

ALPHA PRO TECH LTD  
Form 10-Q  
August 09, 2006

# SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

## FORM 10-Q

Quarterly Report pursuant to Section 13 or 15(d)  
of the Securities Exchange Act of 1934

For the Quarter Ended June 30, 2006

Commission File No. 01-15725

### Alpha Pro Tech, Ltd.

(exact name of registrant as specified in its charter)

**Delaware, U.S.A.**

(State or other jurisdiction of incorporation)

**Suite 112, 60 Centurian Drive  
Markham, Ontario, Canada**

(Address of principal executive offices)

**63-1009183**

(I.R.S. Employer Identification No.)

**L3R 9R2**

(Zip Code)

Registrant's telephone number, including area code: **(905) 479-0654**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2).

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.)

Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of August 7, 2006.

24,095,953 shares of common stock, \$.01 par value



**Alpha Pro Tech, Ltd.**

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1 Consolidated Financial Statements (Unaudited)

- a) Consolidated Balance Sheets -  
June 30, 2006 and December 31, 2005
- b) Consolidated Statements of Operations  
for the three and six months ended June 30, 2006  
and June 30, 2005
- c) Consolidated Statement of Shareholders' Equity  
for the six months ended June 30, 2006
- d) Consolidated Statements of Cash Flows  
for the six months ended June 30, 2006  
and June 30, 2005
- e) Notes to Consolidated Financial Statements

ITEM 2 Management's Discussion and Analysis of Financial  
Condition and Results of Operations

Cautionary Statements Regarding Forward-Looking Information

New Accounting Standards

ITEM 3 Quantitative and Qualitative Disclosures About Market Risk

ITEM 4 Controls and Procedures

PART II. OTHER INFORMATION

ITEM 5 Submission of Matters to a Vote Security Holders

ITEM 6 Exhibits and Reports on Form 8-K

SIGNATURES

EXHIBITS

Exhibit 31.1: Certification by CEO pursuant to Rule 13a-14(b) and  
Rule 15d-14(b)  
of the Exchange Act (filed herewith)

Exhibit 31.2: Certification by CFO pursuant to Rule 13a-14(b) and  
Rule 15d-14(b)  
of the Exchange Act (filed herewith)

Edgar Filing: ALPHA PRO TECH LTD - Form 10-Q

Exhibit 32.1: Certification by CEO pursuant to Section 906 of the Sarbanes-Oxley Act (filed herewith)

Exhibit 32.2: Certification by CFO pursuant to Section 906 of the Sarbanes-Oxley Act (filed herewith)

---

**Alpha Pro Tech, Ltd.**

**PART I. FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

We have prepared the following unaudited interim consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to these rules and regulations.

You should read the following unaudited interim consolidated financial statements and the accompanying notes together with our Annual Report on Form 10-K for the year ended December 31, 2005. Our 2005 Annual Report contains information that may be helpful in analyzing the financial information contained in this report and in comparing our results of operations for the three and six months ended June 30, 2006 with the same period in 2005.

1

---

**Consolidated Balance Sheets (Unaudited)**

	June 30, 2006	December 31, 2005 (1)
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 349,000	\$ 1,163,000
Accounts receivable, net of allowance for doubtful accounts of \$80,000 at June 30, 2006 and \$76,000 at December 31, 2005	5,609,000	3,954,000
Inventories, net	11,323,000	10,612,000
Prepaid expenses and other current assets	561,000	715,000
Deferred income taxes	430,000	430,000
Total current assets	18,272,000	16,874,000
Property and equipment, net	3,382,000	3,389,000
Goodwill, net	55,000	55,000
Intangible assets, net	133,000	119,000
Equity investments in and advances to unconsolidated affiliates	1,414,000	1,434,000
Total assets	\$ 23,256,000	\$ 21,871,000
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 524,000	\$ 648,000
Accrued liabilities	1,313,000	1,928,000
Total current liabilities	1,837,000	2,576,000
Deferred income taxes	652,000	652,000
Total liabilities	2,489,000	3,228,000
Shareholders' equity		
Common stock, \$.01 par value, 50,000,000 shares authorized, 24,095,955 and 23,787,955 issued and outstanding at June 30, 2006 and December 31, 2005, respectively	241,000	238,000
Additional paid-in capital	25,029,000	24,683,000
Accumulated deficit	(4,503,000)	(6,278,000)
Total shareholders' equity	20,767,000	18,643,000
Total liabilities and shareholders' equity	\$ 23,256,000	\$ 21,871,000

(1) The condensed consolidated balance sheet as of December 31, 2005 has been prepared using information from the audited financial statements at that date.

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

**Consolidated Statements of Operations (Unaudited)**

	For the Three Months Ended		For the Six Months Ended	
	June 30, 2006	2005	June 30, 2006	2005
Net sales	9,879,000	\$ 9,040,000	\$ 17,850,000	\$ 16,022,000
Cost of goods sold, excluding depreciation and amortization	5,256,000	4,813,000	9,586,000	8,634,000
Gross margin	4,623,000	4,227,000	8,264,000	7,388,000
Expenses:				
Selling, general and administrative	2,719,000	2,516,000	5,214,000	4,868,000
Depreciation and amortization	112,000	123,000	223,000	246,000
Income from operations	1,792,000	1,588,000	2,827,000	2,274,000
Other income (expense)				
Equity in income (loss) of unconsolidated affiliates, net of eliminations	(10,000 )		(20,000 )	
Interest, net	6,000	7,000	11,000	23,000
Income before provision for income taxes	1,788,000	1,595,000	2,818,000	2,297,000
Provision for income taxes	662,000	592,000	1,043,000	850,000
Net income	\$ 1,126,000	\$ 1,003,000	\$ 1,775,000	\$ 1,447,000
Basic net income per share	\$ 0.05	\$ 0.04	\$ 0.07	\$ 0.06
Diluted net income per share	\$ 0.05	\$ 0.04	\$ 0.07	\$ 0.06
Basic weighted average shares outstanding	24,092,384	23,678,955	24,081,010	23,662,572
Diluted weighted average shares outstanding	24,987,217	25,075,759	25,012,983	25,059,376

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

**Consolidated Statement of Shareholders Equity (Unaudited)**

	<b>Common Stock Shares</b>	<b>Amount</b>	<b>Additional Paid-in Capital</b>	<b>Accumulated Deficit</b>	<b>Total</b>
Balance at December 31, 2005	23,787,955	\$ 238,000	\$ 24,683,000	(\$6,278,000 )	\$ 18,643,000
Options exercised	308,000	3,000	346,000		349,000
Net income				1,775,000	1,775,000
Balance at June 30, 2006	24,095,955	\$ 241,000	\$ 25,029,000	(\$4,503,000 )	\$ 20,767,000

The accompanying notes are an integral part of these consolidated financial statements

4

---



**Consolidated Statements of Cash Flows (Unaudited)**

	<b>For the Six months Ended</b>	
	<b>June 30,</b>	
	<b>2006</b>	<b>2005</b>
<b>Cash Flows From Operating Activities:</b>		
Net income	\$ 1,775,000	\$ 1,447,000
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	223,000	246,000
Equity in loss of unconsolidated affiliate	20,000	
Changes in assets and liabilities:		
Accounts receivable, net	(1,655,000 )	(1,569,000 )
Inventories, net	(711,000 )	(3,552,000 )
Prepaid expenses and other current assets	154,000	182,000
Accounts payable and accrued liabilities	(739,000 )	237,000
Net cash used in operating activities:	(933,000 )	(3,009,000 )
<b>Cash Flows From Investing Activities:</b>		
Purchase of property and equipment	(196,000 )	(451,000 )
Purchase of intangible assets	(34,000 )	(10,000 )
Investment in Joint Venture		(550,000 )
Net cash used in investing activities	(230,000 )	(1,011,000 )
<b>Cash Flows From Financing Activities:</b>		
Proceeds from the exercise of stock options	349,000	289,000
Payments for the repurchase of common stock		(21,000 )
Net cash provided by financing activities	349,000	268,000
Decrease in cash during the period	(814,000 )	(3,752,000 )
Cash and cash equivalents, beginning of period	1,163,000	4,875,000
Cash and cash equivalents, end of period	\$ 349,000	\$ 1,123,000

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

**Notes to Consolidated Financial Statements (Unaudited)**

**1. The Company**

Alpha Pro Tech, Ltd. (Alpha ProTech, the Company, we, our, us) manufactures and distributes a line of disposable protective apparel and a line of infection control products for the cleanroom, industrial, pharmaceutical, medical and dental markets. The disposable protective apparel consists of a complete line of shoecovers, bouffant caps, coveralls, gowns, frocks and lab coats. The infection control line of products includes a line of face masks and eye shields. The Company also manufactures and distributes a line of medical bed pads and accessories as well as a line of pet beds. The Company's products are sold both under the Alpha Pro Tech brand name as well as under private label and are predominantly sold in the United States of America.

During the first quarter of 2005, the Company commenced sales from a new business segment, Alpha ProTech Engineered Products, Inc., a wholly-owned subsidiary of Alpha Pro Tech. This new segment consists of a line of construction supply weatherization products as well as a line of paint with antimicrobials. The construction supply weatherization products consist of house wrap and synthetic roof underlayment.

**2. Basis of Presentation**

The interim financial information included herein is unaudited; however, the information reflects all adjustments (consisting of normal recurring adjustments) that are, in the opinion of management, necessary for the fair presentation of the consolidated financial position, results of operations and cash flows for the interim periods. The consolidated financial statements should be read in conjunction with the consolidated financial statements for the year ended December 31, 2005, which are included in the Company's Annual Report on Form 10-K for the year ended December 31, 2005 (2005 10-K). The results of operations for the three and six months ended June 30, 2006 are not necessarily indicative of the results to be expected for the full year. The consolidated balance sheet at December 31, 2005 was extracted from the audited consolidated financial statements contained in the 2005 10-K and does not include all disclosures required by accounting principles generally accepted in the United States of America for annual consolidated financial statements.

Certain December 31, 2005 balances have been reclassified to conform to the current year's presentation.

**3. Stock Based Compensation**

The Company maintains two stock option plans under which the Company may grant incentive stock options and non-qualified stock options to employees and non-employee directors. Stock options have been granted with exercise prices at or above the fair market value on the date of grant. Options vest and expire according to terms established at the grant date.

The Company adopted Statement of Financial Accounting Standards No. 123R, Share-Based Payment (SFAS 123R) effective January 1, 2006, using the modified prospective application method. SFAS 123R requires companies to record compensation expense for the value of all outstanding and unvested share-based payments, including employee stock options and similar awards. As of December 31, 2005, the Company had no outstanding and unvested share-based awards. After December 31, 2005, no new awards of any kind have been granted under any of the option plans. As a result, the Company did not recognize any share-based compensation expense in its consolidated financial statements for the six months ended June 30, 2006.

Prior to the adoption of SFAS 123R, the Company accounted for its stock-based employee compensation plans using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees. No stock-based employee compensation cost was reflected in net income as all options granted under those stock-based

employee compensation plans had exercise prices equal to the market values of the underlying common shares on the dates of grant. The following table illustrates the effect on net income and earnings per share as if the Company had applied the fair value recognition provisions of SFAS 123R to stock-based employee compensation.

	<b>For the Three Months Ended June 30,</b>	<b>For the Six Months Ended June 30,</b>
	<b>2005</b>	<b>2005</b>
Net income, as reported	\$ 1,003,000	\$ 1,447,000
Add: Total stock-based employee compensation expense included in reported net income, net of related tax effects		
Deduct: Total stock-based employee compensation expense determined using the fair value method for all rewards, net of related tax effects	(93,000 )	(183,000 )
Pro forma net income	\$ 910,000	\$ 1,264,000
Net income per share:		
Basic as reported	\$ 0.04	\$ 0.06
Basic pro forma	0.04	0.05
Diluted as reported	0.04	0.06
Diluted pro forma	0.04	0.05

Stock options to purchase 2,505,000 and 2,972,000 shares of common stock were outstanding at June 30, 2006 and 2005, respectively. Of these outstanding stock options, all of the options to purchase common stock at June 30, 2006 and 2005 were included in the computation of diluted earnings per share because the exercise prices of the stock options were greater than the average share price of the Company's common stock and, therefore, the effect would have been dilutive. Based on the application of the treasury stock method, the dilutive effect of stock options was 894,834 and 931,973 for the three and six months ended June 30, 2006.

The following table summarizes stock option activity during the six months ended June 30, 2006:

	<b># of Options</b>	<b>Weighted-Average Price</b>
Options outstanding and exercisable December 31, 2005	2,813,000	\$1.03
Exercised	(308,000 )	1.13
Forfeited or expired	0	0.00
Options outstanding and exercisable at June 30, 2006	2,505,000	\$1.02

The weighted-average contractual life of stock options outstanding and exercisable at June 30, 2006 was 2.45 years. At June 30, 2006, the aggregate intrinsic value of stock options outstanding and exercisable was \$3,418,000. The intrinsic value is the amount by which the market value of the underlying common stock exceeds the exercise price of the respective stock option. The intrinsic value of stock options exercised during the three and six months ended June 30, 2006 was \$7,000 and \$ 352,000, respectively.

#### 4. New Accounting Standards

Based on the Company's review of new accounting standards released during the quarter ended June 30, 2006 the Company did not identify any standards requiring adoption that would have a significant impact on its consolidated financial statements.

We adopted Statement of Financial Accounting Standards No. 123R, Share-Based Payment (SFAS 123R) effective January 1, 2006, using the modified prospective application method. SFAS 123R requires companies to record compensation expense for the value of all outstanding and unvested share-based payments, including employee stock options and similar awards. As of January 1, 2006, we had no outstanding and unvested share-based awards.

As a result, we did not recognize any compensation expense related to share-based payments in our consolidated financial statements for the six months ended June 30, 2006.

#### 5. Inventories

Inventories consist of the following:

	June 30, 2006	December 31, 2005
Raw materials	\$ 8,706,000	\$ 7,489,000
Work in process	130,000	325,000
Finished goods	2,798,000	3,124,000
	11,634,000	10,938,000
Less reserve for slow-moving, obsolete or unusable inventory	(311,000)	(326,000)
	\$ 11,323,000	\$ 10,612,000

#### 6. Investment in and Advances to Unconsolidated Affiliates

On June 14, 2005, Alpha ProTech Engineered Products, Inc. entered into a joint venture with a manufacturer in India for the production of building products. Under terms of the joint venture agreement, a private company, Harmony Plastics Private Limited ( Harmony ), was created with ownership interests of 41.66% by Alpha ProTech Engineered Products, Inc. and 58.34% by Maple Industries and Associates. Alpha ProTech Engineered Products, Inc. contributed \$508,000 for share capital and Maple Industries and Associates contributed \$708,000.

This joint venture positions Alpha ProTech Engineered Products to respond to current and expected increased product demand for house wrap and synthetic roofing underlayment, and future capacity for sales of specialty roofing component products and custom products for industrial applications requiring high quality extrusion coated fabrics.

The capital from the initial funding along with a bank loan, which is guaranteed exclusively by Maple Industries and Associates and the assets of Harmony Plastics Private Limited, was utilized to purchase an existing 33,000 square-foot manufacturing facility in India; this facility includes manufacturing equipment necessary to produce roof underlayment. Harmony has also built a new 60,000 square-foot facility for the manufacturing of house wrap and other building products.

The Company is subject to the provisions of FIN 46 which defines the criteria by which the Company determines the proper accounting for its investments in related entities. Specifically, FIN 46 requires the Company to assess whether or not related entities are variable interest entities (VIEs), as defined. For those related entities that qualify as variable interest entities, FIN 46 requires the Company to determine whether or not the Company is the primary beneficiary of the VIE, and if so, to consolidate the VIE.

The Company has determined that Harmony is not a VIE and is therefore considered to be an unconsolidated affiliate.

The Company records its investment in Harmony as Equity investments in and advances to unconsolidated affiliates on the accompanying Consolidated Balance Sheets. The Company records its equity interest in Harmony's results of operations as equity in income (loss) of unconsolidated affiliates on the accompanying Consolidated Statements of Operations. The Company has not received distributions from Harmony related to its investment.

The Company reviews its investment in Harmony for impairment in accordance with APB No. 18, The Equity Method of Accounting for Investments in Common Stock. APB No. 18 requires recognition of a loss when the decline in an investment is other-than-temporary. In determining whether the decline is other-than-temporary, the Company considers the nature of the industry in which Harmony operates, their historical performance, their performance in relation to their peers and the current economic environment.

As of June 30, 2006, Alpha ProTech Engineered Products has invested \$1,450,000 in the joint venture; \$508,000 for share capital and a \$942,000 long term advance. The \$942,000 long term advance for materials is to be fifty percent repaid monthly over a six year term commencing in July 2006 and the balance is to be paid in the seventh year. Effective April 2006, interest of 3.5% is to be paid on this advance.

Harmony commenced operations in August of 2005. For the three and six months ended June 30, 2006, Alpha ProTech Engineered Products purchased \$1,762,000 and \$3,618,000, respectively from Harmony. For the three months ended June 30, 2006, we recorded an equity loss in unconsolidated affiliate of \$10,000. For the six months ended June 30, 2006, we recorded an equity loss in unconsolidated affiliate of \$20,000. As of June 30, 2006, our investment in Harmony is \$1,414,000 which comprised our original \$1,450,000 investment less \$36,000 in total equity loss in unconsolidated affiliate.

## 7. Accrued Liabilities

Accrued liabilities consist of the following:

	June 30, 2006	December 31, 2005
Payroll accrual	\$ 182,000	\$ 188,000
Commission and bonus accrual	465,000	669,000
Accrued professional fees	117,000	160,000
Accrued rebates and other	172,000	354,000
Income taxes payable	377,000	557,000
	\$ 1,313,000	\$ 1,928,000

## 8. Basic and Diluted Net Income Per Share

The following table provides a reconciliation of both net income and the number of shares used in the computation of basic earnings per share (EPS), which utilizes the weighted average number of shares outstanding without regard to potential shares, and diluted EPS, which includes all such dilutive shares:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2006	2005	2006	2005
Net income (Numerator)	\$ 1,126,000	\$ 1,003,000	\$ 1,775,000	\$ 1,447,000
Shares (Denominator):				
Basic weighted average shares outstanding	24,092,384	23,678,955	24,081,010	23,662,572
Add: Dilutive effect of stock options and warrants	894,833	1,396,804	931,973	1,396,804
Diluted weighted average shares outstanding	24,987,217	25,075,759	25,012,983	25,059,376
Net income per share:				
Basic	\$ 0.05	\$ 0.04	\$ 0.07	\$ 0.06
Diluted	\$ 0.05	\$ 0.04	\$ 0.07	\$ 0.06

## 9. Activity of Business Segments

The Company operates through four segments:

**Disposable Protective Apparel Products:** consisting of a complete line of disposable protective clothing such as shoecovers (including the Aqua Track and spunbond shoecovers), bouffant caps, coveralls, frocks, lab coats and hoods, for the pharmaceutical, cleanroom, industrial and medical markets.

**Infection Control Products:** consisting of a line of face masks and eye shields principally for the medical, dental and industrial markets.

**Extended Care Products:** consisting of a line of medical bed pads using Unreal Lambskin® (synthetic lambskin). The Unreal Lambskin® is used to produce medical bed pads, which prevent decubitus ulcers or bedsores on long term care patients. The Unreal Lambskin® is also used to manufacture bedrail pads, knee and elbow protectors, as well as wheelchair accessories. The Company also manufactures a line of pet beds and pet toy accessories with this material.

**Engineered Products:** this fourth segment was formed during the second quarter 2004 with the establishment of Alpha ProTech Engineered Products, Inc., a wholly-owned subsidiary. This segment consists of a line of construction supply weatherization products as well as a line of paint with antimicrobials. The construction supply weatherization products consist of building wrap,

synthetic roof underlayment and antimicrobial mold resistant framing sealant. The line of paint with antimicrobials is designed to inhibit growth of bacteria, fungi and algae on the painted surfaces in hospitals, surgical rooms and cleanrooms and associated controlled environments. Of note, our equity in income (loss) of unconsolidated affiliates (Harmony) is included in the total segment income for Engineered products in the table below.

The accounting policies of the segments are the same as those described previously under *Summary of Significant Accounting Policies* in the 2005 10-K. Segment data excludes charges allocated to head office and corporate sales/marketing departments and income taxes. The Company evaluates the performance of its segments and allocates resources to them based primarily on net sales

The following table shows net sales for each segment for the three months ended June 30, 2006 and 2005:

	For the Three Months Ended		For the Six Months Ended	
	June 30, 2006	2005	June 30, 2006	2005
Disposable protective apparel	\$ 5,518,000	\$ 6,419,000	\$ 9,588,000	\$ 10,662,000
Infection control	1,833,000	1,165,000	3,516,000	2,381,000
Engineered products	2,210,000	1,115,000	3,992,000	2,105,000
Extended care	318,000	341,000	754,000	874,000
Consolidated total net sales	\$ 9,879,000	\$ 9,040,000	\$ 17,850,000	\$ 16,022,000

The following table shows the reconciliation of total segment income to total consolidated net income for the three months and six months ended June 30, 2006 and 2005:

	For the Three Months Ended		For the Six Months Ended	
	June 30, 2006	2005	June 30, 2006	2005
Disposable protective apparel	\$ 2,083,000	\$ 2,574,000	\$ 3,453,000	\$ 4,057,000
Infection control	895,000	482,000	1,688,000	959,000
Engineered products	290,000	34,000	415,000	(81,000)
Extended care	25,000	17,000	83,000	105,000
Total segment income	3,293,000	3,107,000	5,639,000	5,040,000
Unallocated corporate overhead expenses	(1,505,000)	(1,512,000)	(2,821,000)	(2,743,000)
Provision for income taxes	(662,000)	(592,000)	(1,043,000)	(850,000)
Consolidated net income	\$ 1,126,000	\$ 1,003,000	\$ 1,775,000	\$ 1,447,000





Revenue Recognition: For sales transactions, we comply with the provisions of the SEC's Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition, which states that revenue should be recognized when the following revenue recognition criteria are met: (1) persuasive evidence of an arrangement exists; (2) the product has been shipped and the customer takes ownership and assumes the risk of loss; (3) the selling price is fixed or determinable; and (4) collection of the resulting receivable is reasonably assured. These criteria are satisfied upon shipment of product and revenues are recognized accordingly.

Sales are reduced for any anticipated sales returns, rebates and allowances based on historical experience. Since our return policy is only 90 days and our products are not generally susceptible to external factors such as technological obsolescence or significant changes in demand, we are able to make a reasonable estimate for returns. We offer end-user product specific and sales volume rebates to select distributors. Our rebates are based on actual sales and accrued monthly.

Stock Based Compensation: The Company adopted Statement of Financial Accounting Standards No. 123R, Share-Based Payment (SFAS 123R) effective January 1, 2006, using the modified prospective application method. SFAS 123R requires companies to record compensation expense for the value of all outstanding and unvested share-based payments, including employee stock options and similar awards. As of January 1, 2006, the Company had no outstanding and unvested share-based payments. The Company did not recognize any share-based compensation expense in its consolidated financial statements for the six months ended June 30, 2006.

Prior to the adoption of SFAS 123R, the Company accounted for its stock-based employee compensation plans using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees. No stock-based employee compensation cost was reflected in net income as all options granted under those stock-based employee compensation plans had exercise prices equal to the market values of the underlying common shares on the dates of grant.

The fair values of stock option grants are determined using the Black-Scholes option pricing model and the following assumptions: expected stock price volatility based on historic and management's expectations of future volatility, risk-free interest rates from published sources, weighted average expected option lives based on historical data and no dividend yield, as management currently does not intend to pay dividends in the near future. The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and that are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including expected stock price volatility. Our stock options have characteristics significantly different from those of traded options and changes in the subjective input assumptions can materially affect their fair value.

## OVERVIEW

Alpha Pro Tech is in the business of protecting people, products and environments. We accomplish this by developing, manufacturing and marketing a line of high-value disposable protective apparel and infection control products for the cleanroom, industrial, pharmaceutical, medical and dental markets. We also manufacture and distribute a line of medical bed pads and accessories as well as a line of pet beds. Our products are sold both under the Alpha Pro Tech brand name as well as under private label.

During the first quarter of 2005, we commenced sales from a new business segment, Alpha ProTech Engineered Products, Inc. (Engineered Products), a wholly-owned subsidiary of Alpha Pro Tech. This new segment consists of a line of construction supply weatherization products as well as a line of paint with antimicrobials. The construction supply weatherization products consists of house wrap (Perma Wrap) and a synthetic roof underlayment (AlphaProtector SUL). The line of paint with antimicrobials is designed to inhibit growth of bacteria, fungi and algae on the painted surfaces in hospitals, surgical rooms and cleanrooms and associated controlled environments. In addition to our paint with antimicrobials, we have also developed a line of sealants with antimicrobials to be used for mold remediation. The Engineered Products segment is expected to contribute significantly to revenue growth in 2006.

This line of products is a natural extension of our core capabilities: creating proprietary products designed to protect people and environments. The house wrap offers a weather resistant barrier designed to lower energy consumption costs. The proprietary synthetic roof underlayment is designed to resist the environment, as opposed to conventional roofing underlayment that is prone to rapid degradation and mold growth.

Our products are classified into six groups: Disposable protective apparel, consisting of a complete line of shoe covers, bouffant caps, gowns, coveralls and lab coats; infection control products, consisting of a line of face masks and eye shields; extended care products, consisting of a line of medical bed pads, wheelchair covers, geriatric chair surfaces, operating room; and a line of paint with antimicrobials designed to inhibit growth of bacteria, fungi and algae on painted surfaces.

Our products as classified above are grouped into four business segments. The Disposable Protective Apparel segment, consisting of disposable protective apparel; the Infection Control segment, consisting of face masks and eye shields; the Extended Care segment, consisting of extended care products, namely medical bed pads and pet beds; and the Engineered Products segment, consisting of construction weatherization products such as house wrap and synthetic roof underlayment as well as a line of antimicrobial paint.

Our target markets are pharmaceutical manufacturing, bio-pharmaceutical manufacturing and medical device manufacturing, lab animal research, high technology electronics manufacturing which includes the semi-conductor market, medical and dental distributors, pet stores and pet distributors and construction supply and roofing distributors.

Our products are used primarily in cleanrooms, industrial safety manufacturing environments, health care facilities such as hospitals, laboratories and dental offices, as well as construction supply sites. Our pet beds are used by pet owners and veterinarians. Our products are distributed principally in the United States through a network consisting of purchasing groups, national distributors, local distributors, independent sales representatives and our own sales and marketing force.

Consolidated sales for the quarter ended June 30, 2006 increased to a record \$9,879,000 from \$9,040,000 for the same quarter of 2005, representing an increase of \$839,000 or 9.3%. Consolidated sales for the six months ended June 30, 2006 increased to \$17,850,000 from \$16,022,000 for the six months ended June 30, 2005, representing an increase of \$1,828,000 or 11.4%.

Engineered Products segment sales of house wrap and synthetic roof underlayment during the second quarter of 2006 was \$2,210,000 compared to \$1,115,000 for the same period of 2005, an increase of 98.2%. For the six months ended June 30, 2006 sales increased by \$1,187,000 or 89.6% to \$3,992,000 from \$2,105,000 in the same period of 2005. This segment is expected to continue to grow significantly in 2006.

Sales in our Disposable Protective Apparel segment that services the pharmaceutical, cleanroom and industrial safety markets declined by 14.0% or \$901,000 to \$5,518,000 for the quarter ended June 30, 2006 compared to \$6,419,000 for the quarter ended June 30, 2005. For the six months ended June 30, 2006 sales were \$9,588,000 compared to \$10,662,000 for the same period of 2005, a decrease of \$1,074,000 or 10.1%. Although sales were down in the second quarter of 2006 as compared to the same period of 2005, sales during this past quarter of \$5.5 million were in fact the second highest in company history next only to the second quarter of 2005. In addition, sales during this past quarter increased sequentially quarter over quarter by 34.1%. For the six months, sales have decreased but shipments by our largest distributor to its end users were up slightly. Even though sales are down year to date, we expect that the second half of 2006 will be significantly better than the second half of last year.

Infection Control segment sales increased by \$668,000 or 57.3% to \$1,833,000 for the second quarter ended June 30, 2006 compared to \$1,165,000 for the same period of 2005. For the six months ended

June 30, 2006 sales increased by \$1,135,000 or 47.7% to \$3,516,000 from \$2,381,000 in the same period of 2005. This is primarily due to strong N-95 Respirator mask sales as a result of concerns about Avian Flu.

## RESULTS OF OPERATIONS

The following table sets forth certain operational data as a percentage of sales for the periods indicated:

	For the Three Months Ended		For the Six Months Ended	
	June 30, 2006	%	2005	%
Sales	100.0	%	100.0	%
Gross profit	46.8		46.7	
Selling, general and administrative	27.5		27.8	
Income from operations	18.1		17.5	
Income before provision for income taxes	18.1		17.6	
Net income	11.4		11.1	

### Three months and six months ended June 30, 2006, compared to the three and six months ended June 30, 2005

**Sales.** Consolidated sales for the quarter ended June 30, 2006 increased to a record \$9,879,000 from \$9,040,000 for the quarter ended June 30, 2005, representing an increase of \$839,000 or 9.3%. We attribute the increase primarily to increased sales of construction supply weatherization products of \$1,095,000 and to increased infection control segment sales of \$668,000, partially offset by decreased sales of disposable protective apparel products of \$901,000 and decreased sales from our Extended Care Unreal Lambskin segment of \$23,000.

Sales for the Disposable Protective Apparel segment for the quarter ended June 30, 2006 decreased by \$901,000 or 14.0% to \$5,518,000 compared to \$6,419,000 for the same period of 2005. Although the Disposable Protective Apparel segment sales were down in the second quarter of 2006 as compared to the same period of 2005, sales during this past quarter of \$5.5 million were in fact the second highest in company history next only to the second quarter of 2005. Sales in the second quarter of 2005 were unusually high due to a back-order situation that occurred in the first quarter of 2005. In addition, sales during this past quarter increased sequentially quarter over quarter by 34.1%. We expect growth in this segment in 2006 as we launch our ComforTech® line of products.

Infection Control segment sales for the quarter ended June 30, 2006 increased by \$668,000 or 57.3% to \$1,833,000 compared to \$1,165,000 for the same period of 2005. Mask sales in this segment, especially sales of our N-95 NIOSH approved Respirator mask, were very strong in the second quarter of 2006 as concerns about Avian Flu continued. We expect continued strength in this segment if the Avian Flu continues to be a worldwide concern.

The Engineered Products segment consists of a line of construction supply weatherization products (house wrap, roof underlayment) as well as a line of paint with antimicrobials. Engineered Products sales for the quarter ended June 30, 2006 increased by \$1,095,000 or 98.2% to \$2,210,000 compared to

## Edgar Filing: ALPHA PRO TECH LTD - Form 10-Q

\$1,115,000 for the same period of 2005. The breakdown of the Engineered Products sales is as follows for the quarter ended June 30, 2006: 69% house wrap and 31% roof underlayment. Roof underlayment sales increased to 31% of total Engineered Products sales in the second quarter of 2006 from 25% for fiscal 2005. In addition, roof underlayment sales increased by 54% in the second quarter of 2006 as compared to the first quarter of 2006. We expect continued significant growth from the roof underlayment product line.

Sales by quarter for Engineered Products are as follows: first quarter 2005 was \$1.0 million, second quarter 2005 was \$1.1 million, third quarter 2005 was \$1.4 million, fourth quarter 2005 was \$1.2 million and first quarter 2006 was \$1.8 million and second quarter 2006 was \$2.2 million. We are working very closely with our exclusive distributor and are encouraged by the response to our product line. We expect significant growth from this segment in 2006.

Sales from our Extended Care segment, which includes a line of medical bed pads as well as pet beds, decreased by \$23,000 or 6.7% to \$318,000 for the quarter ended June 30, 2006 from \$341,000 for the quarter ended June 30, 2005. The decrease in sales is primarily the result of less medical bed pad sales, partially offset by increased pet bed sales. This line of products is not expected to be a growth segment for the Company.

Consolidated sales for the six months ended June 30, 2006 increased to \$17,850,000 from \$16,022,000 for the six months ended June 30, 2005, representing an increase of \$1,828,000 or 11.4%. We attribute the increase primarily to increased sales of construction supply weatherization products of \$1,887,000 and to increased infection control segment sales of \$1,135,000, partially offset by decreased sales of disposable protective apparel products of \$1,074,000 and decreased sales from our Extended Care segment of \$120,000.

Sales for the Disposable Protective Apparel segment for the six months ended June 30, 2006 were \$9,588,000 compared to \$10,662,000 for the same period of 2005, a decrease of \$1,074,000 or 10.1%. Although segment sales have decreased for the six months ended June 30, 2006, shipments by our largest distributor to its end users were up slightly. Even though the Apparel segment is down year to date, we expect that the second half of 2006 will be significantly better than the second half of last year. Sales for the last six months of 2005 were the lowest of any six month period since 2003. Although our sales dropped significantly in the latter half of 2005, our largest distributor's sales to their end users were fairly consistent with prior periods. The decline in sales to this distributor can be attributed to slowdown in orders from them to reduce their inventory levels. We anticipate long-term growth from this segment.

Infection Control segment sales for the six months ended June 30, 2006 increased by \$1,135,000 or 47.7% to \$3,516,000 from \$2,381,000 in the same period of 2005. Sales of our N-95 NIOSH approved Respirator mask have been very strong in the six months ended June 30, 2006 due to concerns about Avian Flu. We have significant manufacturing capacity for the N-95 Respirator mask in the event that demand surges.

The Engineered Products segment sales for the six months ended June 30, 2006 increased by \$1,887,000 or 89.6% to \$3,992,000 from \$2,105,000 in the same period of 2005. The breakdown of the construction supply weatherization products is as follows for the six months ended June 30, 2006: 72% house wrap and 28% roof underlayment. The construction supply weatherization products account for almost all of the sales for the six months ended June 30, 2006. Management expects this segment to contribute significantly to overall consolidated revenue growth.

Sales of the Company's Extended Care segment decreased by \$120,000 or 13.7% to \$754,000 for the six months ended June 30, 2006 from \$874,000 for the six months ended June 30, 2005. This decrease of \$120,000 in sales is primarily the result of a decrease in medical bed pad sales.

**Gross Profit** Gross profit increased by 9.4% to \$4,623,000 for the quarter ended June 30, 2006 from \$4,227,000 for the same period in 2005. Gross profit margin remained basically flat at 46.8% for the quarter ended June 30, 2006 as compared to 46.7% for the same period in 2005. Gross profit margin was relatively unchanged at 46.3% for the six months ended June 30, 2006 from 46.1% for the same period in 2005.

Gross profit margin on the Engineered Products segment was 31.0% for the quarter ended June 30, 2006 as compared to 25.2% for the same period of 2005. Gross profit margin was 30.3% for the six months ended June 30, 2006 as compared to 23.0% for the same period of 2005. Gross profit by quarter for Engineered Products is as follows: first quarter 2005 was 20.6%, second quarter 2005 was 25.2%, third quarter 2005 was 28.2%, fourth quarter 2005 was 25.1%, first quarter 2006 was 29.5% and second quarter 2006 was 31.0%. Gross profit on this product line is expected to be in low to mid 30% range for the second half of this year.

**Selling, General and Administrative Expenses.** Selling, general and administrative expenses increased by \$203,000 or 8.1% to \$2,719,000 for the quarter ended June 30, 2006 from \$2,516,000 for the quarter ended June 30, 2005. As a percentage of net sales, selling, general and administrative expenses decreased slightly to 27.5% for the quarter ended June 30, 2006 from 27.8% for the same period in 2005. We believe that we have built the infrastructure required to substantially grow our business and as our revenue grows our expenses are expected to continue to decrease as a percentage of sales.

The increase of \$203,000 in selling, general and administrative expenses primarily consists of increased employee compensation expense of \$79,000, increased expenses for Engineered Products of \$131,000, increased expense for the executive bonus program of \$22,000 and increased general office expenses of \$16,000, partially offset by decreased Sarbanes-Oxley Corporate Governance costs of \$45,000.

Selling, general and administrative expenses increased by \$346,000 or 7.1% to \$5,214,000 for the six month ended June 30, 2006 from \$4,868,000 for the six months ended June 30, 2005. As a percentage of net sales, selling, general and administrative expenses decreased to 29.2% for the six months ended June 30, 2006 from 30.4% for the same period in 2005. The increase in selling, general and administrative expenses primarily consists of increased payroll costs of \$239,000, increased expenses for Engineered Products of \$190,000, increased expense for the executive bonus program of \$58,000 and increased general expenses of \$1,000, partially offset by decreased Sarbanes-Oxley Corporate Governance costs of \$89,000, decreased non Engineered Products marketing expenses of \$53,000.

The chief executive officer and president are each entitled to a bonus equal to 5% of the pre-tax profits of the Company. Bonuses of \$199,000 were accrued for the quarter ended June 30, 2006 as compared to \$177,000 in the same period of 2005. Total bonuses of \$313,000 were accrued for the six months ended June 30, 2006 as compared to \$255,000 in the same period of 2005.

**Depreciation and Amortization.** Depreciation and amortization expense decreased by \$11,000 or 8.9% to \$112,000 for the quarter ended June 30, 2006 from \$123,000 for the same period in 2005. Depreciation and amortization expense decreased by \$23,000 to \$223,000 for the six months ended June 30, 2006 from \$246,000 for the same period in 2005. The decrease is primarily attributable to a reduction in depreciation for office equipment, computers and software, partially offset by increased depreciation for Engineered Products.

**Income from Operations.** Income from operations increased by \$204,000 or 12.8%, to \$1,792,000 for the quarter ended June 30, 2006 as compared to income from operations of \$1,588,000 for the quarter ended June 30, 2005. The increase in income from operations is due to an increase in gross profit of \$396,000 and a decrease in depreciation and amortization of \$11,000, partially offset by an increase in selling, general and administrative expenses of \$203,000.

Income from operations increased by \$553,000 or 24.3%, to \$2,827,000 for the six months ended June 30, 2006 as compared to income from operations of \$2,274,000 for the six months ended June 30, 2005.



## Edgar Filing: ALPHA PRO TECH LTD - Form 10-Q

The increase in income from operations is primarily due to an increase in gross profit of \$876,000 and a decrease in depreciation and amortization of \$23,000, partially offset by an increase in selling, general and administrative expenses of \$346,000.

**Net Interest.** For the quarter ended June 30, 2006, we had net interest income of \$6,000 compared to net interest income of \$7,000 for the quarter ended June 30, 2005. Interest expense remained flat at \$2,000 for the quarter ended June 30, 2006 compared to the same period of 2005. Interest income decreased to \$8,000 for the quarter ended June 30, 2006 as compared to \$9,000 for the same period of 2005.

For the six months ended June 30, 2006, we had net interest income of \$11,000 compared to net interest income of \$23,000 for the quarter ended June 30, 2005. Interest expense remained unchanged at \$4,000 for the six months ended June 30, 2006 compared to \$4,000 for the same period of 2005. Interest income decreased by \$12,000 to \$15,000 for the six months ended June 30, 2006 as compared to \$27,000 for the same period of 2005.

**Equity in income (loss) of unconsolidated affiliates, net of eliminations.** On June 14, 2005 Alpha ProTech Engineered Products, Inc. entered into a joint venture with a manufacturer in India for the production of building products. Under terms of the joint venture agreement, a private company, Harmony Plastics Private Limited (Harmony), was created with ownership interests of 41.66% by Alpha ProTech Engineered Products, Inc. and 58.34% by Maple Industries and Associates. Alpha ProTech Engineered Products has invested \$1,450,000 in the joint venture; \$508,000 for share capital and \$942,000 in a long term advance. Effective April 2006, interest of 3.5 % is to be paid on this advance. Half of this \$942,000 advance is to be repaid monthly over a six year term commencing in July 2006 and the balance is to be paid in the seventh year.

The Company is subject to the provisions of FASB Interpretation ( FIN ) No. 46, Consolidation of Variable Interest Entities an interpretation of ARB No. 51, which redefines the criteria by which the Company determines the proper accounting for its investments in related entities. Specifically, FIN 46 requires the Company to assess whether or not related entities are variable interest entities ( VIE s), as defined. For those related entities that qualify as variable interest entities, FIN 46 requires the Company to determine whether or not the Company is the primary beneficiary of the VIE, and if so, to consolidate the VIE. The Company has determined that Harmony is not a VIE and is therefore considered to be an unconsolidated affiliate.

Harmony commenced operations in August of 2005. For the three months ended June 30, 2006, we recorded an equity loss in unconsolidated affiliate of \$10,000. For the six months ended June 30, 2006, we recorded an equity loss in unconsolidated affiliate of \$20,000.

**Income Before Provision for Income Taxes.** Income before provision for income taxes for the quarter ended June 30, 2006 was \$1,788,000 compared to \$1,595,000 for the quarter ended June 30, 2005, representing an increase of \$193,000 or 12.1%. The increase in income before provision for income taxes is due to an increase in gross profit of \$396,000, a decrease in depreciation and amortization of \$11,000, partially offset by an increase in selling, general and administrative expenses of \$203,000, a decrease in net interest income of \$1,000 and a loss of \$10,000 from our unconsolidated affiliate.

Three months and six months ended June 30, 2006, compared to the three and six months ended June 30, 2005

## Edgar Filing: ALPHA PRO TECH LTD - Form 10-Q

Income before provision for income taxes for the six months ended June 30, 2006 was \$2,818,000 compared to \$2,297,000 for the six months ended June 30, 2005, representing an increase of \$521,000 or 22.7%. The increase in income from operations is primarily due to an increase in gross profit of \$876,000 and a decrease in depreciation and amortization of \$23,000, partially offset by an increase in selling, general and administrative expenses of \$346,000, a decrease in net interest income of \$12,000 and a loss of \$20,000 from our unconsolidated affiliate.

For the Engineered Products segment, income from operations for the three months ended June 30, 2006 was \$290,000 as compared to \$34,000 for the second quarter of 2005. Engineered Products income from operations for six months ended June 30, 2006 was \$415,000 as compared to a loss from



operations of \$81,000 for the same period of 2005. We expect profitability on this segment to continue to improve as our sales grow.

**Provision for Income Taxes** The provision for income taxes for the quarter ended June 30, 2006 was \$662,000 compared to \$592,000 for the quarter ended June 30, 2005. The increase in income taxes is due to higher income before provision for income taxes in 2006. The effective tax rate was 37.0% for the quarter ended June 30, 2006 as compared to 37.1% for the same period in 2005.

The provision for income taxes for the six months ended June 30, 2006 was \$1,043,000, as compared to \$850,000 for the six months ended June 30, 2005. The increase in income taxes is due to higher income before provision for income taxes in 2005. The effective tax rate was approximately 37.0% for both the six months ended June 30, 2006 and the same period in 2005.

**Net Income.** Net income for the quarter ended June 30, 2006 was \$1,126,000 compared to net income of \$1,003,000 for the quarter ended June 30, 2005, an increase of \$123,000 or 12.3%. The net income increase was primarily due to an increase in income before provision for income taxes of \$193,000, partially offset by an increase in income taxes of \$70,000. Net income as a percentage of sales for the quarter ended June 30, 2006 and 2005 was 11.4% and 11.1% respectively. Basic and diluted income per share for the quarter ended June 30, 2006 and 2005 were \$0.05 and \$0.04, respectively.

Net income for the six months ended June 30, 2006 was \$1,775,000 compared to net income of \$1,447,000 for the same period of 2005, an increase of \$328,000 or 22.7%. The net income increase was primarily due to an increase in income before provision for income taxes of \$521,000, partially offset by an increase in income taxes of \$193,000. Basic and diluted income per share for the six months ended June 30, 2006 and 2005 were \$0.07 and \$0.06, respectively

#### **LIQUIDITY AND CAPITAL RESOURCES**

As of June 30, 2006, we had cash and cash equivalents of \$349,000 and working capital of \$16,435,000, an increase in working capital of 14.9% or \$2,137,000 since December 31, 2005. As of June 30, 2006, our current ratio was 9.95:1 as compared to 6.55:1 as of December 30, 2005. Cash decreased by \$814,000 to \$349,000 as of June 30, 2006 as compared to \$1,163,000 as of December 31, 2005. The decrease in cash is primarily due to cash used in operating activities of \$933,000, the purchase of property and equipment of \$196,000 and the purchases of intangible assets of \$34,000, partially offset by cash proceeds of \$349,000 from the exercise of stock options.

We have a \$3,500,000 credit facility with a bank, consisting of a line of credit with interest at prime plus 0.5%. At June 30, 2006, the prime interest rate was 8.25%. The line of credit was renewed in May 2005 and expires in May 2007. The Company's borrowing capacity on the line of credit was \$3,500,000 at June 30, 2006. The available line of credit is based on a formula of eligible accounts receivable and inventories. As of June 30, 2006, we had not borrowed on this line of credit. As of June 30, 2006, we did not have any debt.

Net cash used in operating activities was \$933,000 for the six months ended June 30, 2006 compared to \$3,009,000 net cash used in operating activities for the quarter ended June 30, 2005. The net cash used in operating activities of \$933,000 for the quarter ended June 30, 2006 is due to an increase in inventory of \$711,000, an increase in accounts receivable of \$1,655,000, and a decrease in accounts payable and accrued liabilities of \$739,000, partially offset by net income of \$1,775,000, a decrease in prepaid expenses of \$154,000, depreciation and amortization of \$223,000 and equity in loss of unconsolidated affiliate of \$20,000. The net cash used in operating activities of \$3,009,000 for the quarter ended June 30, 2005 is due to an increase in inventory of \$3,552,000 and an increase in accounts receivable of \$1,569,000, and partially offset by net income of \$1,447,000, an increase in accounts payable and

## Edgar Filing: ALPHA PRO TECH LTD - Form 10-Q

accrued liabilities of \$237,000 a decrease in prepaid expenses of \$182,000 and depreciation and amortization of \$246,000.

Accounts receivable increased by \$1,655,000 or 41.9% to \$5,609,000 for the six months ended June 30, 2006 from \$3,954,000 as of December 31, 2005. This increase is due to increased sales of 40.8% for the second quarter of 2006 as compared to the fourth quarter of 2005. The number of days sales outstanding as of June 30, 2006 was 52 days as compared to the same 51 days as of December 31, 2005.

Inventory increased by \$711,000 to \$11,323,000 for the six months June 30, 2006 from \$10,612,000 as of December 31, 2005. The increase is primarily attributable to an increase of \$1.4 million in inventory for the Engineered Product segment, partially offset by a decrease in Disposable Apparel inventory of \$0.7 million. Current inventory levels of \$6.2 million for the Engineered Product segment are high based on present sales levels. With anticipated sales growth, and reduced purchases from our joint venture in India, inventory levels for Engineered Products are expected to be lower by year end.

Prepaid expenses and other current assets decreased by \$154,000 to \$561,000 for the six months ended June 30, 2006 from \$715,000 as of December 31, 2005. The decrease of \$154,000 is primarily due to a decrease in prepaid expenses Engineered Products of \$255,000, and partially offset by an increase in prepaid rent of \$51,000, an increase in prepaid insurance for Engineered Products of \$43,000 and an increase of \$6,000 in prepaid trade shows.

Accounts payable and accrued liabilities as of June 30, 2006 decreased by \$739,000 to \$1,837,000 from \$2,576,000. The net change in 2006 was primarily due to a decrease in trade payables of \$124,000, a decrease in accrued commission/bonus payable of \$204,000, a decrease in accrued rebates and other of \$182,000, a decrease in income tax payable of \$180,000, a decrease in accrued professional fees of \$43,000 and a decrease in payroll accrual of \$6,000.

Net cash used in investing activities was \$230,000 and \$1,011,000 for the six months ended June 30, 2006 and 2005, respectively. Our investing activity in 2006 consisted primarily of expenditures for property and equipment of \$196,000 and the purchase of intangible assets of \$34,000. This compared to expenditures for property and equipment of \$451,000 and purchases of intangible assets of \$10,000. The expenditures for property and equipment in 2006 and 2005 were principally for the purchase of equipment for our Engineered Products segment.

In 2005, Alpha ProTech Engineered Products, Inc. entered into a joint venture with a manufacturer in India for the production of building products. Under terms of the joint venture agreement, a private company, Harmony Plastics Private Limited (Harmony), was created with ownership interest of 41.66% by Alpha ProTech Engineered Products, Inc. and 58.34% by Maple Industries and Associates. Alpha ProTech Engineered Products, Inc. contributed \$508,000 and Maple Industries and Associates contributed \$708,000 for share capital. The Company has determined that its investment in Harmony is not a variable interest entity and is considered an unconsolidated affiliate.

Alpha ProTech Engineered Products has invested \$1,450,000 in Harmony; \$508,000 for share capital and a \$942,000 advance. Effective April 2006, interest of 3.5 % is to be paid on this advance. Half of this \$942,000 advance is to be repaid monthly over a six year term commencing in July 2006 and the balance is to be paid in the seventh year. Harmony commenced operations in August of 2005. For the six months ended June 30, 2006, we recorded an equity loss in unconsolidated affiliate of \$20,000.

We expect to purchase approximately \$225,000 of equipment in 2006. These expenditures will be primarily for equipment for the Engineered Products and Infection Control segments.

In August 2004, we announced that our Board of Directors had approved the buy-back of up to an additional \$500,000 of the Company's outstanding common stock. This share repurchase program is the sixth \$500,000 buyback authorized by the Board of Directors. In all instances, we are retiring the shares. For the quarter ended June 30, 2006, we did not buy back any shares of common stock. As of June 30,

2006, we have bought back a total of 2,333,800 shares of common stock at a cost of \$2,518,000 since the end of 1999.

For the quarter ended June 30, 2006, net cash provided by financing activities was \$349,000 compared to cash provided by financing activities of \$268,000 for the same period of 2005. Our financing activities in 2006 consisted of cash proceeds of \$349,000 from the exercise of 308,000 stock options. Our financing activities in 2005 consisted primarily of cash proceeds of \$289,000 from the exercise of 232,106 stock options, partially offset by payments of \$21,000 for the repurchase of 10,000 shares of common stock.

As shown below, at June 30, 2006, our contractual cash obligations totaled approximately \$1,313,000.

#### Contractual Obligations

	Payments Due by Period				
	Total	1 Year	2-3 Years	4-5 Years	After 5 years
Operating leases	\$ 1,313,000	\$ 352,000	\$ 740,000	\$ 221,000	
Line of credit					
Total contractual cash obligations	\$ 1,313,000	\$ 352,000	\$ 740,000	\$ 221,000	

We believe that cash generated from operations, our current cash balance and the funds available under our credit facility will be sufficient to satisfy our projected working capital and planned capital expenditures for the foreseeable future.

#### New Accounting Standards

Based on the Company's review of new accounting standards released during the quarter ended June 30, 2006, the Company did not identify any standards requiring adoption that would have a significant impact on its consolidated financial statements.

We adopted Statement of Financial Accounting Standards No. 123R, Share-Based Payment (SFAS 123R) effective January 1, 2006, using the modified prospective application method. SFAS 123R requires companies to record compensation expense for the value of all outstanding and unvested share-based payments, including employee stock options and similar awards. As of January 1, 2006, we had no outstanding and unvested share-based payments. As a result, we did not recognize any compensation expense related to share-based payments in our consolidated financial statements for the six months ended June 30, 2006.

#### Item 3. Quantitative and Qualitative Disclosures About Market Risk

We subcontract the manufacture of products in China and Mexico and have a joint venture in India. The Company's results of operations could be negatively affected by factors such as changes in foreign currency exchange rates due to stronger economic conditions in those countries.

The Company doesn't expect any significant effect on its results of operations from inflationary or interest and currency rate fluctuations. The Company does not hedge its interest rate or foreign exchange risks.

**ITEM 4. CONTROLS AND PROCEDURES**

Disclosure Controls and Procedures

The Company's chief executive officer and its chief financial officer, after evaluating the effectiveness of the Company's disclosure controls and procedures as of June 30, 2006, have concluded that the Company's disclosure controls and procedures were designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Act is accumulated and communicated to the Company's management, including its chief executive and chief financial officers as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting.

There has been no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during our fiscal quarter ended June 30, 2006, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II - OTHER INFORMATION**

---

**Item 5 Submission of Matters to a Vote of Security Holders**

- (a) Registrant held its Annual Meeting of Shareholders June 12, 2006.
- (b) The following persons were elected Directors pursuant to the votes indicated:

<u>Name</u>	<u>For</u>	<u>Withheld</u>
Sheldon Hoffman	22,161,237	440,994
Alexander Millar	22,165,387	436,844
Donald Bennett, Jr.	22,238,537	363,694
Robert Isaly	22,187,211	415,020
John Ritota	21,913,281	688,950
Russell Manock	22,187,461	414,770
David Anderson	21,930,561	671,670

(c) The only other matter to be voted upon was the ratification of the appointment of PricewaterhouseCoopers LLP as the Registrant's independent registered public accountants as follows:

<u>For</u>	<u>Against</u>	<u>Abstain</u>
22,570,374	12,650	19,207

**ITEM 6 EXHIBITS AND REPORTS ON FORM 8-K**

(a) Exhibits

31.1 Certification Pursuant to Rule 13a-14(b) and Rule 15d-14(b) of the Exchange Act, Signed by Chief Executive Officer (filed herewith)

31.2 Certification Pursuant to Rule 13a-14(b) and Rule 15d-14(b) of the Exchange Act, Signed by Chief Financial Officer (filed herewith)

32.1 Certification Pursuant to 18 U.S.C Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, Signed by Chief Executive Officer (filed herewith)

32.2 Certification Pursuant to 18 U.S.C Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, Signed by Chief Financial Officer (filed herewith)

(b) Reports on Form 8-K

On May 8, 2006 registrant issued a release announcing its financial results for the first quarter of 2006.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934, the Registrant has fully caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**ALPHA PRO TECH, LTD.**

DATE: August 9, 2006

BY: /s/ SHELDON HOFFMAN  
Sheldon Hoffman  
Chief Executive Officer and Director

DATE: August 9, 2006

BY: /s/ LLOYD HOFFMAN  
Lloyd Hoffman  
Chief Financial Officer and Senior Vice President