



**AIRBOSS OF AMERICA  
CORP.**



RESEARCH

DEVELOPMENT

TECHNOLOGY

INCREASED CAPACITY

GROWTH

FOCUS

STRATEGIES FOR SUCCESS

2005 THIRD QUARTER INTERIM REPORT

## **AIRBOSS OF AMERICA CORP.**

*AirBoss of America Corp. develops, manufactures and sells high quality, proprietary rubber-based products offering enhanced performance and productivity. The Company is focused on the manufacturing of quality rubber compounds as well as specialty rubber and plastic moulded products.*

*AirBoss is one of North America's largest custom rubber mixers with a capacity to supply over 200 million pounds of rubber annually to a diverse group of rubber products manufacturers.*

*AirBoss engineers and moulds rubber and plastic products for the transportation, military and industrial markets as well as for its own proprietary designs of military protective wear.*

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## THIRD QUARTER 2005 RESULTS

(thousands \$ CDN, except per share amounts)	Three months ended September 30		Nine months ended September 30	
	2005	2004	2005	2004
Net sales	\$ 53,827	\$ 50,002	\$ 174,984	\$143,349
Gross margin	5,537	7,044	20,641	20,507
Income before interest, taxes & amortization (EBITDA) (Note 1)	(513)	4,246	8,643	12,735
Interest expense	728	664	2,309	2,110
Net income (loss) from continuing operations	(1,562)	1,428	1,779	4,038
Net (loss) from discontinued operations	(182)	(500)	(407)	(1,546)
Net income (loss)	(1,744)	928	1,372	2492
Net income (loss) per share, from continuing operations				
– Basic	\$ (0.07)	\$ 0.06	\$ 0.08	\$ 0.18
– Diluted	(0.06)	0.06	0.07	0.18
Net income (loss) per share				
– Basic	\$ (0.08)	\$ 0.04	\$ 0.06	\$ 0.11
– Diluted	(0.07)	0.04	0.06	0.11
Cash flow before changes in non-cash working capital from continuing operations	\$ (1,550)	\$ 2,458	\$ 4,836	\$ 9,220
Common shares outstanding (millions)				
– Basic	22.8	22.5	22.7	22.5
– Diluted	24.1	23.0	23.9	23.0

**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.

(thousands)	Three months ended September 30		Nine months ended September 30	
	2005	2004	2005	2004
Income (loss) from continuing operations before income taxes	\$ (2,478)	\$ 2,195	\$ 2,534	\$ 6,026
Interest expense	728	664	2,309	2,110
Amortization from continuing operations	1,237	1,387	3,800	4,599
EBITDA – continuing operations	\$ (513)	\$ 4,246	\$ 8,643	\$ 12,735

# Letter to Shareholders

*Sales for the nine month period increased by 22% while income before interest, income taxes and unusual items increased by 6.0%. Impacting the results was the recognition of the negative Court ruling received by our Railway Products Division and the closure of the temporary rubber compound production facility in Waynesville, North Carolina.*

## **AIRBOSS RUBBER COMPOUNDING**

Volumes increased by 12% to approximately 130 million pounds for the nine month period ended September 30, 2005 while sales increased by 25%. The Kitchener facility produced at practical capacity for most of the third quarter although volumes were impacted by a slightly higher than normal maintenance and repair downtimes in July. This was an expected result of operating at near capacity for most of the year.

Prices for key raw materials such as natural rubber, synthetic rubber and carbon black continued to be extremely volatile throughout the period. Factors which have contributed to this have been supply disruptions, exchange rate fluctuations and oil price influences. Disruption of domestic production of synthetic rubber resulting from hurricane damage affected many rubber product producers. At September 30, 2005 it was estimated that 44% of domestic styrene butadiene rubber production capacity was shutdown. AirBoss sources a significant portion of its requirements offshore and was not faced with any immediate shortages. Shortages are also not anticipated for the fourth quarter; however, the longer term impact on the industry is less predictable.

Energy and freight costs also increased in the period. Electricity costs for the year have risen by well over 30% and represent the second largest non-material input cost after labour. The industry issued a series of non-material related price increases at the end of September and beginning of October. These increases were also required to justify funding of capital requirements of increased demand.

The temporary satellite mixing plant in Waynesville, North Carolina continued to have a significant negative impact and it was closed in August. Accumulated operating losses from this project amounted to over \$1.3 million or \$0.04 after-tax per share. This location was never able to consistently produce to AirBoss standards.

## **AIRBOSS DEFENSE**

This division continues to perform at or ahead of expectations. Major accomplishments achieved include securing U.S. DOD Joint Services contracts for our CBRN gloves and overboots. Completion of phase III testing is anticipated sometime in 2006. AirBoss is currently finalizing plans to add manufacturing capacity in Scotland Neck, North Carolina to service the increased demand for these products. Interim U.S. orders have been received and these, combined with western European contracts, should result in sales growth of 20% for the current year.

## **AIRBOSS RAILWAY PRODUCTS**

Sales in U.S. dollars for the nine month period ended September 30, 2005 increased by 30% to \$16.4 million and divisional earnings before interest and taxes increased to \$1.2 million in 2005 from \$0.3 million last year. We expect the record volumes to continue for the remainder of the year. A new design of fastening clips has recently been approved for a South American installation. Sales will start in late October 2005. The division is typically seasonal with fourth quarter sales being limited. This new product will reverse that trend.

## **LEGAL**

The U.S. Court of Appeals has upheld the judgment against AirBoss Railway Products for patent infringement of approximately \$3.3 million plus interest. While the Company is disappointed in this result given the legal opinions it received prior to producing the products in question, it has decided not to pursue the matter further. The ruling does not affect or limit in any way the current products being sold by the Company.



## OUTLOOK

Demand for rubber compound, railway fastening products and military protective wear is expected to continue to be strong for the remainder of the year and into 2006. Profitability from operations will improve as a result of rubber compound industry-wide price increases issued in the fourth quarter to recover the increased energy and other costs experienced in the second and third quarter of the calendar year. Results should also improve with the closing of Waynesville. The equipment in Scotland Neck is being installed and start-up is anticipated as planned.



**P.G. Schoch**  
Chairman



**R.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 month and nine month periods ended September 30, 2005 prepared as of November 1, 2005, should be read in conjunction with the unaudited interim consolidated financial statements and notes thereto, as well as the MD&A and audited consolidated financial statements for the year ended December 31, 2004 contained in the 2004 Annual Report to Shareholders. The consolidated interim financial statements have not been audited or reviewed on behalf of shareholders by the Company's independent external auditors. All 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)

**AirBoss Forward-Looking Statement Disclaimer** – *The information in this Management's Discussion and Analysis contains certain forward-looking statements which reflect the Company's current view of future events, business outlook and anticipated financial performance. Such statements are subject to assumptions, which may be incorrect, and to risks and uncertainties which are difficult to predict. As a result, actual results could be materially different and readers are cautioned not to place undue reliance on such information.*

*Risks that could cause actual results to materially differ from current expectations may include, but are not limited to, those described in the "Risk factors and uncertainties" section of the MD&A in the 2004 Annual Report to Shareholders.*

## SIGNIFICANT EVENTS

**Bank Financing** – During the first quarter, the Company secured an additional term loan facility of US \$6.0 million maturing October 16, 2006, amortized over a ten year period following the final draw-down of funds to finance capital requirements for its US expansion. In addition, on April 28, 2005, the Company completed negotiations for a new \$45.0 million operating line facility to finance working capital and future growth requirements.

**Rail Patent Judgement** – During the third quarter, AirBoss Railway Products, Inc., a wholly owned subsidiary of the Company, was notified that the United States Court of Appeals for the Federal Circuit has upheld an award of damages of US \$3.4 million (CDN \$4.0 million) payable to the plaintiff in a patent infringement suit. These damages have been recorded as a one-time charge in the third quarter results and were paid subsequent to the quarter end. The ruling does not affect the current products sold by the Company.

**Waynesville** – The temporary U.S. compounding facility in Waynesville, North Carolina was closed in the third quarter. The facility had been unable to achieve necessary operating efficiencies and had experienced serious losses associated with defective raw materials.

# Management's Discussion and Analysis of Financial Condition and Results of Operations *(continued)*

**Environmental** – The Company completed certain remediation work at Acton subsequent to the third quarter end and the costs will be claimed against the former owners of Acton under the terms of the environmental indemnity clause contained in the purchase and sale agreement.

## CHANGES IN ACCOUNTING POLICIES

**Consolidation of Variable Interest Entities** – In 2003, the CICA issued Accounting Guideline 15, Consolidation of Variable Interest Entities, ("VIE"), which establishes additional criteria to apply consolidation accounting. A variable interest entity does not have sufficient equity at risk to finance its activities or equity holders lack the characteristics of a controlling financial interest. For entities exposed to the majority of expected gains and losses, ACG-15 requires consolidation of the VIE's results. There is no impact on the Company's financial condition and results of operations upon adopting this guideline.

## SELECTED FINANCIAL INFORMATION

(thousands, except per share amounts)

	Three months ended September 30		Nine months ended September 30	
	2005	2004	2005	2004
Net sales	\$ 53,827	\$ 50,002	\$ 174,984	\$ 143,349
Net income (loss)	(1,744)	928	1,372	2,492
Net income (loss) per share – continuing operations				
– Basic	\$ (0.07)	\$ 0.06	\$ 0.08	\$ 0.18
– Diluted	(0.06)	0.06	0.07	0.18
Net income per share – continuing operations excluding the rail patent judgement				
– Basic	\$ 0.04	\$ 0.06	\$ 0.19	\$ 0.18
– Diluted	0.04	0.06	0.18	0.18
Cash flow before changes in non-cash working capital	(1,550)	2,458	4,836	9,220
Cash dividends declared	\$ –	\$ –	\$ –	\$ –

(thousands)

	September 30, 2005	December 31, 2004
Total assets	\$ 120,064	\$ 122,164
Demand loan	13,051	12,483
Current portion of term loan and other debt	3,643	4,096
Long-term portion of term loan and other debt	16,762	17,500

## QUARTERLY INFORMATION

(thousands, except per share amounts)

Quarter Ended	Net Sales Continuing Operations	Net Income (Loss)		Net Income (Loss) Per Share – Continuing Operations		Net Income (Loss) Per Share	
		Continuing	Total	Basic	Diluted	Basic	Diluted
Sept. 30, 2005	\$ 53,827	\$ (1,562)	\$ (1,744)	\$ (0.07)	\$ (0.06)	\$ (0.08)	\$ (0.07)
June 30, 2005	61,589	1,784	1,597	0.08	0.07	0.07	0.07
Mar. 31, 2005	59,568	1,558	1,520	0.07	0.07	0.07	0.06
Dec. 31, 2004	49,259	834	(759)	0.04	0.04	(0.03)	(0.03)

(thousands, except per share amounts)

Quarter Ended	Net Sales Continuing Operations	Net Income (Loss)		Net Income (Loss) Per Share – Continuing Operations		Net Income (Loss) Per Share	
		Continuing	Total	Basic	Diluted	Basic	Diluted
Sept. 30, 2004	\$ 50,002	\$ 1,428	\$ 928	\$ 0.06	\$ 0.06	\$ 0.04	\$ 0.04
June 30, 2004	49,655	1,338	973	0.06	0.06	0.04	0.04
Mar. 31, 2004	44,055	1,272	591	0.06	0.06	0.03	0.03
Dec. 31, 2003	30,346	(2,317)	(5,723)	(0.10)	(0.10)	(0.25)	(0.25)

## RESULTS OF OPERATIONS

Three month and nine month periods ended September 30, 2005 compared to the same period in 2004.

### SALES FROM CONTINUING OPERATIONS

Sales revenue for the third quarter ended September 30, 2005 of \$53.8 million represented an increase of \$3.8 million or 7.6% in 2005 compared with 2004, and an increase of \$31.6 million or 22.1% for nine month year-to-date period. Net sales in the quarter to non-Canadian customers represented 64.7% (2004 – 70.8%) of net sales.

Three month period ended September 30 (thousands)	Rubber Compounding Operations	Engineered Products		Total
		Railway Products	AEP & Other	
<b>Net Sales – 2005</b>	<b>\$ 38,925</b>	<b>\$ 5,902</b>	<b>\$ 9,000</b>	<b>\$ 53,827</b>
– 2004	34,708	3,517	11,777	50,002
Increase (decrease)	\$ 4,217	\$ 2,385	\$ (2,777)	\$ 3,825
Increase (decrease)	12.1%	67.8%	(23.6%)	7.6%

Nine month period ended September 30 (thousands)	Rubber Compounding Operations	Engineered Products		Total
		Railway Products	AEP & Other	
<b>Net Sales – 2005</b>	<b>\$ 117,541</b>	<b>\$ 20,121</b>	<b>\$ 37,322</b>	<b>\$ 174,984</b>
– 2004	94,361	16,767	32,221	143,349
Increase	\$ 23,180	\$ 3,354	\$ 5,101	\$ 31,635
Increase	24.6%	20.0%	15.8%	22.1%

**Rubber Compounding** – Net sales revenue for the quarter ended September 30, 2005 increased by \$4.2 million or 12.1% to \$38.9 million, compared to \$34.7 million for the third quarter in 2004. Volumes increased 3.8% as a result of continued strong demand in all markets, including conveyor belting. The balance of the increase is associated with selling price increases attributable to rising raw material costs.

Net sales revenue for the nine-month period increased \$23.2 million or 24.6% including 12.0% from unit volume increases.

**Railway Products** – Net sales for the quarter and year-to-date increased 67.8% and 20.0% respectively over 2004, from higher sales volumes of tie plates and fastening clips.

**AirBoss Engineered Products and Other** – Net sales decreased \$2.8 million or 23.6% for the quarter, and \$5.1 million or 15.8% year-to-date, due to the timing of shipments on military sales contracts, lower exchange rates and lower volume of industrial sales when compared to the previous year.

### GROSS MARGIN

Gross margin for the three month period ended September 30, 2005 decreased by \$1.5 million from \$7.0 million to \$5.5 million compared to 2004, representing a 21.4% decrease. Although overall net sales revenues increased by 7.6% for the third quarter, gross margin rates continue to be negatively affected by competitive pricing, rising commodity prices, energy cost increases, and losses from the closure of the Waynesville facility.

## Management's Discussion and Analysis of Financial Condition and Results of Operations *(continued)*

Three month period ended September 30 (thousands)	Rubber Compounding Operations	Engineered Products		Total
		Railway Products	AEP & Other	
<b>Gross Margin – 2005</b>	<b>\$ 3,223</b>	<b>\$ 735</b>	<b>\$ 1,579</b>	<b>\$ 5,537</b>
– 2004	4,217	215	2,612	7,044
Increase (decrease)	\$ (994)	\$ 520	\$ (1,033)	\$ (1,507)
<b>% of net sales – 2005</b>	<b>8.3%</b>	<b>12.5%</b>	<b>17.5%</b>	<b>10.3%</b>
– 2004	12.1%	7.6%	22.2%	14.1%

Although the gross margin percentage declined on a year-to-date basis, gross margin for the nine-month-period increased \$0.1 million from higher net sales.

Nine month period ended September 30 (thousands)	Rubber Compounding Operations	Engineered Products		Total
		Railway Products	AEP & Other	
<b>Gross Margin – 2005</b>	<b>\$ 9,362</b>	<b>\$ 2,804</b>	<b>\$ 8,475</b>	<b>\$ 20,641</b>
– 2004	10,493	2,297	7,717	20,507
Increase (decrease)	\$ (1,131)	\$ 507	\$ 758	\$ 134
<b>% of net sales – 2005</b>	<b>8.0%</b>	<b>13.9%</b>	<b>22.7%</b>	<b>11.8%</b>
– 2004	11.1%	13.7%	23.9%	14.3%

**Rubber Compounding** – As in previous quarters, input commodity prices continued to rise through the third quarter, particularly for carbon black and rubber, in response to increasing petro-chemical costs and supply limitations. Rising utility costs and the inefficiencies of the temporary facility in Waynesville increased conversion costs and further compressed margins. As well, a strengthening Canadian dollar adversely affects margins realized on U.S. dollar denominated sales.

On a year-to-date basis, gross margin rates in the Division continue to lag behind historical levels, due to the competitiveness of the marketplace and the difficulty the industry has had in absorbing a sequence of higher commodity prices.

**Railway Products** – Gross margin increased by \$0.5 million from higher sales; and the gross margin percentage improved slightly due to product mix.

**AirBoss Engineered Products and Other** – Although the three-month margin declined, increased sales volume and favourable product sales mix of military products accounted for the majority of the improvement in gross margin for the nine months. In 2005, sales are more heavily weighted to the beginning of the year, than in 2004.

### OPERATING EXPENSES

Operating expenses decreased by \$0.8 million primarily in the railway segment during the third quarter ended September 30, 2005 compared to the same quarter in 2004.

Three month period ended September 30 (thousands)	Rubber Compounding Operations	Engineered Products		Corporate & Intercompany Eliminations	Total
		Railway Products	AEP & Other		
<b>Operating expenses<sup>(1)</sup> – 2005</b>	<b>\$ 2,262</b>	<b>\$ (127)</b>	<b>\$ 1,251</b>	<b>\$ 627</b>	<b>\$ 4,013</b>
– 2004	1,973	686	1,493	697	4,849
Increase (decrease)	\$ 289	\$ (813)	\$ (242)	\$ (70)	\$ (836)



Nine month period ended September 30 (thousands)	Rubber Compounding Operations	Engineered Products		Corporate & Intercompany Eliminations	Total
		Railway Products	AEP & Other		
<b>Operating expenses<sup>(1)</sup> – 2005</b>	<b>\$ 6,796</b>	<b>\$ 895</b>	<b>\$ 4,410</b>	<b>\$ 2,004</b>	<b>\$ 14,105</b>
– 2004	6,413	2,045	4,079	1,944	14,481
Increase (decrease)	\$ 383	\$ (1,150)	\$ 331	\$ 60	\$ (376)

<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 were \$2.3 million or 5.8% of net sales in the quarter as compared to \$2.0 million or 5.7% of net sales in the third quarter of 2004. The increase of \$0.1 million was mostly due to higher travel to support Waynesville, increased computer costs in response to system enhancements, new hires in office administration, and allocated interest, offset by some freight savings on production transferred to Waynesville from Kitchener. The year-to-date results reflect the same matters.

**Railway Products** – Operating expenses were a recovery of \$0.1 million or 2% of sales in the quarter as compared to \$0.7 million or 19.5% of sales in the third quarter of 2004. A decrease of \$0.5 million relates to lower incentives compensation accruals for the current year attributable to the rail patent settlement. The 2004 year-to-date results reflected higher amortization of research and development costs.

**AirBoss Engineered Products and Other** – Operating expenses were \$1.3 million or 13.9% of sales in the quarter as compared to \$1.5 million or 12.7% of sales in the third quarter of 2004. The decrease is primarily due to royalty income and a recovery of group insurance costs.

**Corporate and Other Eliminations** – Operating expenses were \$0.6 million in the quarter as compared to \$0.7 million in the third quarter of 2004. There is no material difference in the year-to-date comparison of operating expenses.

#### RAIL PATENT JUDGEMENT

During the quarter, the Company recorded a US \$3.4 million (CDN \$4.0 million) one-time charge as a result of losing a court appeal relating to a patent infringement case in the rail business segment. After tax, this represents approximately \$0.10 earnings per share.

#### INCOME TAX EXPENSE

The Company recorded an income tax recovery for the quarter of \$0.9 million or 36.9% of income from continuing operations before income taxes, compared to \$0.8 million or 34.9% in the third quarter of 2004. Year to date, the effective tax rate for 2005 and 2004 was 29.8% and 33% respectively.

The effective income tax rate for the nine months ended September 30, 2005 was affected by non-income based taxes, such as the federal large corporation tax. Income taxes for the comparable quarters were as follows:

Third Quarter year-to-date ended September 30 (thousands)	2005	2004
Canadian tax rate net of manufacturing and processing deduction	\$ 653	\$ 1,163
Federal large corporations tax	17	68
Foreign tax differentials	(229)	5
Tax recoveries and other	109	(94)
	\$ 550	\$ 1,142
Income tax expense, Continuing operations	\$ 755	\$ 1,988
Income tax expense (recovery), Discontinued operations	(205)	(846)
	\$ 550	\$ 1,142

# Management's Discussion and Analysis of Financial Condition and Results of Operations *(continued)*

## NET LOSS FROM DISCONTINUED OPERATIONS

Net sales and net loss for the quarter decreased by \$4.1 million and \$0.4 million, respectively, compared to 2004, primarily as a result of the Company ceasing production of the commercial footwear operation in February, 2005. Year-to-date net sales and net loss had decreased by \$8.9 million and \$1.1 million, respectively. The Company sold the remaining consignment inventory in the quarter and collected most of its receivables subsequent to quarter end. The expenses reflect a \$0.2 million charge for legal fees relating to an arbitration process with the original vendors of the footwear division.

Although not reflected as a discontinued operation, Waynesville's results contributed \$3.0 million sales, \$1.3 million loss before tax, and reduced the earnings per share by approximately \$0.04.

## NET INCOME AND EARNINGS PER SHARE

Net income decreased in the third quarter of 2005 by \$2.7 million to \$1.7 million loss from \$0.9 million income in 2004. From continuing operations, basic earnings per share were (\$0.07) and diluted earnings per share were (\$0.06) in 2005, and \$0.06 and \$0.06 respectively in 2004. From net income, the basic and diluted earnings per share was (\$0.08) compared to \$0.04 in 2004. The basic weighted average number of shares outstanding in the quarter increased by 74,725 to 22,838,923 (compared to 22,541,183 in 2004), as a result of employees exercising options in the previous quarters. The fully diluted weighted average number of shares outstanding increased in the quarter by 199,379 to 24,180,843 as compared to 23,005,192 in the same quarter of 2004, mainly due to more options being exercisable.

## LIQUIDITY AND CAPITAL RESOURCES

**Cash flows from continuing operations** – AirBoss consumed a net of \$1.5 million in operating cash flows before changes in non-cash working capital balances during the third quarter ended September 30, 2005 compared to generating \$2.5 million in 2004. The decrease is mainly due to the railway patent infringement judgement as well as the change in future income taxes. Year-to-date, \$4.8 million was provided from operations compared to \$9.2 million last year, also due to the lawsuit and future income taxes.

**Non-cash working capital** – The investment in non-cash working capital relating to continuing operations was \$31.5 million at September 30, 2005 compared to \$25.1 million at the end of the third quarter of 2004.

The working capital requirements increased in the third quarter of 2005 by \$12.2 million due to:

- A decrease in accounts receivable of \$2.6 million reflecting an improvement in days sales outstanding
- A decrease in inventory of \$8.2 million reflecting a concerted effort to reduce overall levels
- A decrease in prepaid expenses of \$0.8 million, reflecting a \$0.7 million reclassification of deferred start-up costs to other assets
- An increase in accounts payable of \$0.4 million from lower raw material purchases
- A \$0.2 million increase in income taxes payable. 2004 reflects the application of loss carry forward amounts to reduce the taxes owing

**Cash from discontinued operations** – Cash provided by discontinued operations was \$2.6 million more than in 2004 for the quarter (\$5.2 million year-to-date), primarily from improved earnings from the footwear operation.

**Capital expenditures** – Capital expenditures for the third quarter ended September 30, 2005 were \$1.9 million compared to less than \$0.1 million in 2004, and \$5.5 million compared to \$2.1 million year-to-date. The majority of the capital expenditures related to the rubber compounding business, of which, \$0.8 million pertains to production equipment for the U.S. expansion, \$0.4 million was spent upgrade production assets and \$0.2 million related to masonry and roof repairs in Kitchener. On a year-to-date basis, \$2.9 million was incurred for production equipment for U.S. expansion, \$1.9 million for Kitchener equipment and capital repairs to the building, and \$0.4 for AEP manufacturing equipment for the military production.

**Other Assets** – The Company reclassified deferral start-up costs of \$0.7 million from prepaid expenses to reflect its long-term nature.

**Financing** – The Company is pursuing a growth strategy to expand rubber compounding capacity. During the first quarter, negotiations to obtain an additional US \$6 million term loan with its existing term lending syndicate were concluded and the Company utilized this additional term facility to finance \$1.6 million of equipment related to U.S. expansion. The term loan bears interest at U.S. bank prime, plus 1.9%, calculated monthly, and principal is repayable in equal monthly instalments (commencing the month following the final advance) with the balance repayable on October 15, 2006.

The Company also obtained a \$45 million operating facility for existing and future working capital requirements. The operating line of credit bears interest at a range from the bank's prime rate less 0.25% to prime plus 0.65% per annum, with respect to loans denominated in Canadian currency and from the U.S. prime rate less 1% with respect to loans denominated in U.S. currency.

The loan agreement provides the lenders with a first security interest on all accounts receivable and inventories of the Company and its subsidiaries, secured guarantees, and an inter-creditor arrangement with the term-loan syndicate.

The Company expects to fund its 2005 operating cash requirements, including required working capital investments, capital expenditures, and scheduled debt repayments from cash on hand, cash flow from operations, and committed borrowing capacity.

During the quarter, the Company had repaid \$6.8 million against its operating line, made the required payments against the term loan, and offset notes outstanding related to the original vendors of the footwear business with recoverable environmental costs pursuant to the purchase and sale agreement.

**Contractual obligations** – The Company's contractual obligations as at December 31, 2004 are described on page 10 in the Company's Annual Report 2004. For the nine month period ended September 30, 2005, the Company did not enter into any material contractual obligations outside the normal course of business, except with respect to its financing arrangements as set out below. During the first quarter, the Company obtained an additional US \$6 million term loan facility and on April 28, 2005, entered into a new \$45 million operating facility as noted in the Financing section above.

The term loan matures in October 2006 which will require it to be treated as a current liability in the fourth quarter of 2005. With the settlement of the patent infringement lawsuit, a certain financial ratio pertaining to the term loan agreement may end up in technical violation of the agreement unless the lenders agree to treat the settlement as a one-time charge unrelated to the nature and prospects of the business.

## OUTLOOK

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Demand for rubber compounds is expected to remain strong for the foreseeable future as the Company services the coal mining and power generation industries. The effects of Hurricane Katrina resulted in further volatility in raw material pricing. The long term impact on supply is not determinable at this point in time. Margins in the rubber compounding business should recover to more acceptable levels as the industry has issued general price increases to recover the increase in energy and transportation costs. Profits will also benefit from the closure of the Waynesville facility.

The rail business has secured a new account to supply rail clips to the market in Columbia. New tooling has been developed and production will commence in the fourth quarter. As well, the demand for the fastening systems remains strong in North America, partially due to strength in the mining sector.

Sales and operating profits from the military division could improve in the fourth quarter due to new glove orders under existing contracts.



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



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

# Consolidated Balance Sheets

(thousands \$ CDN)

	September 30, 2005 (unaudited)	December 31, 2004
<b>ASSETS</b>		
<b>Current assets:</b>		
Accounts receivable	\$ 26,492	\$ 24,471
Inventories	25,174	28,228
Prepaid expenses	630	455
Current assets of discontinued operations (Note 2)	1,444	3,917
Total current assets	53,740	57,071
Capital assets, net	48,004	45,840
Long-term assets of discontinued operations (Note 2)	114	226
Goodwill	16,620	16,620
Other assets	1,586	2,407
Total assets	\$ 120,064	\$ 122,164
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current liabilities:</b>		
Demand loan (Note 8)	\$ 13,051	\$ 12,483
Accounts payable and accrued liabilities	18,650	22,133
Income taxes payable	2,140	387
Current liabilities of discontinued operations (Note 2)	106	640
Current portion of term loan and other debt	3,643	4,096
Total current liabilities	37,590	39,739
Term loan and other debt (Note 7)	16,762	17,500
Future income tax liabilities	8,527	9,780
Accrued post retirement benefit liability	1,265	1,071
Total liabilities	64,144	68,090
<b>Shareholders' equity:</b>		
Share capital	38,978	38,631
Contributed surplus (Note 3)	1,329	936
Cumulative translation adjustment (Note 10)	(266)	-
Retained earnings	15,879	14,507
Total shareholders' equity	55,920	54,074
Total liabilities and shareholders' equity	\$ 120,064	\$ 122,164

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, thousands \$ CDN, except per share amounts)

	Three months ended September 30		Nine months ended September 30	
	2005	2004	2005	2004
<b>NET SALES</b>	<b>\$ 53,827</b>	\$ 50,002	<b>\$ 174,984</b>	\$143,349
Cost of sales	<b>48,290</b>	42,958	<b>154,343</b>	122,842
Gross margin	<b>5,537</b>	7,044	<b>20,641</b>	20,507
<b>OPERATING EXPENSES:</b>				
General and administrative	<b>1,312</b>	1,703	<b>5,788</b>	5,820
Selling, marketing and distribution	<b>1,478</b>	1,874	<b>5,193</b>	5,612
Product research	<b>343</b>	331	<b>1,140</b>	1,039
Total operating expenses	<b>3,133</b>	3,908	<b>12,121</b>	12,471
Income before undernoted items	<b>2,404</b>	3,136	<b>8,520</b>	8,036
Rail patent judgement (Note 9)	<b>(4,002)</b>	-	<b>(4,002)</b>	-
Income (loss) before interest expense and other income	<b>(1,598)</b>	3,136	<b>4,518</b>	8,036
Interest expense	<b>728</b>	664	<b>2,309</b>	2,110
Other expense (income)	<b>152</b>	277	<b>(325)</b>	(100)
Income (loss) from continuing operations, before income taxes	<b>(2,478)</b>	2,195	<b>2,534</b>	6,026
Provision for income taxes (Note 4)	<b>(916)</b>	767	<b>755</b>	1,988
Net income (loss) from continuing operations	<b>(1,562)</b>	1,428	<b>1,779</b>	4,038
Loss from discontinued operations, net of tax (Note 2)	<b>(182)</b>	(500)	<b>(407)</b>	(1,546)
Net income (loss)	<b>(1,744)</b>	928	<b>1,372</b>	2,492
Retained earnings, beginning of period	<b>17,623</b>	14,339	<b>14,507</b>	12,775
Retained earnings, end of period	<b>\$ 15,879</b>	\$ 15,267	<b>\$ 15,879</b>	\$ 15,267
Net income (loss) per share				
From continuing operations				
– Basic	<b>\$ (0.07)</b>	\$ 0.06	<b>\$ 0.08</b>	\$ 0.18
– Diluted	<b>\$ (0.06)</b>	\$ 0.06	<b>\$ 0.07</b>	\$ 0.18
From net income (loss)				
– Basic	<b>\$ (0.08)</b>	\$ 0.04	<b>\$ 0.06</b>	\$ 0.11
– Diluted	<b>\$ (0.07)</b>	\$ 0.04	<b>\$ 0.06</b>	\$ 0.11

See accompanying notes to consolidated financial statements.



# Consolidated Statements of Cash Flows

(unaudited, thousands \$ CDN)

	Three months ended September 30		Nine months ended September 30	
	2005	2004	2005	2004
<b>CASH PROVIDED BY (USED IN):</b>				
<b>Operating Activities:</b>				
Net income from continuing operations	\$ (1,562)	\$ 1,428	\$ 1,779	\$ 4,038
Items not affecting cash:				
Amortization	1,236	1,387	3,800	4,599
Future income taxes	(1,298)	61	(1,253)	599
Foreign exchange loss	(172)	(544)	(77)	(260)
Options expense	181	66	393	66
Post-retirement benefits expense	65	60	194	178
	(1,550)	2,458	4,836	9,220
Changes in non-cash operating working capital balances	12,235	6,820	(871)	(1,171)
Net cash provided by continuing operations	10,685	9,278	3,965	8,049
Net cash provided by (used in) discontinued operations	97	(2,482)	1,644	(3,590)
Cash provided by operating activities	10,782	6,796	5,609	4,459
<b>Investing Activities:</b>				
Purchase of capital assets	(1,927)	–	(5,474)	(2,100)
Purchase of other assets	(785)	–	(1,099)	(5)
Disposition of other assets	–	–	1,240	–
Cash used in investing activities	(2,712)	–	(5,333)	(2,105)
<b>Financing Activities:</b>				
Net increase (decrease) in demand loan	(6,786)	(6,049)	568	(58)
Net increase (decrease) in term loan	(81)	–	1,512	–
Repayment of term debt	(750)	(750)	(2,250)	(2,250)
Repayment of other debt	(453)	3	(453)	(46)
Issuance of share capital	–	–	347	–
Cash used in financing activities	(8,070)	(6,796)	(276)	(2,354)
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	\$ 463	\$ 708	\$ 2,290	\$ 1,981
Cash income taxes remitted (recovered)	566	45	961	(297)

See accompanying notes to consolidated financial statements.

# Notes to Consolidated Financial Statements

Nine months ended September 30, 2005 and 2004 (Unaudited)

(thousands \$ CDN, 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, 2004, 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 2004.

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

## NOTE 2 – DISCONTINUED OPERATIONS

**Commercial Footwear** – During the quarter ended June 30, 2004, the Company adopted a formal plan to discontinue the manufacture of commercial footwear and to focus its footwear resources on the manufacture and sale of specialized products for emergency response and military markets. Commercial footwear production had become increasingly uncompetitive with foreign-sourced imports. The Company concluded an agreement to permit a third party to manufacture commercial footwear under the "Acton" brand-name. The Company agreed to continue to produce selected items until February 2005 to assist in the transition. The financial statements have been reclassified to segregate the results of the commercial footwear activities from continuing operations. The discontinued operations were previously reflected in the "AirBoss Engineered Products & Other" segment of the segmented results.

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

	Three months ended September 30		Nine months ended September 30	
	2005	2004	2005	2004
Net sales	\$ 175	\$ 3,749	\$ 1,357	\$ 8,982
Gross Margin	–	(22)	(52)	781
Operating expenses	(252)	688	341	2,441
Loss before tax	(252)	(710)	(393)	(1,660)
Net loss	\$ (171)	\$ (487)	\$ (267)	\$ (1,139)

Assets and liabilities held in discontinued operations:

	September 30, 2005	December 31, 2004
Accounts receivable	\$ 117	\$ 1,494
Inventory	–	1,011
Current assets	117	2,505
Accounts payable	26	488

The Company's assets and liabilities related to the commercial footwear activities will be liquidated in the normal course of business. The remaining finished goods were sold by August 2005 under the terms of a purchase agreement.

**Tire Manufacturing and Distribution** – During the quarter ended December 31, 2004, the Company adopted a formal plan to discontinue the manufacture of solid and segmented tires and to offer the business for sale. This segment of the tire market had become increasingly uncompetitive due to the performance and cost improvements made to pneumatic tires, with which this business competed. During the first quarter of 2005, the Company received expressions of interest in the business. Negotiations have been concluded for a sale of the related assets. The financial statements have been reclassified to segregate the results of the tire production unit located in Kitchener, Ontario and the sales, marketing and distribution subsidiary, AirBoss Polymer Products Inc., from continuing operations. The discontinued operations were previously reflected in the "AirBoss Engineered Products & Other" and the "Railway and distribution" segments of the segmented results.

## Notes *(continued)*

	Three months ended September 30		Nine months ended September 30	
	2005	2004	2005	2004
Net sales	\$ 438	\$ 838	\$ 1,706	\$ 2,373
Gross Margin	7	119	76	109
Operating expenses	15	210	294	858
Loss before tax	(8)	(91)	(218)	(749)
Net loss	\$ (11)	\$ (13)	\$ (140)	\$ (407)

Assets and liabilities held in discontinued operations:

	September 30, 2005	December 31, 2004
Accounts receivable	\$ 572	\$ 388
Inventory	740	994
Prepaid expenses	15	31
Current assets	1,327	1,412
Accounts payable	80	152
Capital assets	\$ 114	\$ 226

### NOTE 3 – STOCK OPTIONS

During the three month periods ended March 31, 2005 and June 30, 2005, the Company issued 50,000 and 306,000 stock options. No options were granted in the third quarter, 2005.

The fair value of options issued has been determined using the Black-Scholes option pricing model using the following assumptions:

	June 30, 2005	March 31, 2005
Risk-free rate	3.30%	3.48%
Dividend yield	0%	0%
Volatility factor of the expected market price of the Company's shares	65%	65%
Average expected option life (years)	5.0	5.0
Weighted-average grant date fair value per share of options granted during the year	\$ 2.62	\$ 2.31

The stock options issued vest as follows:

	June 13	February 31
2006	45,900	7,500
2007	45,900	7,500
2008	61,200	10,000
2009	76,500	12,500
2010	76,500	12,500
	306,000	50,000

The Company recorded stock-based compensation of \$0.1 million relating to current and prior year option grants in each of the first 2 quarters and \$0.2 million in the third quarter in general and administrative expenses in the statement of operations.

During the first quarter of 2005, 85,000 stock options were exercised at an exercise price of \$1.12 and in the second quarter, 130,000 stock options were exercised at an average exercise price of \$1.93. No stock options were exercised in the third quarter of 2005.

## NOTE 4 – INCOME TAXES

The provision for income taxes varies from the statutory rate for the following reasons:

	Three months ended September 30		Nine months ended September 30	
	2005	2004	2005	2004
Canadian tax rate net of manufacturing and processing deduction	\$ (888)	\$ 498	\$ 653	\$ 1,163
Federal large corporations tax	6	22	17	68
Foreign tax differentials	(182)	(21)	(229)	5
Permanent differences and other	69	(19)	109	(94)
	\$ (995)	\$ 480	\$ 550	\$ 1,142
Income tax expense, Continuing operations	\$ (916)	\$ 767	\$ 755	\$ 1,988
Income tax expense (recovery), Discontinued operations	(79)	(287)	(205)	(846)
	\$ (995)	\$ 480	\$ 550	\$ 1,142

## NOTE 5 – 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 U.S. and Canadian dollars. Amounts denominated in U.S. currency represents 66% of total accounts receivable, 78% of accounts payable, and 100% of bank indebtedness.

## NOTE 6 – FUTURE RETIREMENT BENEFITS

During the three month periods ended September 30, 2005 and 2004, the Company's future retirement benefits expenses were \$65,000 and \$60,000 respectively. Year-to-date, the retirement benefits expensed were \$194,000 and \$178,000 respectively.

## NOTE 7 – TERM LOAN

During the first quarter, negotiations to obtain an additional US \$6 million term loan with its existing term lending syndicate were concluded and the Company utilized \$1.6 million of this additional term facility to finance equipment related to the U.S. expansion. The term loan bears interest at U.S. bank prime plus 1.9%, calculated monthly, and principal is repayable in equal monthly installments (commencing the month following the final advance) with the balance repayable on October 15, 2006.

## NOTE 8 – OPERATING FACILITY

On April 28, 2005, the Company completed its process to obtain a new operating line facility to finance growth requirements which increased borrowing capacity from \$27 million to \$45 million.

The operating line of credit bears interest at a range from the bank's prime rate less 0.25% to prime plus 0.65% per annum, with respect to loans denominated in Canadian currency and from the U.S. prime rate less 1% to the U.S. prime rate with respect to loans denominated in U.S. currency.

The credit/security/letter agreement provides the lenders with a perfected first security interest on all accounts receivable and inventories of the Company and its subsidiaries, secured guarantees, and an inter-creditor arrangement with the term loan syndicate.

## NOTE 9 – RAIL PATENT JUDGEMENT

During the third quarter, AirBoss Railway Products, Inc., a wholly owned subsidiary of the Company, was notified that the United States Court of Appeals for the Federal Circuit has awarded damages of US \$3.4 million (CDN \$4.0 million) payable to the plaintiff in a patent infringement suit. These damages have been recorded as a one-time charge in the third quarter results and were paid subsequent to the quarter end. The ruling does not affect the current products sold by the Company.

## NOTE 10 – FOREIGN CURRENCY TRANSLATION

Prior to July 1, 2005, Railway Products was classified as an integrated foreign operation. It was determined that the operations of Railway Products do not impact the day-to-day foreign exposure of the Company in Canada, the operations themselves are not subject to material Canadian dollar exposure, and the exposure to exchange rate changes is essentially limited to the Company's net investment in the foreign operation. As a result, this foreign operation has been classified as self-sustaining and the current method was used to translate the balances of the foreign operation on consolidation. The self-sustaining foreign operations are translated into Canadian dollars at the period end exchange rate for assets and liabilities, and the average exchange rate in effect for the period for revenue and expenses. Net unrealized exchange gains and losses arising from the translation of foreign subsidiaries are shown in cumulative translation adjustment, as a separate component of shareholders' equity.

This change in practice was adopted prospectively effective July 1, 2005 and resulted in an increase in net income of approximately \$172,000 for the three month period ended September 30, 2005. The change also resulted in a decrease in net assets of \$94,000 and the creation of a cumulative translation loss of \$266,000.

## Notes *(continued)*

### NOTE 11 – SEGMENTED INFORMATION

Three months ended September 30, 2005	Sales excluding Inter-Company				Inter- Company
	Canada	USA	Other	Total	
Rubber compounding operations	\$ 16,996	\$ 21,929	\$ 2	\$ 38,927	\$ 370
Engineered products					
Railway Products	–	5,891	–	5,891	–
Acton and other	2,001	6,212	796	9,009	2,156
	<b>\$ 18,997</b>	<b>\$ 34,032</b>	<b>\$ 798</b>	<b>\$ 53,827</b>	<b>\$ 2,526</b>

Three months ended September 30, 2005	Engineered Products					Total
	Rubber Compounding Operations	Railway and Distribution Products	AEP & Other	Corporate & Inter-Company Eliminations	Rail Patent Judgement	
Sales	\$ 39,297	\$ 5,893	\$ 11,163	\$ (2,526)		\$ 53,827
Cost of sales	36,074	5,158	9,584	(2,526)		48,290
	3,223	735	1,579	–		5,537
Operating expenses	2,262	(127)	1,251	627		4,013
Rail patent judgement					4,002	4,002
Income (loss) before income taxes	961	862	328	(627)	(4,002)	(2,478)
Provision for income taxes						916
Net income (loss)/continuing operations						\$ (1,562)
Purchase of capital assets	\$ 1,522	\$ 144	\$ 250	\$ 11		\$ 1,927
Amortization – Capital and other assets	625	92	389	130		1,236

Three months ended September 30, 2004	Sales excluding Inter-Company				Inter- Company
	Canada	USA	Other	Total	
Rubber compounding operations	\$ 12,991	\$ 21,605	\$ 112	\$ 34,708	\$ 1,526
Engineered products					
Railway and distribution	61	3,446	10	3,517	10
Acton and other	1,546	8,429	1,802	11,777	1,187
	<b>\$ 14,598</b>	<b>\$ 33,480</b>	<b>\$ 1,924</b>	<b>\$ 50,002</b>	<b>\$ 2,723</b>

Three months ended September 30, 2004	Engineered Products					Total
	Rubber Compounding Operations	Railway and Distribution Products	AEP & Other	Corporate & Inter-Company Eliminations		
Sales	\$ 36,234	\$ 3,531	\$ 12,960	\$ (2,723)		\$ 50,002
Cost of sales	32,017	3,316	10,348	(2,723)		42,958
	4,217	215	2,612	–		7,044
Operating expenses	1,973	686	1,493	697		4,849
Income (loss) before income taxes	2,244	(471)	1,119	(697)		2,195
Provision for income taxes						(767)
Net income/continuing operations						\$ 1,428
Purchase of capital assets	\$ 295	\$ 1	\$ (299)	\$ 3		\$ –
Amortization – Capital and other assets	441	148	745	53		1,387



Nine months ended September 30, 2005	Sales excluding Inter-Company				Inter- Company
	Canada	USA	Other	Total	
Rubber compounding operations	\$ 50,356	\$ 66,966	\$ 219	\$ 117,541	\$ 869
Engineered products					
Railway Products	29	20,087	5	20,121	–
Acton and other	6,313	28,772	2,237	37,322	7,406
	<b>\$ 56,698</b>	<b>\$ 115,825</b>	<b>\$ 2,461</b>	<b>\$ 174,984</b>	<b>\$ 8,275</b>

Nine months ended September 30, 2005	Engineered Products					Total
	Rubber Compounding Operations	Railway and Distribution Products	AEP & Other	Corporate & Inter-Company Eliminations	Rail Patent Judgement	
Sales	\$ 118,411	\$ 20,121	\$ 44,727	\$ (8,275)		\$ 174,984
Cost of sales	109,049	17,317	36,252	(8,275)		154,343
	9,362	2,804	8,475	–		20,641
Operating expenses	6,796	895	4,410	2,004		14,105
Rail patent judgement					4,002	4,002
Income (loss) before income taxes	2,566	1,909	4,065	(2,004)	(4,002)	2,534
Provision for income taxes						(755)
Net income/continuing operations						\$ 1,779
Assets employed – Canada	\$ 74,191	\$ –	\$ 35,148	\$ 839		\$ 110,177
– USA	3,766	4,562	–	–		8,328
– Total	\$ 77,957	\$ 4,562	\$ 35,148	\$ 839		\$ 118,506
Purchase of capital assets	\$ 4,723	\$ 159	\$ 571	\$ 21		\$ 5,474
Amortization – Capital and other assets	1,851	281	1,359	309		3,800

Nine months ended September 30, 2004	Sales excluding Inter-Company				Inter- Company
	Canada	USA	Other	Total	
Rubber compounding operations	\$ 33,742	\$ 60,385	\$ 234	\$ 94,361	\$ 4,973
Engineered products					
Railway Products	129	16,617	21	16,767	14
Acton and other	5,651	23,825	2,745	32,221	4,880
	<b>\$ 39,522</b>	<b>\$ 100,827</b>	<b>\$ 3,000</b>	<b>\$ 143,349</b>	<b>\$ 9,867</b>

Nine months ended September 30, 2004	Engineered Products					Total
	Rubber Compounding Operations	Railway and Distribution Products	AEP & Other	Corporate & Inter-Company Eliminations		
Sales	\$ 99,334	\$ 16,781	\$ 37,676	\$ (9,867)		\$ 143,349
Cost of sales	88,841	14,484	29,959	(9,867)		122,842
	10,493	2,297	7,717	–		20,507
Operating expenses	6,413	2,045	4,079	1,944		14,481
Income (loss) before income taxes	4,080	252	3,638	(1,944)		6,026
Provision for income taxes						(1,988)
Net income/continuing operations						\$ 4,038
Assets employed – Canada	\$ 68,940	\$ –	\$ 37,751	\$ (962)		\$ 105,729
– USA	–	4,319	–	–		4,319
– Total	\$ 68,940	\$ 4,319	\$ 37,751	\$ (962)		\$ 110,048
Purchase of capital assets	\$ 1,582	\$ 99	\$ 415	\$ 4		\$ 2,100
Amortization – Capital and other assets	1,617	710	2,110	162		4,599

# AIRBOSS OF AMERICA CORP.

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