



AIRBOSS OF AMERICA CORP. THIRD 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>Q3 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.	\$39 million	<ul style="list-style-type: none"><li>• 53.6% 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>• 85% 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.	\$8 million	<ul style="list-style-type: none"><li>• 87% sales to US</li><li>• Plastic pads and insulators, and metal rail fastening clips</li></ul>

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## THIRD QUARTER 2006 RESULTS

(unaudited, in thousands of Canadian dollars, except per share and share amounts)	Three months ended September 30		Nine months ended September 30	
	2006	2005	2006	2005
Net sales	\$ 55,681	\$ 54,206	\$ 177,680	\$ 174,984
Gross margin	6,943	5,676	24,344	20,641
Earnings before interest, taxes & amortization (EBITDA) (Note 1)	3,999	(634)	14,461	8,045
Interest expense	888	728	2,514	2,309
Net income (loss) from continuing operations	1,580	(1,644)	6,809	1,370
Net income (loss) from discontinued operations	19	(100)	(311)	2
Net income (loss)	1,599	(1,744)	6,498	1,372
Net income (loss) per share, from continuing operations				
- Basic	\$ 0.07	\$ (0.07)	\$ 0.29	\$ 0.06
- Diluted	0.07	(0.07)	0.28	0.06
Net income (loss) per share				
- Basic	\$ 0.07	\$ (0.08)	\$ 0.28	\$ 0.06
- Diluted	0.07	(0.07)	0.27	0.06
Cash flow before changes in non-cash working capital	2,483	(1,631)	8,691	4,427
Common shares outstanding (millions):				
- Basic	23.8	22.8	23.5	22.7
- Diluted	24.2	24.2	23.9	24.0

### 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 September 30		Nine months ended September 30	
	2006	2005	2006	2005
Income (loss) from continuing operations				
before income taxes	\$ 2,027	\$ (2,599)	\$ 8,360	\$ 1,936
Interest expense	888	728	2,514	2,309
Amortization from continuing operations	1,084	1,237	3,587	3,800
EBITDA - continuing operations	\$ 3,999	\$ (634)	\$ 14,461	\$ 8,045

## TO OUR SHAREHOLDERS

Sales for the nine-month period ended September 30, 2006 increased by 1% compared to the same period in 2005 while pre-tax income from continuing operations increased by \$6.4 million or 332% and net income from continuing operations increased to \$6.8 million from \$1.4 million in the previous year. Net income per share from continuing operations for the nine-month period increased to \$0.29 per share compared to \$0.06 per share in 2005.

### **AirBoss Rubber Compounding**

Net sales increased by 12% for the nine-month period over the same period a year ago. This reflects the continued inflationary pressure of rising raw material prices. During the third quarter, significant increases were experienced in both natural rubber and carbon black. Sales volumes were again led by strong demand for rubber compounds for products which service the energy generation and mining industries. Overall volumes for the year-to-date were flat as increases in this sector were offset by declines in the automotive and transportation industries. During the quarter a major US producer of rubber compounds announced its intentions to cease operations by the end of the year. AirBoss is the leading manufacturer of compounds for products servicing the energy and mining sectors and accordingly was not affected as severely as others in the industry.

Margins, expressed as a percentage of sales, decreased slightly due to the higher material costs, however, efficiency gains experienced in the first half of the year as a result of operational improvements continued. Reduced manufacturing cycle times and limiting of overtime costs 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 as changes are made to add an inline mill to the mixer in Scotland Neck.

The volatility in world prices of certain raw materials continues to be a short-term concern. Natural rubber has increased by over 25% in the third quarter before most of these increases were reversed at the end of the period. Carbon black prices have not been affected by the recent decline in oil prices and synthetic rubber prices have spiked again for the fourth quarter due to an apparent shortage in butadiene, a key raw material. With the significant lowering of North American demand in key rubber consuming industries such as automotive and pneumatic tires, these increases are difficult to explain in the short-term as they are tied to many interrelated factors including exchange rates, oil prices and speculative pressures.

### **AirBoss-Defense**

Sales of CBRN protective wear continue to be lower than expected due to delays in receiving releases under existing military supply contracts. A significant order for \$9.6 million US for CBRN boots was received from the US Military at the end of the third quarter. This order will be produced and delivered over the next twelve months. The uncertainty of various military funding allocations and other timing issues may still negatively impact sales of CBRN gloves and gas masks over the next few quarters, although the long range forecast remains substantially the same.

### **AirBoss-Railway Products**

This Division contributed slightly higher profits from operations for the nine months ended September 30, 2006 compared to last year despite the unfavourable exchange rate. 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.

New products in development, designed to address existing problem areas in track maintenance are scheduled for accelerated testing in the fourth quarter. If successful, we anticipate sales to result as early as the third quarter of 2007.

### **Outlook**

The relatively strong third quarter performances of the Rubber Compounding and Railway Products Divisions despite softening demand for rubber compounds, rising commodity prices, and uncertainties with the US economy are reasons to continue to pursue the strategies that we are currently following in these industries.

Long-term debt financing of \$9 million CDN and \$10 million US has been renewed on very competitive terms and this aspect of the Company's financial structure is in place for the next 5 years. AirBoss is on sound financial footings to take advantage of whatever opportunities arise during, what continues to be, challenging times for the rubber industry.



**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 nine month periods ended September 30, 2006 prepared as of November 9, 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.airbossamerica.com](http://www.airbossamerica.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".

### **SUBSEQUENT EVENTS**

Subsequent to quarter end, the Company refinanced its term facility. Two loans were advanced consisting of CDN \$9 million and US \$10 million, both having a five year term and fifteen year amortization. The proceeds were used to retire CDN \$15 million and US \$5.8 million of the existing term facility.

### **OUTSTANDING COMMON SHARES**

The number of common shares outstanding at September 30, 2006 was 23,755,423.

### **CHANGES IN ACCOUNTING POLICIES**

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

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

**Selected Financial Information**

(\$ thousands, except per share amounts)	Three months ended September 30		Nine months ended September 30	
	2006	2005	2006	2005
Net sales	\$ 55,681	\$ 54,206	\$ 177,680	\$ 174,984
Net income (loss) from continuing operations	1,580	(1,644)	6,809	1,370
Net income (loss)	1,599	(1,744)	6,498	1,372
Net income (loss) per share (continuing)				
- Basic	\$ 0.07	\$ (0.07)	\$ 0.29	\$ 0.06
- Diluted	0.07	(0.07)	0.28	0.06
Cash flow before changes in non-cash working capital	2,483	(1,631)	8,691	4,427
Capital expenditures	1,011	1,927	4,202	5,474

  

(\$ thousands)	September 30, 2006	December 31, 2005
Total assets	\$ 136,372	\$ 124,679
Demand loan	16,660	11,763
Current portion of term loan and other debt	21,721	22,429

**RESULTS OF OPERATIONS**

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

**SALES FROM CONTINUING OPERATIONS**

Sales revenue for the third quarter ended September 30, 2006 was \$55.7 million and \$177.7 million for the nine month year-to-date period.

Three month periods ended September 30 (\$ thousands)	ENGINEERED PRODUCTS			
	RUBBER COMPOUNDING	AEP AND OTHER	RAILWAY PRODUCTS	TOTAL
Net sales <b>2006</b>	<b>39,177</b>	<b>8,983</b>	<b>7,521</b>	<b>55,681</b>
2005	38,925	9,379	5,902	54,206
Increase (decrease) \$	252	(396)	1,619	1,475
Increase (decrease) %	0.6%	(4.2%)	27.4%	2.7%

Nine month periods ended September 30 (\$ thousands)	ENGINEERED PRODUCTS			
	RUBBER COMPOUNDING	AEP AND OTHER	RAILWAY PRODUCTS	TOTAL
Net sales <b>2006</b>	<b>131,740</b>	<b>27,371</b>	<b>18,569</b>	<b>177,680</b>
2005	117,541	37,322	20,121	174,984
Increase (decrease) \$	14,199	(9,951)	(1,552)	2,696
Increase (decrease) %	12.1%	(26.7%)	(7.71%)	1.5%

**Rubber Compounding**

Net sales revenue for the quarter ended September 30, 2006 increased by 1% or \$0.3 million as a result of higher prices to recover material cost increases in natural rubber and carbon black. This was offset by lower volumes primarily in the automotive and major tire company sectors which was reflective of general conditions in that portion of the rubber industry serving those sectors.

Net sales for the nine-month period ended September 30, 2006 increased by 12.1% or \$14.2 million. This was as a result of price increases to recover higher raw material costs while volumes were flat for the nine-month period.

### AirBoss Engineered Products & Other

Net sales decreased \$0.4 million or 4.2% for the quarter. Industrial sales decreased \$1.2 million due to reduced demand for calendared rubber products used in the manufacture of tracks for recreational vehicles. Sales of CBRN Military protective wear increased by \$0.8 million.

On a year-to-date basis, net sales declined \$9.9 million or 26.7%. Of this amount, a \$2.1 million decrease was due to calendared products and \$7.8 million was due to military products. Military sales were lower due to the late issuance of an order for CBRN overshoes for US \$9.6 million which was not received until September, 2006.

### Railway Products

Net sales for the quarter ended September 30, 2006 increased \$1.6 million due to increased sales of tie plates and clips in both the US and South America. Sales expressed in Canadian dollars have declined by \$1.6 million for the nine-month period compared to 2005 due to the translation of the lower US dollar and a decline in low margin cast tie plates.

### GROSS MARGIN

Gross margin for the three month period ended September 30, 2006 increased by \$1.2 million from \$5.7 million to \$6.9 million compared to 2005, representing a 22.3% increase.

Three month periods ended September 30 (\$ thousands)	RUBBER COMPOUNDING	ENGINEERED PRODUCTS		TOTAL
		AEP AND OTHER	RAILWAY PRODUCTS	
Gross Margin <b>2006</b>	<b>3,816</b>	<b>1,764</b>	<b>1,363</b>	<b>6,943</b>
2005	3,223	1,579	874	5,676
Increase (decrease) \$	593	185	489	1,267
% net of sales <b>2006</b>	<b>9.7</b>	<b>19.6</b>	<b>18.1</b>	<b>12.5</b>
2005	8.3	16.8	14.8	10.5

Nine month periods ended September 30 (\$ thousands)	RUBBER COMPOUNDING	ENGINEERED PRODUCTS		TOTAL
		AEP AND OTHER	RAILWAY PRODUCTS	
Gross Margin <b>2006</b>	<b>14,574</b>	<b>6,462</b>	<b>3,308</b>	<b>24,344</b>
2005	9,362	8,475	2,804	20,641
Increase (decrease) \$	5,212	(2,013)	504	3,703
% net of sales <b>2006</b>	<b>11.1</b>	<b>23.6</b>	<b>17.8</b>	<b>13.7</b>
2005	8.0	22.7	13.9	11.8

### Rubber Compounding

Gross margin for the quarter and nine-month period ended September 30, 2006 increased \$0.6 million and \$5.2 million respectively, from initiatives to enhance the profitability of low margin compounds and increase labour efficiencies. Commodity price increases were substantially recovered in selling prices.

### AirBoss Engineered Products and Other

Despite 4.2% lower sales, gross margin improved in the quarter from head count reductions. For the nine month year-to-date period, lower sales in the military business decreased gross margin by \$2.0 million. Margins as a percentage of sales, however, remained strong due to favourable sales mix in the military products group.

### Railway Products

Gross margin percentages for the quarter and nine-month period increased 3.3% and 3.9% due to a favourable change in product mix.



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

## OPERATING EXPENSES

Operating expenses increased by \$0.6 million during the third quarter ended September 30, 2006 compared to the same quarter in 2005.

Three month periods ended September 30 (\$ thousands)	ENGINEERED PRODUCTS				CORPORATE & INTERCOMPANY ELIMINATIONS	TOTAL
	RUBBER COMPOUNDING	AEP AND OTHER	RAILWAY PRODUCTS			
Operating expenses <sup>(1)</sup> <b>2006</b>	<b>2,528</b>	<b>1,348</b>	<b>557</b>	<b>483</b>		<b>4,916</b>
2005	2,262	1,375	8	628		4,273
Increase (decrease) \$	266	(27)	549	(145)		643
% of net sales <b>2006</b>	<b>6.5</b>	<b>15.0</b>	<b>7.4</b>	-		<b>8.8</b>
2005	5.8	14.7	0.1	-		7.9

Nine month periods ended September 30 (\$ thousands)	ENGINEERED PRODUCTS				CORPORATE & INTERCOMPANY ELIMINATIONS	TOTAL
	RUBBER COMPOUNDING	AEP AND OTHER	RAILWAY PRODUCTS			
Operating expenses <sup>(1)</sup> <b>2006</b>	<b>8,204</b>	<b>4,849</b>	<b>1,457</b>	<b>1,474</b>		<b>15,984</b>
2005	6,796	5,008	895	2,004		14,703
Increase (decrease) \$	1,408	(159)	562	(530)		1,281
% of net sales <b>2006</b>	<b>6.2</b>	<b>17.7</b>	<b>7.8</b>	-		<b>9.0</b>
2005	5.8	13.4	4.4	-		8.4

<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 \$0.3 million for the quarter and by \$1.4 million for the nine-month period ended September 30, 2006. The year-to-date amounts represented slight increases as a percentage of net sales and is attributable to higher general and administrative costs in Kitchener and Scotland Neck, as well as interest charges to finance the US operations.

### AirBoss Engineered Products and Other

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

### Railway Products

The operating costs were comparable with the exception of an adjustment in 2005 year-to-date operating expenses to reflect a \$0.5 million reduction in incentives attributable to the rail patent lawsuit.

### Corporate and other eliminations

Operating expenses decreased \$0.5 million for the nine-month period primarily as a result of lower personnel and non-cash costs associated with the granting of stock options.

## INCOME TAX EXPENSE

The Company recorded an income tax expense of \$0.5 million or 22.1% effective tax rate for the quarter reflecting \$0.2 million reduction in tax provisions, compared to a \$1.0 million tax recovery or 36.8% effective tax rate in the third quarter of 2005. On a year-to-date basis, the income tax expense for year-to-date fiscal 2006 was \$1.5 million or 18.5% of income from continuing operations compared to \$0.6 million or 29.2% 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;
- ii) Filing differences related to \$0.2 million of research and development tax credits; and
- iii) \$0.2 million reduction in tax provisions

### **NET INCOME (LOSS) FROM DISCONTINUED OPERATIONS**

Net sales and net loss from discontinued operations were \$0.0 million and \$0.0 million the third quarter of 2006 compared with \$0.6 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 \$3.1 million net sales and \$0.0 million net income in 2005.

### **NET INCOME AND EARNINGS PER SHARE**

Net income from continuing operations increased in the third quarter of 2006 by \$3.2 million to \$1.6 million income from a loss of \$1.6 million in 2005 primarily from improvements in the compounding business. Fiscal 2005's net income was affected by the one time rail patent judgement of \$4.0 million. From continuing operations, basic earnings and diluted earnings per share were \$0.07 compared with a loss of \$0.07 in 2005. From net income, the basic and diluted earnings per share were \$0.07 compared to a loss of \$0.08 and a loss of \$0.07, respectively, in 2005. The basic weighted average number of shares outstanding in the quarter increased by 81,346 to 23,755,423 (22,744,713 in 2005). The fully diluted weighted average number of shares outstanding was 24,240,434 during the third quarter of 2006 (24,180,843 in 2005).

### **LIQUIDITY AND CAPITAL RESOURCES**

#### **Cash flows from continuing operations**

Operating cash flows before changes in non-cash working capital balances increased by \$4.1 million in the quarter compared to 2005 and by \$4.3 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 \$35.1 million at September 30, 2006 compared to \$31.5 million at the end of the third quarter of 2005.

The non-cash working capital increased by \$2.2 million in the third quarter of 2006 due to:

- A decrease in accounts receivable of \$0.1 million as a result of improving collections
- A decrease in inventory of \$0.9 million
- An increase in prepaid insurance of \$0.3 million due to the timing of the premium payments
- A decrease in accounts payable of \$2.8 million from lower inventories
- A \$0.2 million decrease in income taxes payable as a result of timing of instalment payments

#### **Cash from discontinued operations**

Cash provided by discontinued operations was \$0.3 million less than in 2005 for the quarter and \$1.3 million less year-to-date since the majority of the assets were disposed of in 2005.

#### **Capital expenditures**

Capital expenditures for the third quarter ended September 30, 2006 were \$1.0 million compared to \$1.9 million last year. For year-to-date 2006, capital expenditures were \$4.2 million compared to \$5.5 million in 2005. The significant additions in 2006 were as follows: \$1.8 million was spent on production equipment and \$0.2 million on computers and software for the US expansion, \$0.6 million for facility and production equipment in Kitchener, \$0.9 million for production equipment and tooling in AEP and \$0.2 million for tooling in Railway.

#### **Other assets**

The release of funds held in escrow decreased other assets by \$2.0 million for the quarter and year-to-date. Other assets increased \$0.2 million for the quarter relating to capitalized research and development and other deferred assets. Deposits in escrow of \$0.5 million, capitalized research and development of \$0.1 million, deferred start-up and other assets of \$0.2 million increased other assets for the year.

#### **Financing**

Historically, working capital requirements peak in the third quarter. The Company expects to fund its remaining 2006 operating cash requirements, including required working capital investments, capital expenditures, and scheduled debt repayments from cash flow from operations, and existing lines of credit.

Term loan repayments in the quarter were \$0.9 million compared to \$0.8 million in the prior year. During the quarter, a final advance against the US loan of \$0.4 million was made. Scheduled term loan repayments were \$2.4 million during the year, compared to \$2.2 million in fiscal 2005.

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

Subsequent to the end of the third quarter the Company finalized new term debt in the amount of \$9 million Canadian and \$10 million US. The proceeds of these five year loans were used to retire existing debt. The term loan denominated in Canadian currency is set at a fixed rate of 6.18%. The term loan denominated in US currency is at floating interest rates and increases the Company's ability to hedge its US dollar denominated monetary assets.

During the third quarter ended September 30, 2006 the net decrease in demand loan was \$0.4 million compared to \$6.8 million for the same period in 2005. On a year-to-date basis, the increase in the demand loan was \$4.9 million in 2006 compared with an increase of \$1.1 million in 2005.

No stock options were exercised during the third quarter.

### Contractual obligations

The Company's contractual obligations as at December 31, 2005 are described on page 32 in the Company's Annual Report 2005. During the second quarter of 2006, AEP committed \$0.4 million to overhaul its mixing line over the balance of the year, of which 0.1 million remains outstanding as of September 30, 2006. Rubber Compounding committed \$2.3 million in the quarter relating to production equipment.

The term loan matures in October, 2006 and accordingly is treated as a current liability. The Company renewed its term loan facility subsequent to the quarter end.

### Forward Exchange Contracts

At September 30, 2006, the Company has three forward foreign exchange contracts to reduce fluctuations in foreign exchange rates. There is a balance of US \$1.5 million commitment at an average exchange rate of 1.1513 to be delivered throughout the balance of 2006. The Company designated a US \$5 million forward contract to protect against fluctuation in US dollar denominated inventory. A new forward contract was committed to purchase US \$0.9 million at an average of 1.1210.

### Related party transactions

During the nine-month period ended September 30, 2006, the Company paid \$67,500 (2005 - \$67,500) 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 \$15,000 (2005 - \$21,000) 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
September 30, 2006	55,681	1,580	1,599	0.07	0.07	0.07	0.07
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)

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 have created a temporary excess capacity in rubber compounding in North America which was experienced in the third quarter and is expected to last throughout the remainder of the year.

The volatility of raw materials also continues to be of concern. Significant increases in the cost of carbon black and natural rubber occurred in the third quarter. While natural rubber has reversed some of these increases in the fourth quarter, synthetic rubber has increased despite lower demand and oil prices.

There continues to be a higher than normal degree of uncertainty concerning orders for the next six months and on certain CBRN products such as gloves and gas masks. Production is set, however for the next 12 months on the production of CBRN overshoes with the receipt of the US military order for \$9.6 million US.

The Railway Products Division should continue its strong performance of the first nine months of the year, although historically the fourth quarter sales are limited to fulfilling maintenance requirements. Continued sales in South and Central America are anticipated. The testing of new products in the latter part of the year holds significant promise to positive impact sales in 2007.

Greater uncertainty relating to rubber compound demand in secondary markets, volatility in commodity prices and the normal fourth quarter seasonal fluctuations are cause for a continued conservative earnings outlook in the last of the year.



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



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

## CONSOLIDATED BALANCE SHEETS

(in thousands of Canadian dollars)

September 30, 2006

December 31, 2005

(unaudited)

### ASSETS

#### Current assets:

Accounts receivable	\$ 27,010	\$ 21,479
Inventories	30,083	24,526
Prepaid expenses	1,334	441
Current assets of discontinued operations (note 2)	442	1,328
Total current assets	58,869	47,774

Capital assets	53,882	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	2,280	1,173
Other assets	4,362	5,840
Total assets	\$ 136,372	\$ 124,679

### LIABILITIES AND SHAREHOLDERS' EQUITY

#### Current liabilities:

Demand loan	\$ 16,660	\$ 11,763
Accounts payable and accrued liabilities	20,925	21,152
Income taxes payable	2,389	1,758
Current liabilities of discontinued operations (note 2)	260	129
Current portion of term loan and other debt (note 7)	21,721	22,429
Total current liabilities	61,955	57,231

Term loan and other debt (note 7)	-	
Future income tax liabilities	9,095	9,851
Accrued post retirement benefit liability (note 5)	1,527	1,349
Total liabilities	72,577	68,431

#### Shareholders' equity:

Share capital	40,394	39,056
Contributed surplus	1,146	1,309
Cumulative translation adjustment	(351)	(225)
Retained earnings	22,606	16,108
Total shareholders' equity	63,795	56,248
Total liabilities and shareholders' equity	\$ 136,372	\$ 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 September 30		Nine months ended September 30	
	2006	2005	2006	2005
<b>NET SALES</b>	<b>\$ 55,681</b>	\$ 54,206	<b>\$ 177,680</b>	\$ 174,984
Cost of sales	<b>48,738</b>	48,530	<b>153,336</b>	154,343
Gross margin	<b>6,943</b>	5,676	<b>24,344</b>	20,641
<b>OPERATING EXPENSES:</b>				
General and administrative	<b>2,044</b>	1,311	<b>7,282</b>	5,788
Selling, marketing and distribution	<b>1,619</b>	1,619	<b>5,404</b>	5,193
Product research	<b>340</b>	342	<b>1,069</b>	1,140
Total operating expenses	<b>4,003</b>	3,272	<b>13,755</b>	12,121
Income before undernoted items	<b>2,940</b>	2,404	<b>10,589</b>	8,520
Rail patent judgement	-	4,002	-	4,002
Other (income) expense	<b>25</b>	273	<b>(285)</b>	273
Income (loss) from continuing operations, before interest expense	<b>2,915</b>	(1,871)	<b>10,874</b>	4,245
Interest expense	<b>888</b>	728	<b>2,514</b>	2,309
Income (loss) from continuing operations, before income taxes	<b>2,027</b>	(2,599)	<b>8,360</b>	1,936
Provision for income taxes	<b>447</b>	(955)	<b>1,551</b>	566
Net income (loss) from continuing operations	<b>1,580</b>	(1,644)	<b>6,809</b>	1,370
Income (loss) from discontinued operations, net of tax (note 2)	<b>19</b>	(100)	<b>(311)</b>	2
Net Income (loss)	<b>1,599</b>	(1,744)	<b>6,498</b>	1,372
Retained earnings, beginning of period	<b>21,007</b>	17,623	<b>16,108</b>	14,507
Retained earnings, end of period	<b>\$ 22,606</b>	\$ 15,879	<b>\$ 22,606</b>	\$ 15,879
Net income (loss) per share				
From continuing operations				
- Basic	<b>\$ 0.07</b>	\$ (0.07)	<b>\$ 0.29</b>	\$ 0.06
- Diluted	<b>\$ 0.07</b>	\$ (0.07)	<b>\$ 0.28</b>	\$ 0.06
From net income				
- Basic	<b>\$ 0.07</b>	\$ (0.08)	<b>\$ 0.28</b>	\$ 0.06
- Diluted	<b>\$ 0.07</b>	\$ (0.07)	<b>\$ 0.27</b>	\$ 0.06

See accompanying notes to consolidated financial statements

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited, in thousands of Canadian dollars)	Three months ended September 30		Nine months ended September 30	
	2006	2005	2006	2005
<b>CASH PROVIDED BY (USED IN):</b>				
<b>Operating Activities:</b>				
Net income (loss) from continuing operations	\$ 1,580	\$ (1,644)	\$ 6,809	\$ 1,370
Items not affecting cash:				
Amortization	1,084	1,237	3,587	3,800
Loss on disposal of capital assets	2	-	2	-
Future income taxes	(308)	(1,298)	(1,863)	(1,253)
Foreign exchange loss	(16)	(172)	(37)	(77)
Options expense	90	181	15	393
Post-retirement benefits expense	51	65	178	194
	<b>2,483</b>	<b>(1,631)</b>	<b>8,691</b>	<b>4,427</b>
Changes in non-cash operating working capital balances	(2,206)	12,234	(11,659)	(871)
Net cash provided by (used in) continuing operations	277	10,603	(2,968)	3,556
Net cash provided by (used in) discontinued operations	(132)	179	750	2,053
Cash provided by (used in) operating activities	145	10,782	(2,218)	5,609
<b>Investing Activities:</b>				
Purchase of capital assets	(1,011)	(1,927)	(4,202)	(5,474)
Increase in other assets	(192)	(785)	(990)	(1,636)
Decrease in other assets	2,043	-	2,043	1,240
Proceeds of disposal of capital assets	18	-	18	-
Cash provided by (used in) investing activities	858	(2,712)	(3,131)	(5,870)
<b>Financing Activities:</b>				
Net increase (decrease) in demand loan	(419)	(6,786)	4,897	1,105
Net increase (decrease) in term loan	439	(81)	1,821	1,512
Repayment of term loan	(861)	(750)	(2,361)	(2,250)
Settlement of other debt	(162)	(453)	(168)	(453)
Issuance of share capital	-	-	1,160	347
Cash provided (used in) financing activities	(1,003)	(8,070)	5,349	261
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	\$ 686	\$ 463	\$ 2,380	\$ 2,290
Cash income taxes remitted	945	566	3,095	961
Transfer of assets from discontinued operations	-	-	61	-

See accompanying notes to consolidated financial statements

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Nine months ended September 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 September 30		Nine months ended September 30	
	2006	2005	2006	2005
Net sales	\$ 12	\$ 613	\$ 372	\$ 3,064
Income (loss) before tax	162	(134)	(359)	(10)
Net income (loss)	19	(100)	(311)	2
Amortization	-	-	44	72

Assets and liabilities held in discontinued operations:

	September 30, 2006	December 31, 2005
Current assets	\$ 442	\$ 1,328
Current liabilities	260	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 third quarter of 2006 and 2005 no stock options were exercised.

During the third quarter of 2006, the Company issued 70,000 stock options. The fair value of options issued has been determined using the Black-Scholes option pricing model using the following assumptions:

	2006
Risk-free rate	4.17%
Dividend yield	0%
Volatility factor of the expected market price of Company's shares	9.46%
Average expected option life (years)	5.0
Weighted average fair value per share of options granted during the period	1.022

The stock options issued in the third quarter ended September 30, 2006 vest as follows:

August 14, 2007	10,500
August 14, 2008	10,500
August 14, 2009	14,000
August 14, 2010	17,500
August 14, 2011	17,500
	<b>70,000</b>



For the three month and nine month period ended September 30, 2006, stock-based compensation expense was \$90,000 and \$15,000 respectively. For the three month and nine month period ended September 30, 2005, stock-based compensation expense was \$181,000 and \$393,000 respectively.

**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 72% of total accounts receivable (2005 – 66%), 82% of accounts payable (2005 – 78%), 91% of bank indebtedness (2005 – 100%) and 30% of term loan (2005 – 8%).

**NOTE 5 FUTURE RETIREMENT BENEFITS**

During the three months ended September 30, 2006 and 2005, the Company's future retirement benefits expenses were \$51,000 and \$65,000 respectively. Year-to-date, the amounts were \$178,000 and \$194,000.

**NOTE 6 SEGMENTED INFORMATION**

	SALES EXCLUDING INTER-COMPANY				INTER-COMPANY
	CANADA	USA	OTHER	TOTAL	
<b>Three months ended September 30, 2006</b>					
Rubber Compounding Operations	18,184	20,968	25	39,177	244
AEP and Other	1,327	6,771	885	8,983	1,688
Railway Products	-	6,559	962	7,521	-
Total	19,511	34,298	1,872	55,681	1,932

	RUBBER COMPOUNDING	AEP AND OTHER	RAILWAY PRODUCTS	CORPORATE AND INTERCOMPANY ELIMINATIONS	TOTAL
<b>Three months ended September 30, 2006</b>					
Sales	39,421	10,671	7,521	(1,932)	55,681
Cost of sales	35,605	8,907	6,158	(1,932)	48,738
	3,816	1,764	1,363	-	6,943
Operating expenses	2,528	1,348	557	483	4,916
Income (loss) before income taxes	1,288	417	805	(483)	2,027
Provision for income taxes					(447)
Net income from continuing operations					1,580
Purchase of capital assets	713	258	39	1	1,011
Amortization of capital assets and other assets	595	345	79	65	1,084

	SALES EXCLUDING INTER-COMPANY				INTER-COMPANY
	CANADA	USA	OTHER	TOTAL	
<b>Three months ended September 30, 2005</b>					
Rubber Compounding Operations	16,996	21,929	-	38,925	371
AEP and Other	2,378	6,212	789	9,379	1,777
Railway Products	-	5,902	-	5,902	-
Total	19,374	34,043	789	54,206	2,148

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

	RUBBER COMPOUNDING	AEP AND OTHER	RAILWAY PRODUCTS	CORPORATE AND INTERCOMPANY ELIMINATIONS	RAIL PATENT JUDGEMENT	TOTAL
<b>Three months ended September 30, 2005</b>						
Sales	39,296	11,156	5,902	(2,148)		54,206
Cost of sales	36,073	9,577	5,028	(2,148)		48,530
	3,223	1,579	874	-		5,676
Operating expenses	2,262	1,375	8	628		4,273
Rail patent judgement					4,002	4,002
Income (loss) before income taxes	960	207	863	(628)	(4,002)	(2,599)
Provision for income taxes						955
Net income from continuing operations						(1,644)
Purchase of Capital assets	1,522	250	144	11	-	1,927
Amortization of capital assets and other assets	625	389	93	130	-	1,237

	SALES EXCLUDING INTER-COMPANY				INTER-COMPANY
	CANADA	USA	OTHER	TOTAL	
<b>Nine months ended September 30, 2006</b>					
Rubber Compounding Operations	60,834	70,405	501	131,740	1,220
AEP and Other	5,948	19,729	1,694	27,371	8,705
Railway Products	-	16,901	1,668	18,569	-
Total	66,782	107,035	3,863	177,680	9,925

	RUBBER COMPOUNDING	AEP AND OTHER	RAILWAY PRODUCTS	INTERCOMPANY ELIMINATIONS	TOTAL
<b>Nine months ended September 30, 2006</b>					
Sales	132,960	36,076	18,569	(9,925)	177,680
Cost of sales	118,386	29,614	15,261	(9,925)	153,336
	14,574	6,462	3,308	-	24,344
Operating expenses	8,204	4,849	1,457	1,474	15,984
Income (loss) before income taxes	6,370	1,613	1,851	(1,474)	8,360
Provision for income taxes					(1,551)
Net income from continuing operations					6,809
Assets employed					
Canada	70,028	42,344	-	1,001	113,373
US	14,746	-	7,811	-	22,557
Total	84,774	42,344	7,811	1,001	135,930
Purchase of Capital assets	2,849	1,100	246	7	4,202
Amortization of capital assets and other assets	1,958	1,126	229	274	3,587
Goodwill	7,944	7,182	1,494	-	16,620

	SALES EXCLUDING INTER-COMPANY				INTER-COMPANY
	CANADA	USA	OTHER	TOTAL	
<b>Nine months ended September 30, 2005</b>					
Rubber Compounding Operations	50,356	66,966	219	117,541	870
AEP and Other	6,313	28,772	2,237	37,322	7,405
Railway Products	29	20,087	5	20,121	-
Total	56,698	115,825	2,461	174,984	8,275

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

	RUBBER COMPOUNDING	AEP AND OTHER	RAILWAY PRODUCTS	CORPORATE AND INTERCOMPANY ELIMINATIONS	RAIL PATENT JUDGEMENT	TOTAL
<b>Nine months ended September 30, 2005</b>						
Sales	118,411	44,727	20,121	(8,275)		174,984
Cost of sales	109,049	36,252	17,317	(8,275)		154,343
	9,362	8,475	2,804	-	-	20,641
Operating expenses	6,796	5,008	895	2,004	-	14,703
Rail patent judgement					4,002	4,002
Income (loss) before income taxes	2,566	3,467	1,909	(2,004)	(4,002)	1,936
Provision for income taxes						(566)
Net income from continuing operations						1,370
Assets employed						
Canada	74,191	38,776	-	839		113,806
US	3,766	-	4,562	-		8,328
Total	77,957	38,776	4,562	839		122,134
Purchase of Capital assets	4,723	571	159	21		5,474
Amortization of capital assets and other assets	1,851	1,359	281	309		3,800
Goodwill	7,944	7,182	1,494	-		16,620

**NOTE 7 TERM LOAN**

The term loan of \$21,844,000 (\$22,383,000 in December 2005) has been recorded as a current liability since it matures within one year, on October 15, 2006. Subsequent to quarter end, the term loan was renewed (see Note 9 "Subsequent Event"). As of September 30, 2006, other debt included a receivable of \$123,000 (\$46,000 liability 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, of which \$112,000 remains outstanding as of September 30, 2006. As well, Rubber Compounding committed \$2.3 million related to production equipment.

**Forward Exchange Contracts**

At September 30, 2006, the Company has two forward foreign exchange contracts to reduce fluctuations in foreign exchange rates. There is a balance of US \$1.5 million commitment at an average exchange rate of 1.1513 to be delivered throughout the balance of 2006. The Company designated a US \$5 million forward contract to protect against fluctuation in US dollar denominated inventory. A new forward contract was committed to purchase US \$0.9 million at an average rate of 1.1210.

**Related Party Transactions**

Lease payments for corporate office space to a company controlled by the Chairman of the Company were \$67,500 for the nine month period (\$67,500 in 2005). Monthly dues relating to a facility in South Carolina totaling \$15,000 for the nine month period (\$21,000 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 refinanced its term loan facility. Two loans were advanced consisting of CDN \$9 million and US \$10 million, both having a five year term and 15 year amortization. The term loan bears interest at a fixed rate of 6.18% with respect to the portion denominated in Canadian currency and at floating interest rates for the portion denominated in US currency. The proceeds were used to retire CDN \$15 million and US \$5.8 million of the existing term loan facility.

## **AIRBOSS OF AMERICA CORP.**

### **OFFICES**

Canada

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

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Chairman: P.G. (Gren) Schoch

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

Vice-President Finance and CFO: Stephen W. Richards

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Vice-President Compounding: Robert Dodd

Vice-President Sales and Marketing: John Tomins

### **SUBSIDIARIES**

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Divisional President, AirBoss Defense Products: Earl Laurie

Sales Manager – Industrial Products: Marcel Courtemanche

United States

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

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Vice-President: Jose Mediavilla



**AIRBOSS OF AMERICA CORP.**