material cost increases were, for the most part, successfully reflected in selling prices. Production inefficiencies were reduced as a result of several changes in production methodologies. This increased productivity permitted the reduction of overtime and downtime costs. Scrap and rework costs were also decreased.

The six month period-to-date results were affected by the same factors.

### AirBoss Engineered Products and Other

Lower sales in the military business decreased gross margin in this segment by \$1.5 million. Margins as a percentage of sales remained strong due to favourable sales mix in the Military products group.

### Railway Products

Gross margin percentages increased 7% from 11.2% to 18.2% due to a favourable change in product mix for the quarter and 4% year-to-date.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND  
RESULTS OF OPERATIONS (CONT'D)

## OPERATING EXPENSES

Operating expenses increased by \$0.3 million during the second quarter ended June 30, 2006 compared to the same quarter in 2005.

Three month periods ended June 30 (\$ thousands)	ENGINEERED PRODUCTS				TOTAL
	RUBBER COMPOUNDING	AEP AND OTHER	RAILWAY PRODUCTS	CORPORATE & INTERCOMPANY ELIMINATIONS	
Operating expenses <sup>(1)</sup> <b>2006</b>	<b>2,519</b>	<b>1,752</b>	<b>509</b>	<b>650</b>	<b>5,430</b>
2005	2,120	1,846	442	724	5,132
Increase(decrease) \$	399	(94)	67	(74)	298
% of net sales <b>2006</b>	<b>5.6</b>	<b>18.8</b>	<b>8.1</b>	-	<b>8.9</b>
2005	5.5	12.1	5.9	-	8.4

Six month periods ended June 30 (\$ thousands)	ENGINEERED PRODUCTS				TOTAL
	RUBBER COMPOUNDING	AEP AND OTHER	RAILWAY PRODUCTS	CORPORATE & INTERCOMPANY ELIMINATIONS	
Operating expenses <sup>(1)</sup> <b>2006</b>	<b>5,677</b>	<b>3,501</b>	<b>900</b>	<b>990</b>	<b>11,068</b>
2005	4,534	3,637	882	1,376	10,429
Increase(decrease) \$	1,143	(136)	18	(386)	639
% of net sales <b>2006</b>	<b>6.1</b>	<b>19.0</b>	<b>8.1</b>	-	<b>9.1</b>
2005	5.8	13.0	6.2	-	8.6

<sup>(1)</sup> Operating expenses include selling, general and administrative expenses, allocated interest expenses on demand loan and long-term debt, and other income and expenses.

### Rubber Compounding

Operating expenses increased by \$0.4 million for the quarter and by \$1.1 million for the six month period ended June 30, 2006. This represented a slight increase as a percentage of sales and is due mainly to Scotland Neck entering its commercial production phase.

### AirBoss Engineered Products and Other

Lower allocated interest costs and higher foreign exchange gains reduced operating costs by \$0.2 million and was partly offset by higher travel, promotional, professional fees and salary costs primarily in the military business.

### Railway Products

Operating expenses increased by \$0.02 million from higher sales and marketing costs.

### Corporate and other eliminations

Operating expenses decreased \$0.3 million for the six month period primarily as a result of the recapture of forfeited stock option benefits.

## INCOME TAX EXPENSE

The Company recorded an income tax expense for the quarter of \$0.3 million reflecting a 7.7% effective tax rate, compared to \$0.9 million or 35.2% in the second quarter of 2005. On a year-to-date basis, the income tax expense for 2006 was \$1.1 million or 17.4% of income from continuing operations, compared to \$1.5 million or 33.6% in 2005.

The primary factors contributing to a lower effective tax rate include:

- i) The Federal Government substantively enacted a 3.1% reduction in the Federal tax rate which triggered a \$0.7 million write-down of the future income tax liabilities; and
- ii) Filing differences related to \$0.2 million of research and development tax credits.

## NET INCOME (LOSS) FROM DISCONTINUED OPERATIONS

Net sales and net loss from discontinued operations were \$0.2 million and \$0.3 million in the second quarter of 2006 compared with \$0.8 million net sales and \$0.1 million net loss in 2005. The decrease in net sales was primarily from ceasing commercial footwear operations in February, 2005 and lower segmented tire sales. Year-to-date 2006, net sales and net loss from discontinued operations were 0.4 million and 0.3 million compared with \$2.4 million net sales and \$ 0.1 million net income in 2005.

## NET INCOME AND EARNINGS PER SHARE

Net income increased in the second quarter of 2006 by \$1.5 million or 95.6% to \$3.1 million income from \$1.6 million income in 2005 primarily from improvements in the compounding business. From continuing operations, basic earnings and diluted earnings per share were \$0.14 compared with \$0.07 in 2005. From net income, the basic and diluted earnings per share were \$0.13 compared to \$0.07 in 2005. The basic weighted average number of shares outstanding in the quarter increased by 653,654 to 23,674,077 (22,764,198 in 2005), as a result of employees exercising options at the end of the first and second quarters. The fully diluted weighted average number of shares outstanding was 24,167,686 during the second quarter of 2006 (23,981,464 in 2005).

## LIQUIDITY AND CAPITAL RESOURCES

### Cash flows from continuing operations

Operating cash flows before changes in non cash working capital balances increased by 0.5 million in the quarter compared to 2005 and by \$0.2 million for the year-to-date in 2006 compared with 2005.

### Non-cash working capital

The investment in non cash working capital relating to continuing operations was \$32.9 million at June 30, 2006 compared to \$43.7 million at the end of the second quarter of 2005.

The non-cash working capital decreased by \$3.5 million in the second quarter of 2006 due to:

- A decrease in accounts receivable of \$4.5 million reflecting lower military sales
- An increase in inventory of \$3.3 million reflecting higher commodity price levels and Scotland Neck entering commercial production
- An increase in prepaid insurance of \$0.2 million due to the timing of the premium payments
- An increase in accounts payable of \$2.2 million from higher raw material purchases
- A \$0.3 million increase in income taxes payable from higher income

### Cash from discontinued operations

Cash provided by discontinued operations was \$0.2 million more than in 2005 for the quarter and \$1.0 million less year-to-date since the majority of the assets were disposed of in 2005.

### Capital expenditures

Capital expenditures for the second quarter ended June 30, 2006 were \$1.7 million compared to \$1.4 million last year. Year-to-date 2006, capital expenditures were \$3.2 million compared to \$3.5 million in 2005. The significant additions in 2006 were as follows: \$1.7 million was spent on production equipment for the US expansion, \$0.2 million for leaseholds and computer equipment in Kitchener and \$0.7 million for production equipment and tooling in AEP.

### Other assets

Other assets increased by \$0.8 million from an employee share purchase loan, capitalized start up costs for Scotland Neck, product development in Railway and funds deposited in escrow.

### Financing

Historically, working capital requirements peak in the third quarter. The Company expects to fund its 2006 operating cash requirements, including required working capital investments, capital expenditures, and scheduled debt repayments from cash on hand, cash flow from operations, and anticipated borrowing capacity.

During the second quarter ended June 30, 2006 the net decrease in demand loan was \$6.3 million compared with a \$0.3 million increase for the same period in 2005. On a year-to-date basis, the increase in demand loan was \$5.3 million in 2006 compared with an increase of \$ 7.9 million in 2005.

Term loan advances in the quarter were \$1.4 million related to the production equipment for the US expansion and scheduled loan repayments of \$0.7 million were made.

Employees exercising stock options provided \$0.3 million of financing. No stock options were exercised between June 30, 2006 and August 1, 2006.

### Contractual obligations

The Company's contractual obligations as at December 31, 2005 are described on page 32 in the Company's Annual Report 2005. For the six month period ended June 30, 2006, AEP committed \$0.4 million to overhaul its mixing line over the balance of the year.

The term loan matures in October, 2006 and is treated as a current liability accordingly. The Company expects to renegotiate its term loan facility.

### Forward Exchange Contracts

At June 30, 2006, the Company has three forward foreign exchange contracts to reduce fluctuations in foreign exchange rates. There is a balance of US \$2.5 million commitment at an average exchange rate of 1.1513 to be delivered throughout the balance of 2006. A new forward contract was committed to purchase US \$0.9 million at an average rate of 1.1186 of which US \$0.6 million is outstanding. The Company designated a US \$5 million forward contract to protect against fluctuation in US dollar denominated inventory.

### Related party transactions

During the six-month period ended June 30, 2006, the Company paid \$45,000 (2005 - \$45,000) in rent to a company controlled by the Chairman of the Company and the Company paid monthly dues relating to a facility in South Carolina of approximately \$10,000 (2005 - \$18,000) to a company in which the Chairman is an officer.

The Company provided a \$0.1 million interest-free share purchase loan with full recourse to an employee and is included in the financial statements under the caption "other assets". The Company has a promissory note and a pledge agreement providing 30,000 AirBoss common shares with the market value of \$0.1 million as collateral. The promissory note matures at the early of June 15, 2009 or when the individual ceases to be an employee.

### QUARTERLY INFORMATION

The following is a summary of selected financial information from the Company's unaudited interim consolidated financial statements from each of the eight most recent quarters.

(\$ thousands except shares and per share amounts)

QUARTER ENDED	NET INCOME (LOSS)			NET INCOME (LOSS) PER SHARE - CONTINUING OPERATIONS		NET INCOME (LOSS) PER SHARE	
	NET SALES CONTINUING OPERATIONS	CONTINUING OPERATIONS	TOTAL	BASIC	DILUTED	BASIC	DILUTED
June 30, 2006	60,884	3,402	3,122	0.14	0.14	0.13	0.13
March 31, 2006	61,115	1,828	1,777	0.08	0.08	0.08	0.08
December 31, 2005	51,258	182	228	0.01	0.01	0.01	0.01
September 30, 2005	54,206	(1,644)	(1,744)	(0.07)	(0.07)	(0.08)	(0.07)
June 30, 2005	61,210	1,696	1,597	0.07	0.07	0.07	0.07
March 31, 2005	59,568	1,319	1,520	0.06	0.06	0.07	0.06
December 31, 2004	49,246	833	(759)	0.04	0.04	(0.03)	(0.03)
September 30, 2004	50,002	1,428	927	0.06	0.06	0.04	0.04

Items that impact the comparability of net income (loss) include:

- i) The third quarter of 2005 results included a \$4 million rail patent settlement.
- ii) The fourth quarter of 2004 reflected a \$1.5 million asset write-down in the discontinued tire operation.

### OUTLOOK

While the Company does not have a large exposure to pneumatic on road tires and automotive parts, these industries consume large amounts of rubber compound. Softening demand and declining production in both these sectors in the last few months has created a temporary excess capacity in rubber compounding in North America. The cost of raw materials also continues to be of concern. Significant increases in the cost of carbon black and natural rubber will occur in the third quarter. These two factors combined will make it difficult for the Rubber Compounding Division to both increase sales and pass along all of the raw material cost increases immediately.

Although sales of CBRN military protective wear was lower than expected, the US military expects to fulfil its commitments over the next five years. There is a higher degree of uncertainty for the next six months and we anticipate exiting 2006 with a significantly higher backlog of CBRN overshoe orders. We do not have the same order visibility on other CBRN products such as gloves and gas masks.

The Railway Products Division should continue its strong, steady performance of the first half of the year. The sale of domestic fastening clips should increase in the next three months.

Greater uncertainty relating to demand and commodity prices are cause for a more conservative earnings outlook in the second half of the year.

signed  
**Robert L. Hagerman**  
President and Chief Executive Officer

signed  
**Stephen W. Richards**  
Vice-President Finance and CFO

## CONSOLIDATED BALANCE SHEETS

(in thousands of Canadian dollars)	<b>June 30, 2006</b>	December 31, 2005
	(unaudited)	
<b>ASSETS</b>		
<b>Current assets:</b>		
Accounts receivable	\$ 27,134	\$ 21,479
Inventories	31,028	24,526
Prepaid expenses	1,028	441
Current assets of discontinued operations (note 2)	262	1,328
Total current assets	<b>59,452</b>	47,774
Capital assets	<b>53,896</b>	52,808
Assets held for sale	359	359
Long-term assets of discontinued operations (note 2)	-	105
Goodwill	16,620	16,620
Future income tax assets	1,825	1,173
Other assets	6,275	5,840
Total assets	<b>\$ 138,427</b>	\$ 124,679
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current liabilities:</b>		
Demand loan	\$ 17,079	\$ 11,763
Accounts payable and accrued liabilities	23,726	21,152
Income taxes payable	2,559	1,758
Current liabilities of discontinued operations (note 2)	231	129
Current portion of term loan and other debt (note 7)	22,305	22,429
Total current liabilities	<b>65,900</b>	57,231
Future income tax liabilities	8,948	9,851
Accrued post retirement benefit liability (note 5)	1,476	1,349
Total liabilities	<b>76,324</b>	68,431
<b>Shareholders' equity:</b>		
Share capital	40,395	39,056
Contributed surplus	1,055	1,309
Cumulative translation adjustment	(354)	(225)
Retained earnings	21,007	16,108
Total shareholders' equity	<b>62,103</b>	56,248
Total liabilities and shareholders' equity	<b>\$ 138,427</b>	\$ 124,679

Commitments and contingencies (Note 8)

See accompanying notes to consolidated financial statements.

On behalf of the Board



**Robert L. Hagerman**  
Director



**Robert L. McLeish**  
Director

## CONSOLIDATED STATEMENTS OF INCOME AND RETAINED EARNINGS

(unaudited, in thousands of Canadian dollars, except per share amounts)	Three months ended June 30		Six months ended June 30	
	2006	2005	2006	2005
<b>NET SALES</b>	<b>\$ 60,884</b>	\$ 61,210	<b>\$ 121,999</b>	\$ 120,778
Cost of sales	<b>51,769</b>	53,460	<b>104,598</b>	105,813
Gross margin	<b>9,115</b>	7,750	<b>17,401</b>	14,965
<b>OPERATING EXPENSES:</b>				
General and administrative	<b>2,670</b>	2,254	<b>5,239</b>	4,476
Selling, marketing and distribution	<b>1,798</b>	1,834	<b>3,784</b>	3,575
Product research	<b>414</b>	366	<b>729</b>	797
Total operating expenses	<b>4,882</b>	4,454	<b>9,752</b>	8,848
Income before interest expense and other income	<b>4,233</b>	3,296	<b>7,649</b>	6,117
Interest expense	<b>796</b>	754	<b>1,626</b>	1,581
Other income	<b>(248)</b>	(76)	<b>(310)</b>	-
Income from continuing operations, before income taxes	<b>3,685</b>	2,618	<b>6,333</b>	4,536
Provision for income taxes	<b>283</b>	922	<b>1,103</b>	1,522
Net income from continuing operations	<b>3,402</b>	1,696	<b>5,230</b>	3,014
Income (loss) from discontinued operations, net of tax (note 2)	<b>(280)</b>	(99)	<b>(331)</b>	103
Net Income	<b>3,122</b>	1,597	<b>4,899</b>	3,117
Retained earnings, beginning of period	<b>17,885</b>	16,027	<b>16,108</b>	14,507
Retained earnings, end of period	<b>\$ 21,007</b>	\$ 17,624	<b>\$ 21,007</b>	\$ 17,624
Net income per share				
From continuing operations				
- Basic	<b>\$ 0.14</b>	\$ 0.07	<b>\$ 0.22</b>	\$ 0.13
- Diluted	<b>\$ 0.14</b>	\$ 0.07	<b>\$ 0.22</b>	\$ 0.13
From net income				
- Basic	<b>\$ 0.13</b>	\$ 0.07	<b>\$ 0.21</b>	\$ 0.14
- Diluted	<b>\$ 0.13</b>	\$ 0.07	<b>\$ 0.21</b>	\$ 0.13

See accompanying notes to consolidated financial statements

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited, in thousands of Canadian dollars)	Three months ended June 30		Six months ended June 30	
	2006	2005	2006	2005
<b>CASH PROVIDED BY (USED IN):</b>				
<b>Operating Activities:</b>				
Net income from continuing operations	\$ 3,402	\$ 1,696	\$ 5,230	\$ 3,014
Items not affecting cash:				
Amortization	1,265	1,306	2,503	2,563
Loss on disposal of capital assets	-	(18)	-	(18)
Future income taxes	(1,105)	(195)	(1,555)	45
Foreign exchange loss	(220)	(3)	(21)	95
Options expense (income)	71	112	(75)	212
Post-retirement benefits expense	62	65	127	129
	<b>3,475</b>	<b>2,963</b>	<b>6,209</b>	<b>6,040</b>
Changes in non-cash operating working capital balances	<b>3,535</b>	(2,937)	<b>(9,453)</b>	(13,105)
Net cash provided by (used in) continuing operations	<b>7,010</b>	26	<b>(3,244)</b>	(7,065)
Net cash provided by discontinued operations	<b>384</b>	153	<b>881</b>	1,874
Cash provided by (used in) operating activities	<b>7,394</b>	179	<b>(2,363)</b>	(5,191)
<b>Investing Activities:</b>				
Purchase of capital assets	(1,718)	(1,354)	(3,191)	(3,547)
Net (increase) decrease in other assets	(289)	53	(798)	(851)
Disposal of other assets	-	1,240	-	1,240
Proceeds of disposal of capital assets	-	18	-	18
Cash used in investing activities	<b>(2,007)</b>	(43)	<b>(3,989)</b>	(3,140)
<b>Financing Activities:</b>				
Net increase (decrease) in demand loan	(6,306)	349	5,316	7,891
Net increase in term loan	1,365	13	1,382	1,593
Repayment of term debt	(750)	(750)	(1,500)	(1,500)
Settlement of other debt	(6)	-	(6)	-
Issuance of share capital	310	252	1,160	347
Cash provided from financing activities	<b>(5,387)</b>	(136)	<b>6,352</b>	8,331
Increase (decrease) in during the period	-	-	-	-
Cash and short-term deposits at the beginning of the period	-	-	-	-
Cash and short-term deposits at the end of the period	\$ -	\$ -	\$ -	\$ -
<b>Supplementary Cash Flow Information:</b>				
Cash interest paid	\$ 754	\$ 721	\$ 1,694	\$ 1,827
Cash income taxes remitted	1,838	316	2,150	395
Transfer of assets from discontinued operations	-	-	61	-

See accompanying notes to consolidated financial statements

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Three months ended June 30, 2006 and 2005

(unaudited, tabular amounts are in thousands of Canadian dollars, except share and per share data)

### NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Basis of Presentation

The unaudited interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles for financial statements, except that certain disclosures required for annual financial statements have not been included. Accordingly, these interim consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2005, except as noted below. The unaudited interim consolidated financial statements have been prepared on a basis that is consistent with the policies set out in the Company's consolidated annual financial statements for fiscal 2005.

#### Seasonality

The Company is not significantly affected by seasonal or cyclical business factors.

### NOTE 2 DISCONTINUED OPERATIONS

A summary statement of operations for the commercial footwear and tire manufacturing operations is as follows:

	Three months ended June 30		Six months ended June 30	
	2006	2005	2006	2005
Net sales	\$ 166	\$ 798	\$ 360	\$ 2,450
Income (loss) before tax	(437)	(158)	(521)	124
Net income (loss)	(280)	(99)	(331)	103
Amortization	41	72	44	72

Assets and liabilities held in discontinued operations:

	June 30, 2006	December 31, 2005
Current assets	\$ 262	\$ 1,328
Current liabilities	231	129
Capital assets	-	105

During the first quarter ended March 31, 2006, \$61,000 of production equipment was transferred to continuing operations. The remaining capital assets were written off during the second quarter.

### NOTE 3 STOCK OPTIONS

During the first quarter of 2006, 759,000 stock options were exercised at an exercise price of \$1.12. No stock options were granted during this period.

During the second quarter of 2006, 105,000 stock options were exercised at an exercise price of \$1.83 and 52,500 options at an exercise price of \$2.25. The Company issued 567,000 stock options. The fair value of options issued has been determined using the Black-Scholes option pricing model using the following assumptions:

	June 30, 2006
Risk-free rate	4.32%
Dividend yield	0%
Volatility factor of the expected market price of Company's shares	9.44%
Average expected option life (years)	5.0
Weighted average fair value per share of options granted during the period	1.047 to 1.109

The stock options issued in the six month period ended June 2006 vest as follows:

<b>June 30, 2006</b>	
May 9, 2007	<b>25,050</b>
May 9, 2008	<b>25,050</b>
May 9, 2009	<b>33,400</b>
May 9, 2010	<b>41,750</b>
May 9, 2011 & May 17, 2011	<b>441,750</b>
	<b>567,000</b>

For the three month period ended June 30, 2006, stock-based compensation expense was \$71,000. The six month period ended June 30, 2006 was a recovery of \$75,000 reflecting the forfeiture of certain options.

**NOTE 4 FOREIGN EXCHANGE RISK**

The Company operates in North America which gives rise to a risk that its income, cash-flows, and shareholders' equity may be adversely impacted by fluctuations in foreign exchange rates between the US and Canadian dollars. Amounts denominated in US currency represents 67% of total accounts receivable (2005 - 67%), 71% of accounts payable (2005 - 74%), 87% of bank indebtedness (2005 - 88%) and 28% of term loan (2005 - 7%).

**NOTE 5 FUTURE RETIREMENT BENEFITS**

During the three month periods ended June 30, 2006 and 2005, the Company's future retirement benefits expenses were \$62,000 and \$65,000 respectively. Year-to-date, the amounts were \$127,000 and \$129,000.

**NOTE 6 SEGMENTED INFORMATION**

	SALES EXCLUDING INTER-COMPANY				INTER-COMPANY
	CANADA	USA	OTHER	TOTAL	
<b>Three months ended June 30, 2006</b>					
Rubber Compounding Operations	21,852	23,363	98	45,313	272
AEP and Other	2,106	7,007	197	9,310	2,537
Railway Products	-	6,261	-	6,261	-
Total	23,958	36,631	295	60,884	2,809
	RUBBER COMPOUNDING	AEP AND OTHER	RAILWAY PRODUCTS	CORPORATE AND INTERCOMPANY ELIMINATIONS	TOTAL
<b>Three months ended June 30, 2006</b>					
Sales	45,585	11,847	6,261	(2,809)	60,884
Cost of sales	40,158	9,298	5,122	(2,809)	51,769
	5,427	2,549	1,139	-	9,115
Operating expenses	2,519	1,752	509	650	5,430
Income (loss) before income taxes	2,908	797	630	(650)	3,685
Provision for income taxes					283
Net income from continuing operations					3,402
Purchase of capital assets	996	583	134	5	1,718
Amortization of capital assets and other assets	726	378	80	81	1,265

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

	SALES EXCLUDING INTER-COMPANY				
	CANADA	USA	OTHER	TOTAL	INTER-COMPANY
<b>Three months ended June 30, 2005</b>					
Rubber Compounding Operations	15,998	22,447	19	38,464	264
AEP and Other	1,500	12,940	833	15,273	3,212
Railway Products	30	7,439	4	7,473	-
Total	17,528	42,826	856	61,210	3,476

	RUBBER COMPOUNDING	AEP AND OTHER	RAILWAY PRODUCTS	CORPORATE AND INTERCOMPANY ELIMINATIONS	TOTAL
<b>Three months ended June 30, 2005</b>					
Sales	38,728	18,485	7,473	(3,476)	61,210
Cost of sales	35,814	14,484	6,638	(3,476)	53,460
	2,914	4,001	835	-	7,750
Operating expenses	2,120	1,846	442	724	5,132
Income (loss) before income taxes	794	2,155	393	(724)	2,618
Provision for income taxes					922
Net income from continuing operations					1,696
Purchase of capital assets	1,142	212	-	-	1,354
Amortization of capital assets and other assets	607	475	100	124	1,306

	SALES EXCLUDING INTER-COMPANY				
	CANADA	USA	OTHER	TOTAL	INTER-COMPANY
<b>Six months ended June 30, 2006</b>					
Rubber Compounding Operations	42,650	49,437	477	92,564	975
AEP and Other	4,621	12,958	808	18,387	7,018
Railway Products	-	11,048	-	11,048	-
Total	47,271	73,443	1,285	121,999	7,993

	RUBBER COMPOUNDING	AEP AND OTHER	RAILWAY PRODUCTS	CORPORATE AND INTERCOMPANY ELIMINATIONS	TOTAL
<b>Six months ended June 30, 2006</b>					
Sales	93,539	25,405	11,048	(7,993)	121,199
Cost of sales	82,781	20,708	9,102	(7,993)	104,598
	10,758	4,697	1,946	-	17,401
Operating expenses	5,677	3,501	900	990	11,068
Income (loss) before income taxes	5,081	1,196	1,046	(990)	6,333
Provision for income taxes					1,103
Net income from continuing operations					5,230
Assets employed					
Canada	72,863	42,844	-	1,296	117,003
US	14,119	-	7,043	-	21,162
Total	86,982	42,844	7,043	1,296	138,165
Purchase of Capital assets	2,136	842	207	6	3,191
Amortization of capital assets and other assets	1,363	781	150	209	2,503
Goodwill	7,944	7,182	1,494	-	16,620

	SALES EXCLUDING INTER-COMPANY				
	CANADA	USA	OTHER	TOTAL	INTER-COMPANY
<b>Six months ended June 30, 2005</b>					
Rubber Compounding Operations	33,360	45,037	218	78,615	499
AEP and Other	3,935	22,560	1,449	27,944	5,628
Railway Products	30	14,185	4	14,219	-
Total	37,325	81,782	1,671	120,778	6,127

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

	RUBBER COMPOUNDING	AEP AND OTHER	RAILWAY PRODUCTS	CORPORATE AND INTERCOMPANY ELIMINATIONS	TOTAL
<b>Six months ended June 30, 2005</b>					
Sales	79,114	33,572	14,219	(6,127)	120,778
Cost of sales	72,974	26,675	12,291	(6,127)	105,813
	6,140	6,897	1,928	-	14,965
Operating expenses	4,534	3,637	882	1,376	10,429
Income (loss) before income taxes	1,606	3,260	1,046	(1,376)	4,536
Provision for income taxes					1,522
Net income from continuing operations					3,014
Assets employed					
Canada	77,004	43,868	-	1,000	122,272
US	4,468	-	5,607	-	10,075
Total	81,872	43,868	5,607	1,000	132,347
Purchase of Capital assets	3,201	321	15	10	3,547
Amortization of capital assets and other assets	1,226	970	188	179	2,563
Goodwill	7,944	7,182	1,494	-	16,620

**NOTE 7 TERM LOAN**

The term loan of \$22,267,000 (\$22,383,000 in December 2005) has been recorded as a current liability since it matures within one year, on October 15, 2006. Management intends to renew AirBoss' term debt. As of June 30, 2006, other debt was \$38,000 (\$46,000 in December, 2005).

**NOTE 8 COMMITMENTS AND RELATED PARTY TRANSACTIONS**

**Commitments**

In the normal course of business AEP committed \$375,000 to overhaul its mixing line over the balance of the year.

**Forward Exchange Contracts**

At June 30, 2006, the Company has three forward foreign exchange contracts to reduce fluctuations in foreign exchange rates. There is a balance of US \$2.5 million commitment at an average exchange rate of 1.1513 to be delivered throughout the balance of 2006. A new forward contract was committed to purchase US \$0.9 million at an average rate of 1.1186 of which US \$0.6 million is outstanding. The Company designated a US \$5 million forward contract to protect against fluctuation in US dollar denominated inventory.

**Related Party Transactions**

Lease payments for corporate office space to a company controlled by the Chairman of the Company were \$45,000 for the six month period (\$45,000 in 2005). Monthly dues relating to a facility in South Carolina totaling \$10,000 for the six month period (\$18,000 in 2005) were paid to a Company in which the Chairman is an officer.

The Company provided a \$0.1 million interest-free share purchase loan with full recourse to an employee and is included in the financial statements under the caption "other assets". The Company has a promissory note and a pledge agreement providing 30,000 AirBoss common shares with the market value of \$0.1 million as collateral. The promissory note matures at the early of June 15, 2009 or when the individual ceases to be an employee.

**NOTE 9 SUBSEQUENT EVENT**

Subsequent to quarter end, the Company received \$2.0 million of the funds held in escrow and took delivery of injection molding equipment in Scotland Neck worth \$0.4 million. As well, the Company had drawn the final amount against its US term loan.

## **AIRBOSS OF AMERICA CORP.**

### **OFFICES**

Canada

#### **NEWMARKET, ONTARIO – AirBoss of America Corp.**

Corporate Office: 16441 Yonge Street, Newmarket, Ontario,  
Canada L3X 2G8

Telephone: 905-751-1188

Facsimile: 905-751-1101

Chairman: P.G. (Gren) Schoch

President and Chief Executive Officer: R.L. (Bob) Hagerman

Vice-President Finance and CFO: Stephen W. Richards

#### **KITCHENER, ONTARIO – AirBoss Rubber Compounding**

Address: 101 Glasgow Street, Kitchener, Ontario,  
Canada N2G 4X8

Telephone: 519-576-5565

Facsimile: 519-576-1315

Vice-President Compounding: Robert Dodd

Vice-President Sales and Marketing: John Tomins

### **SUBSIDIARIES**

#### **QUÉBEC – AirBoss Produits d'Ingénierie Inc./AirBoss Engineered Products Inc.**

Address: 881 rue Landry, Acton Vale, Québec, Canada J0H 1A0

Telephone: 450-546-2776

Facsimile: 450-546-3735

Director of Manufacturing: Yvan Ambeault

Divisional President, AirBoss Defense Products: Earl Laurie

Sales Manager – Industrial Products: Marcel Courtemanche

United States

#### **NORTH CAROLINA – AirBoss Rubber Compounding (NC), Inc.**

Address: 500 AirBoss Parkway, Scotland Neck,

North Carolina, U.S.A. 27874

Telephone: 252-826-4919

Facsimile: 252-826-4994

General Manager: Robert Dodd

#### **MISSOURI – AirBoss Railway Products, Inc.**

Address: 9237 Ward Parkway, Suite 206, Kansas City,

Missouri, U.S.A. 64114

Telephone: 816-822-7599

Facsimile: 816-822-0150

President: Robert (Bob) Magnuson

Vice-President: Jose Mediavilla



**AIRBOSS OF AMERICA CORP.**