



PSP: TSX Venture Exchange  
www.pacsafety.com

# Investor Report

## Quarter Two Fiscal 2005

For the Second Quarter and Year to Date Results  
December 31, 2004 with Comparative Results for 2003

---

## Message to Shareholders

### Review

The second quarter of Fiscal 2005 continued to be a productive planning and preparation quarter for PSP. The Company worked closely with Canada's Department of National Defence ("DND") to finalize specifications for a contract for 33,000 Fragmentation Protective Vests ("FPV") which is slated to be in full production in February 2005. The Operations Group was also finishing the last steps in ramping up capacity for production of this contract as well as another contract for DND for Chemical Warfare Coveralls. Our sales team was working hard to expand the Company's international opportunities for similar types of products and has identified a number which show promise. The US market continues to be a major focus for PSP as the demand for safety related products remains exceptionally strong and we continue to see good growth in this area. To date, total US sales for armor products, while still relatively small, is more than double last year's revenue.

In November, we held our Annual General Meeting and were pleased to see that not only did all of our Board members stand for re-election, but that they were all re-elected. We have an exceptionally strong Board who are firmly committed to representing minority shareholders. Our Employee Share Ownership Plan, which has had good participation from our staff over the past few years, was approved for another year. Shareholders also approved a change to our stock option plan which increased the maximum number of options in the pool to 2,000,000. This will help in attracting talented management staff as the Company will be looking to fill key positions.

The Company chose to raise additional capital in January through a second equity private placement with Acumen Capital Partners. The private placement was completed January 6, 2005 with gross proceeds of \$4.8 million through a unit offering at an issue price of \$2.75. This, along with a previous private placement in the Company's first quarter, will provide sufficient capital for PSP to finance existing major contracts as well as its short to mid-term growth initiatives.

As noted in a recent news release we have extended the deadline to February 28, 2005 for establishing a definitive agreement with ArmorWorks Enterprises Llc. ("ArmorWorks"). The extension was required to give both parties more time to negotiate and complete the agreements. These types of relationships will be a focus for PSP in upcoming quarters as we see this as an ideal way for the Company to access international markets such as the United States, as well as to provide our current Canadian customers with the exceptional products manufactured by companies such as ArmorWorks. We have already started working with ArmorWorks to jointly pursue opportunities and have submitted a bid for a combat desert jacket contract for the United States Marine Corps. The contract has a potential value of over \$42 million (CAD) and is just one example of PSP's objective of working with partners to enter new markets and provide total solution ensembles to our customers.

To stay current with the ever-evolving technological market we have undertaken an international search for an Executive Vice President of Research and Development. This individual will be responsible for the continuing development and implementation of strategies to ensure our long-term success, while providing the company with the most up to date knowledge of the latest technological trends in safety equipment.

### The Future

As we came to the close of the second quarter of PSP's 2005 fiscal year, we found ourselves well positioned and fully resourced to deliver our current order book of \$46 million. If options are exercised on the current contracts, there is potential to increase the order book by \$12 million in addition to the future business we are currently working on. We will continue to work on developing strategies to take advantage of our position as a highly regarded supplier of innovative safety products. We will work on developing partnerships and new relationships that will enable us to enter new markets with integrated system solutions.

I am pleased to report that the production of the FPV contract began in the third quarter. The start of production of this contract was delayed at the request of our customer to make design changes and contract amendments. Although we were disappointed that production did not start in the second quarter, we anticipate receiving a benefit from this delay as the value of the contract is expected to significantly increase.

The upcoming six months will be the busiest months ever experienced at PSP. I would like to thank all of our stakeholders for their support and would like to encourage everyone to enjoy some of the most exciting growth years in the Company's history

Sincerely,

A handwritten signature in black ink, consisting of several overlapping loops and a long horizontal stroke at the end, likely representing the name Brad Field.

Brad Field, President and Chief Executive Officer  
Pacific Safety Products Inc.

## MANAGEMENT DISCUSSION AND ANALYSIS

The purpose of this document is to provide a quarterly update to the information contained in management's discussion and analysis ("MD&A") section of Pacific Safety Products Inc.'s ("PSP" or "the Company") 2004 annual report. This discussion is intended to aid readers in understanding the Company's history, business environment, strategies, performance and risk factors through "the eyes of management". The information provided should be read in conjunction with PSP's 2004 annual report and the accompanying unaudited interim financial statements and notes for the second quarter ended December 31, 2004. The information in this report includes information available to January 26, 2005, and includes forward-looking statements based on current expectations and is subject to risks and uncertainties. Many internal and external factors may cause actual results to differ materially.

The following discussion and analysis is related to the Company's unaudited interim financial statements for the three months and six months ended December 31, 2004 and December 31, 2003. It should be read in conjunction with the Company's unaudited interim financial statements and notes for the three months and six months ended December 31, 2004, and the Company's unaudited consolidated interim financial statements for the three months and six months ended December 31, 2003, the Message to Shareholders and other management discussion included in this quarterly report. Reference should also be made to management's discussion and analysis included in the Company's last annual report, which includes audited consolidated financial statements for the year ended June 30, 2004 and June 30, 2003.

### OVERVIEW OF THE BUSINESS

The mission statement of Pacific Safety Products Inc. is *...we bring everyday heroes home safely™*. PSP is an established industry leader in the production, distribution and sale of high-performance and high-quality safety products. These products primarily include body armor to protect against ballistic, stab and fragmentation threats. PSP is the largest armor manufacturer in Canada and has significant international customers. The Company also produces tactical clothing and emergency medical kits. These products are marketed under the labels **Pacific Emergency Products®**, **PROTECTED by PSP™**, **EXPLOSAFE®**, and **O<sub>2</sub>B.O.S.S.™**. The Company's primary customers include military agencies, law enforcement agencies, private security companies, fire departments and emergency medical service organizations.

The Company strives to provide quality protection solutions by effectively integrating the latest technologies to serve these customers' needs. Founded in 1984, PSP has grown to include more than 130 employees at three Canadian facilities in Kelowna, British Columbia; Brampton, Ontario; and Arrnprior, Ontario. These facilities are equipped with complete design, production and research capabilities. The Kelowna facility has one of the most advanced non-government operated ballistic research labs in North America.

The financial data has been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and the Company's reporting currency is the Canadian dollar. Pacific Safety Products Inc. is a reporting issuer in Canada in the provinces of British Columbia, Alberta and Ontario. The Company trades on the TSX Venture Exchange under the symbol PSP. Additional regulatory information relating to Pacific Safety Products Inc. can be found at the System for Electronic Document Analysis and Retrieval ("SEDAR") web site at [www.sedar.com](http://www.sedar.com).

### Overall Strategy

Pacific Safety Products Inc.'s strategic plan ("the Plan") is the Company's road map for growth. The Plan's primary objective is to achieve consistent quarter after quarter increases in revenue and profitability.

### Envisioned Future

To become the most innovative and practical solution provider in the safety products industry and have the PSP brand name synonymous with the finest quality safety products in the world.

### Strategic Plan Objectives

To increase significantly the amount of our base business through the plan's four main strategic imperatives:

- Maximize profit and capitalize on major contracts awards
- Create new product development initiatives in each market segment
- Use free cash-flow to acquire complementary businesses and technologies
- Selectively enter new markets

### Capability to Deliver Results

PSP has in place the essential resources to deliver its current order book of \$46 million. The Company has secured the financial resources necessary to ramp up capacity and purchase raw materials for two Canadian Armed Forces contracts, as well as develop future markets and products. A \$2.8 million equity financing was completed in September 2004, which will also provide for the potential of an additional \$1.7 million cash injection if all the attached warrants are exercised. A second equity financing was completed in January 2005. The Company received gross proceeds of \$4.8 million with the potential of a further \$3.3 million if all the related warrants are exercised.

The Company has invested significant time and funds to develop an infrastructure that will encompass the current government contracts and core order book as well as providing an adaptable environment for future manufacturing. This involves outfitting our two manufacturing locations with upgraded equipment, improved floor layouts and on-going training for the production staff. In addition to our highly skilled manufacturing team, PSP has a strong base of talented individuals in Sales and Marketing and Administration. PSP has positioned its sales team across Canada and into the United States to ensure an ongoing relationship with current customers and to attract new customers in all markets. This, along with the dedicated management team, provides PSP with the capability to deliver results.

## OVERALL CORPORATE PERFORMANCE

SUMMARY OF OPERATIONS	THREE	THREE	SIX	SIX
	MONTHS ENDED DECEMBER 31, 2004	MONTHS ENDED DECEMBER 31, 2003	MONTHS ENDED DECEMBER 31, 2004	MONTHS ENDED DECEMBER 31, 2003
SALES	\$ 2,938,423	\$ 2,701,610	\$ 5,326,667	\$ 6,732,204
COST OF SALES	2,334,655	1,998,437	4,028,541	4,746,765
GROSS MARGIN	603,768	703,173	1,298,126	1,985,439
EXPENSES	1,366,346	944,420	2,499,122	1,748,284
INTEREST ON LONG-TERM DEBT	146,668	126,757	296,799	255,841
TOTAL EXPENSES	1,513,014	1,071,177	2,795,921	2,004,125
LOSS BEFORE INCOME TAXES	(909,246)	(368,004)	(1,497,795)	(18,686)
INCOME TAXES RECOVERY	(327,497)	(128,864)	(533,489)	(6,597)
LOSS	\$ (581,749)	\$ (239,140)	\$ (964,306)	\$ (12,089)
BASIC LOSS PER SHARE <sup>(1)</sup>	\$ (0.035)	\$ (0.019)	\$ (0.065)	\$ (0.001)
WEIGHTED AVERAGE COMMON SHARES ISSUED AND OUTSTANDING	16,710,836	12,340,480	14,823,638	12,335,980

CASHFLOW	THREE	THREE	SIX	SIX
	MONTHS ENDED DECEMBER 31, 2004	MONTHS ENDED DECEMBER 31, 2003	MONTHS ENDED DECEMBER 31, 2004	MONTHS ENDED DECEMBER 31, 2003
Cash flow from continuing operations	\$ (774,759)	\$ 6,444	\$ (1,153,766)	\$ (862,741)
Investing activities and capital expenditures	(457,494)	(185,475)	(539,700)	(552,923)
Financing activities	(22,362)	444,608	2,496,677	355,205
	\$ (1,254,615)	\$ 265,577	\$ 803,211	\$ (1,060,459)

### FINANCIAL POSITION

AS AT	DECEMBER 31, 2004	JUNE 30, 2004	DECEMBER 31, 2003
Cash and cash equivalents (bank indebtedness)	\$ (317,855)	\$ (1,121,066)	\$ (802,840)
Working capital	\$ 2,594,094	\$ 1,348,455	\$ 1,931,146
Long-term debt (long-term portion only)	\$ 3,839,000	\$ 4,062,000	\$ 4,241,998
Shareholders' equity	\$ 5,143,023	\$ 3,359,652	\$ 3,888,738

### CONSOLIDATED QUARTERLY RESULTS

Consolidated quarterly results are presented in the following table. Quarterly revenue and earnings will vary from quarter to quarter depending on the size of the order book and the timing of the award of significant contracts to PSP. It is difficult to predict when major contracts will be awarded. Once awarded, the production start dates of the large contracts and the timing of revenue recognized from these contracts can have a significant impact on results from quarter to quarter.

#### Eight Quarters Trailing Results

	Q2 2005	Q1 2005	Q4 2004	Q3 2004	Q2 2004	Q1 2004	Q4 2003	Q3 2003
Sales	\$2,938,423	\$2,388,244	\$3,429,766	\$2,398,678	\$2,701,610	\$4,030,594	\$2,205,527	\$3,889,033
Net income (loss)	\$(581,749)	\$(382,557)	\$(342,442)	\$(295,378)	\$(239,140)	\$227,051	\$(411,489)	\$42,101
Basic earnings (loss) per share <sup>(1)</sup>	\$(0.035)	\$(0.030)	\$(0.027)	\$(0.024)	\$(0.019)	\$0.018	\$(0.033)	\$0.003

### SELECTED ANNUAL INFORMATION

	2004	2003	2002
Total revenue	\$12,560,648	\$14,512,579	\$19,331,937
Net income (loss)	\$(613,868)	\$(306,046)	\$309,097
Total assets	\$10,358,465	\$9,804,484	\$12,293,744
Total long-term financial liabilities	\$4,309,842	\$4,125,007	\$1,903,325
Basic earnings (loss) per share <sup>(1)</sup>	\$(0.050)	\$(0.025)	\$0.025

### MANAGEMENT'S EXPLANATION OF THE RESULTS OF OPERATIONS

The Company reported a loss after taxes of \$581,749 for the quarter ended December 31, 2004 compared to a loss after taxes of \$239,140 in the same quarter last year. Although sales for the quarter were \$236,000 higher than in quarter two, fiscal 2004, lower gross margin and higher expenses related to ramping up production for two major contacts resulted in the increased loss. Product mix also contributed to a decrease in the Company's gross margin.

(1) Fully diluted earnings (loss) per share has not been disclosed, as it does not differ significantly from basic earnings (loss) per share.

A change in the accounting policy regarding the recording of stock based compensation also contributed to decreased profitability. The Company strives to comply with GAAP, and with the new accounting policy adopted in the first quarter of this fiscal year, \$25,606 was recognized as an expense in the statement of operations. This is a non-cash cost, but it had a significant effect on earnings due to the increase in the share price during the second quarter period.

The Company continued to generate costs in preparation for the production of the Fragmentation Protective Vest ("FPV") contract. PSP management fully expected that production would begin in the second quarter, and made the decision to ensure infrastructure was in place to meet the demands of the contract. These expenditures are essential in order to ensure production is started as soon as possible. Delays in the government approval process have moved the start of production to quarter three. One benefit of the delay is that the contract value may be increased due to a change in the design and sizing matrix.

## **SALES**

PSP recorded \$2.9 million in sales for the quarter ended December 31, 2004, which represents an increase of \$0.2 million, or 8.8% over last year's second quarter. The Company experiences sales cycles that can be dependent on the award of contracts by major Canadian police forces and government departments. While management is working to reduce the impact of these cycles, they are not predictable and will cause variations in revenue and profitability from quarter to quarter.

## **GROSS MARGIN**

The Company's strategies to increase the percentage of gross margin include implementing lean enterprise initiatives to reduce the cost of manufacturing, eliminating products and product lines that do not meet the Company's minimum gross profit margin targets, and ensuring products are appropriately priced for each market. However, low sales volume and product mix can still negatively impact gross margin. Lower sales volumes result in fixed manufacturing overhead costs contributing to a larger portion of the cost of sales. Gross margin for quarter two was 20.5% of revenue compared to 26.0% of revenue in the same period last year. Although sales in quarter two were \$236,000 higher than in quarter two of 2004, the mix of products sold contributed less to the overall gross margin. In addition, PSP continues to incur operating costs related to the ramp up of production facilities for major military contracts. If not for these additional costs PSP would have realized its historical gross margin of 29%.

## **EXPENSES**

### **Sales and Marketing**

Sales and marketing expenses were \$514,811 compared to \$319,167 in the same quarter last year, an increase of \$195,644. As expected, these expenditures increased as the Company invested more in its sales and marketing department. The sales and marketing team continues to develop increased exposure of our products by attending more tradeshows and increasing print advertising. Year to date sales and marketing expenditures increased to \$914,552 from \$609,714 in the same six month period last year.

### **Research and Development**

Research and development expenditures totaled \$136,731 for the quarter compared to \$148,881 in quarter two last year. Research and Development expenses for the quarter were offset by the accrual of Scientific Research and Experimental Development ("SR&ED") tax credits. During the quarter, the Company received confirmation from the Canadian Revenue Agency that our 2002 and 2003 claims have been assessed as filed.

### **General and Administration**

General administration expenditures increased \$235,014 to \$643,877 compared to \$408,863 in the same quarter last year. There were a number of one-time expenditures during the quarter. This included a write-down of accounts receivable of \$70,000 related to a difference of opinion regarding billable design changes with a customer. PSP opted to ensure an ongoing positive relationship with the customer and absorb the cost of the uncollected receivable. In addition, there were one-time costs related to investing in a consultant to recover \$224,084 in SR&ED tax credits, which the efforts to date have been successful. Expenses also increased due to the increasing costs of public company requirements, investor relations costs and stock based compensation expenses. The increases in public company expenses are the result of new regulations and rules adopted by the Company in the first quarter of fiscal 2005.

Amortization of property, plant and equipment increased \$4,165 to \$33,140 compared to \$28,975 in the same quarter last year. Amortization of other assets increased \$13,261 to \$31,751 compared to \$18,490 in quarter two of last year. This is due to increasing the amortization of product development costs related to new product lines. Goodwill was evaluated by management and it was determined that there was no impairment in value during the period, therefore no adjustments were made.

Interest calculated on the operating line for the quarter decreased \$14,008 to \$6,036 compared to \$20,044 in quarter two, fiscal 2004. The decrease in this expenditure is due to a lower average operating line balance throughout the quarter.

Interest on long-term debt increased \$19,911 to \$146,668 compared to \$126,757 in quarter two, fiscal 2004. This is the result of increasing the bonus interest accrual to \$27,000 per quarter, from \$15,000.

### **Income Taxes**

Income taxes were calculated at an effective rate of 36% for the quarter ended December 31, 2004.

## RESULTS OF OPERATIONS

### Loss Before Interest on Long-Term Debt and Income Taxes

The Company incurred an operating loss of \$762,578, or \$0.051 per share, compared to an operating loss of \$241,247, or \$0.020 per share in quarter two, fiscal 2004.

### Earnings Before Interest, Taxes, Depreciation and Amortization ("EBITDA")

For the quarter ended December 31, 2004 EBITDA was \$(652,284) compared to \$(406,377) for the quarter ended December 31, 2003.

### Loss After Taxes

Increased operating expenditures, lower gross profit margin and higher costs for interest on long-term debt contributed to a larger loss than in the comparable quarter. This loss was \$581,749, or \$0.035 per share, compared to a loss of \$239,140, or \$0.019 per share in quarter two, fiscal 2004.

### Cash Flow

Cash flow used in operating activities was \$774,759 compared to \$6,444 in cash generated in quarter two, fiscal 2004 using the direct method under generally accepted accounting principles. The change relates mainly to lower amounts of cash received from customers and higher amounts paid out to employees and suppliers during the quarter. \$457,494 was used for investments in new product development, intangible assets and property, plant and equipment compared to \$185,475 during the same period last year. These cash outlays relate mainly to procuring manufacturing equipment and preparing the facilities for production of the two major Canadian contracts. Financing activities decreased cash to \$22,362 compared to \$444,608 generated in quarter two, fiscal 2004. There were no other significant changes over the quarter and financing activities related mainly to the normal principal repayment of long-term debt.

## LIQUIDITY AND CAPITAL RESOURCES

### Working Capital

PSP's liquidity was significantly enhanced in quarter one as the Company raised \$2.8 million through an equity offering. At December 31, 2004, PSP's working capital position was \$2,594,094 compared to \$1,348,455 at December 31, 2003. PSP has enough working capital to meet current commitments and deliver future orders.

### Bank Indebtedness

Currently PSP's maximum operating line is \$2 million and combined with the cash on hand will be sufficient to deliver current orders in hand. The amount drawn on the bank operating line increased to \$1,011,078 compared to \$882,038 at December 31, 2003.

### Inventory

At December 31, 2004 inventory increased \$772,201 to \$2,066,235 compared to \$1,294,034 at December 31, 2003. A significant portion of this increase relates to the purchase of raw materials for the Fragmentation Protective Vest contract. There was also an increase in inventory due to orders anticipated in December which will not be delivered until the third quarter.

### Investment Tax Credits Receivable

\$224,084 in investment tax credits receivable were recorded at quarter end relating to scientific research and development expenses incurred in fiscal 2002, 2003 and 2004. The Company received confirmation from Canada Revenue Agency that applications for fiscal 2002 and 2003 have been assessed as filed and a refund will be issued in due course. An application has been submitted for fiscal 2004 which is currently under review by the Canada Revenue Agency.

### Future Income Taxes Recoverable

At December 31, 2004, PSP had accumulated an estimated \$1.9 million in tax loss carry forwards available to be used against future taxable income. PSP has recorded related future income taxes recoverable of \$1,001,680 at December 31, 2004 (June 30, 2004 - \$468,369, December 31, 2003 - \$312,348). This has been recorded as a current asset as forecasts based on the current order book and shipment schedule of the FPV contract for the Canadian military will provide enough taxable income to use the loss carry forwards in the next twelve months.

### Other Working Capital Items

Changes in other working capital items were due to normal operations.

## PROPERTY, PLANT AND EQUIPMENT AND OTHER ASSETS

During the quarter, the Company spent \$457,494 in investing activities. A significant portion of these charges relate to the FPV contract and will be amortized once production begins. The main increase in costs is related to the ramp up for production of large contracts.

## LONG-TERM DEBT

A cash sweep payment of \$150,000 of the unsecured subordinated debenture was repaid during the quarter. There were no other significant changes in long-term debt during the quarter other than regular payments of principal and interest.

**SHARE CAPITAL**

PSP issued 57,470 shares to employees of the Company under its fourth Employee Share Ownership Plan for net proceeds of \$15,518. Also during the quarter, 133,500 stock options were exercised by employees for the issue of 133,500 common shares at a weighted average exercise price of \$0.47 per share for proceeds of \$77,966. 105,000 stock options were issued with a weighted average exercise price of \$1.58 per share. Currently there are 829,500 options outstanding with a weighted average exercise price of \$0.65. This represents nearly 5% of PSP's issued and outstanding common shares.

**OFF BALANCE SHEET FINANCING**

The Company does not have any significant off balance sheet financing arrangements and there were no significant changes in operating leases from those disclosed in the MD&A for the year ended June 30, 2004.

**RELATED PARTY TRANSACTIONS**

Disclosure of related party transactions is included in note 5 of the unaudited interim financial statements.

**CRITICAL ACCOUNTING ESTIMATES**

There were no significant changes in the critical accounting estimates as disclosed in the MD&A for the year ended June 30, 2004.

**FINANCIAL INSTRUMENTS**

Full disclosure of financial instruments is made in note 6 of the interim financial statements. There are no financial instruments other than those held in the ordinary course of business.

**RISKS AND UNCERTAINTIES**

There were no significant changes in risks and uncertainties as disclosed in the MD&A for the year ended June 30, 2004.

**OUTLOOK**

PSP has a significant amount of orders on hand, which are a minimum of \$46 million and could increase by another \$12 million should the Canadian government exercises options on current contracts. PSP is well positioned to deliver consistent quarterly results going forward as it has secured the necessary financial resources and has a comprehensive manufacturing plan to scale up production capacity. The Company should start realizing steady revenue and profitability growth in the upcoming quarters. The timing of the initial revenue from these contracts is dependent on when production commences.

**MEASURES NOT IN ACCORDANCE WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES**

The following measure included in this report does not have a standardized meaning under Canadian generally accepted accounting principles and, therefore, is unlikely to be comparable to similar measures presented by other companies:

EBITDA, while not a concept recognized by generally accepted accounting principles, is an indirect measure for operating cash flow, a significant indicator of the success of any business.

Forward-Looking Statements: This document may contain forward-looking statements based on management's expectations, estimates and projections. All statements that address expectations or projections about the future, including statements about the Company's strategy for growth, product development, market position, expected expenditures and financial results are forward-looking statements. Some of the forward-looking statements may be identified by words like "expects," "anticipates," "plans," "intends," "projects," "indicates" and similar expressions. These statements are not guarantees of future performance and involve a number of risks, uncertainties and assumptions. Many factors, including those discussed more fully elsewhere in this release and in documents, which may be filed with the British Columbia Securities Commission, the Alberta Securities Commission, the Ontario Securities Commission, the TSX Venture Exchange, as well as others, could cause results to differ materially from those stated. These factors include, but are not limited to changes in the laws, regulations, policies and economic conditions, including inflation, interest and foreign currency exchange rates, of countries in which the Company does business; competitive pressures; successful integration of structural changes, including restructuring plans, acquisitions, divestitures and alliances; cost of raw material, research and development of new products, including regulatory approval and market acceptance; and seasonality of sales in some products.

**PACIFIC SAFETY PRODUCTS INC.**  
**BALANCE SHEET**  
**(UNAUDITED)**

**AS AT** **DECEMBER 31, 2004** **JUNE 30, 2004** **DECEMBER 31, 2003**

**ASSETS**

**CURRENT ASSETS**

Cash and cash equivalents	\$ 693,223	\$ 50,326	\$ 79,198
Accounts receivable	2,169,736	1,649,554	2,083,792
Corporation taxes recoverable	-	-	66,144
Inventory	2,066,235	1,397,916	1,294,034
Prepaid expenses and deposits	357,076	270,261	346,101
Investment tax credits receivable	224,084	201,000	-
Future income taxes recoverable	1,001,680	468,369	312,348

Total Current Assets 6,512,034 4,037,426 4,181,617

**PROPERTY, PLANT AND EQUIPMENT**

**2,887,249** 2,813,461 2,850,355

**OTHER ASSETS** 299,497 350,992 545,344

**INTANGIBLE ASSETS** (note 2) 614,672 322,233 226,512

**GOODWILL** (note 2) 2,834,353 2,834,353 2,834,353

**TOTAL ASSETS** **\$ 13,147,805** **\$ 10,358,465** **\$ 10,638,181**

**LIABILITIES**

**CURRENT LIABILITIES**

Bank indebtedness	\$ 1,011,078	\$ 1,171,392	\$ 882,038
Accounts payable and accrued liabilities	2,378,228	1,128,190	1,057,394
Corporation taxes payable	-	-	46,303
Deferred revenue	161,634	23,356	4,339
Current portion of long-term debt	367,000	366,033	260,397

Total Current Liabilities 3,917,940 2,688,971 2,250,471

**LONG-TERM DEBT** 3,839,000 4,062,000 4,241,998

**FUTURE INCOME TAXES PAYABLE** 247,842 247,842 256,974

**TOTAL LIABILITIES** **8,004,782** **6,998,813** **6,749,443**

**SHAREHOLDERS' EQUITY**

**EQUITY INSTRUMENTS** (note 3) 7,281,575 4,453,967 4,381,274

**DEFICIT** (2,138,552) (1,094,315) (492,536)

**TOTAL SHAREHOLDERS' EQUITY** **5,143,023** **3,359,652** **3,888,738**

**TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY** **\$ 13,147,805** **\$ 10,358,465** **\$ 10,638,181**

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

**APPROVED BY THE BOARD OF DIRECTORS:**



John Jennings, Director



David Scott, Director

**PACIFIC SAFETY PRODUCTS INC.**  
**STATEMENT OF OPERATIONS AND DEFICIT**  
**(UNAUDITED)**

	<b>THREE MONTHS ENDED DECEMBER 31, 2004</b>	<b>THREE MONTHS ENDED DECEMBER 31, 2003</b>	<b>SIX MONTHS ENDED DECEMBER 31, 2004</b>	<b>SIX MONTHS ENDED DECEMBER 31, 2003</b>
<b>SALES</b>	<b>\$ 2,938,423</b>	<b>\$ 2,701,610</b>	<b>\$ 5,326,667</b>	<b>\$ 6,732,204</b>
<b>COST OF SALES</b>				
Amortization of property, plant and equipment	45,403	40,801	89,681	81,189
Materials, labour and manufacturing overhead	2,289,252	1,957,636	3,938,860	4,665,576
Total Cost of Sales	2,334,655	1,998,437	4,028,541	4,746,765
<b>GROSS MARGIN</b>	<b>603,768</b>	<b>703,173</b>	<b>1,298,126</b>	<b>1,985,439</b>
<b>EXPENSES</b>				
Sales and marketing	514,811	319,167	914,552	609,714
Research and development	136,731	148,881	297,201	256,588
General administration	643,877	408,863	1,131,546	760,983
Amortization of property, plant and equipment	33,140	28,975	64,974	52,125
Amortization of other assets	31,751	18,490	70,312	38,960
Interest on operating line	6,036	20,044	20,537	29,914
Total Expenses	1,366,346	944,420	2,499,122	1,748,284
<b>INCOME (LOSS) BEFORE INTEREST ON LONG-TERM DEBT AND INCOME TAXES</b>	<b>(762,578)</b>	<b>(241,247)</b>	<b>(1,200,996)</b>	<b>237,155</b>
<b>INTEREST ON LONG-TERM DEBT</b>				
Periodic interest on long-term debt	119,668	111,757	242,799	225,841
Bonus interest on subordinated debenture	27,000	15,000	54,000	30,000
<b>TOTAL INTEREST ON LONG-TERM DEBT</b>	<b>146,668</b>	<b>126,757</b>	<b>296,799</b>	<b>255,841</b>
<b>LOSS BEFORE INCOME TAXES</b>	<b>(909,246)</b>	<b>(368,004)</b>	<b>(1,497,795)</b>	<b>(18,686)</b>
<b>INCOME TAXES (RECOVERY)</b>				
Future	(327,497)	(72,148)	(533,489)	(55,856)
Current	-	(56,716)	-	49,259
Total Income Taxes (Recovery)	(327,497)	(128,864)	(533,489)	(6,597)
<b>LOSS</b>	<b>(581,749)</b>	<b>(239,140)</b>	<b>(964,306)</b>	<b>(12,089)</b>
<b>DEFICIT, BEGINNING</b>	<b>(1,556,803)</b>	<b>(253,396)</b>	<b>(1,094,315)</b>	<b>(480,447)</b>
<b>CHANGE IN ACCOUNTING POLICY</b>	<b>-</b>	<b>-</b>	<b>(79,931)</b>	<b>-</b>
<b>DEFICIT, ENDING</b>	<b>\$ (2,138,552)</b>	<b>\$ (492,536)</b>	<b>\$ (2,138,552)</b>	<b>\$ (492,536)</b>
<b>BASIC LOSS PER SHARE</b>	<b>\$ (0.035)</b>	<b>\$ (0.019)</b>	<b>\$ (0.065)</b>	<b>\$ (0.001)</b>
<b>WEIGHTED AVERAGE COMMON SHARES ISSUED AND OUTSTANDING</b>	<b>16,710,836</b>	<b>12,340,480</b>	<b>14,823,638</b>	<b>12,335,980</b>

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

**PACIFIC SAFETY PRODUCTS INC.**  
**STATEMENT OF CASH FLOW**  
**(UNAUDITED)**

	<b>THREE MONTHS ENDED DECEMBER 31, 2004</b>	<b>THREE MONTHS ENDED DECEMBER 31, 2003</b>	<b>SIX MONTHS ENDED DECEMBER 31, 2004</b>	<b>SIX MONTHS ENDED DECEMBER 31, 2003</b>
<b>OPERATING ACTIVITIES</b>				
Cash receipts from customers	\$ 2,526,014	\$ 3,568,240	\$ 4,921,679	\$ 5,742,165
Cash paid to suppliers and employees	(3,155,068)	(3,518,967)	(5,812,109)	(6,438,123)
Interest paid	(145,705)	(161,801)	(263,336)	(285,755)
Income taxes recovered	-	118,972	-	118,972
<b>CASH FLOW FROM OPERATING ACTIVITIES</b>	<b>(774,759)</b>	<b>6,444</b>	<b>(1,153,766)</b>	<b>(862,741)</b>
<b>INVESTING ACTIVITIES</b>				
Purchase of property, plant and equipment	(157,175)	(89,148)	(229,943)	(395,686)
Proceeds from the sale of property, plant and equipment	-	-	1,500	-
Investment in new product development	(32,326)	(69,487)	(37,120)	(121,638)
Investment in intangible assets	(267,993)	(26,840)	(274,137)	(35,599)
<b>CASH FLOW FROM INVESTING ACTIVITIES</b>	<b>(457,494)</b>	<b>(185,475)</b>	<b>(539,700)</b>	<b>(552,923)</b>
<b>FINANCING ACTIVITIES</b>				
Proceeds of long-term debt	-	500,000	-	500,000
Repayment of long-term debt	(185,167)	(66,538)	(222,033)	(152,464)
Costs related to financing	(4,905)	-	(289,150)	(3,477)
Costs related to Employee Share Ownership Plan	(1,000)	-	(1,000)	-
Proceeds from the issue of capital stock	168,710	11,146	3,008,860	11,146
<b>CASH FLOW FROM FINANCING ACTIVITIES</b>	<b>(22,362)</b>	<b>444,608</b>	<b>2,496,677</b>	<b>355,205</b>
<b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>(1,254,615)</b>	<b>265,577</b>	<b>803,211</b>	<b>(1,060,459)</b>
<b>CASH AND CASH EQUIVALENTS (BANK INDEBTEDNESS), BEGINNING</b>	<b>936,760</b>	<b>(1,068,417)</b>	<b>(1,121,066)</b>	<b>257,619</b>
<b>BANK INDEBTEDNESS, ENDING</b>	<b>\$ (317,855)</b>	<b>\$ (802,840)</b>	<b>\$ (317,855)</b>	<b>\$ (802,840)</b>
<b>REPRESENTED BY:</b>				
Cash and cash equivalents	\$ 693,223	\$ 79,198	\$ 693,223	\$ 79,198
Bank indebtedness	(1,011,078)	(882,038)	(1,011,078)	(882,038)
<b>TOTAL BANK INDEBTEDNESS</b>	<b>\$ (317,855)</b>	<b>\$ (802,840)</b>	<b>\$ (317,855)</b>	<b>\$ (802,840)</b>
<b>NON-CASH TRANSACTIONS</b>				
Stock-based financing costs	\$ -	\$ -	\$ (183,849)	\$ -
Stock-based compensation	(105,915)	-	(178,734)	-
Increase in share capital	105,915	-	362,583	-
Decrease in inventory	(22,720)	-	(22,720)	-
Increase in other assets	22,720	-	22,720	-
Increase in property, plant and equipment due to reallocation of deposit on equipment	-	-	47,700	-
Decrease in prepaid expenses	-	-	(47,700)	-
	\$ -	\$ -	\$ -	\$ -

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

**PACIFIC SAFETY PRODUCTS INC.**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE SECOND QUARTER AND YEAR TO DATE RESULTS ENDED DECEMBER 31, 2004 WITH COMPARATIVE**  
**RESULTS FOR 2003**  
**(UNAUDITED)**

**1. SIGNIFICANT ACCOUNTING POLICIES**

**Basis of Presentation**

The accompanying unaudited financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles and include the accounts of Pacific Safety Products Inc. The prior period comparative figures include the accounts of Pacific Safety Products Inc. and its wholly owned subsidiary, AEGIS Engineered Textile Products Inc. Effective February 29, 2004 AEGIS Engineered Textile Products Inc. was wound up into Pacific Safety Products Inc. The wind-up had no material effect on the Company's financial statements.

These unaudited interim financial statements follow the same accounting policies and methods of application as the most recent annual audited consolidated financial statements dated June 30, 2004. The disclosures provided herein are incremental to those included in the annual audited consolidated financial statements. These unaudited interim financial statements should be read in conjunction with the Company's June 30, 2004 annual audited consolidated financial statements.

**Use of Estimates**

The presentation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make assumptions and estimates that affect the reported amounts and other disclosures in these financial statements. Actual results may differ from those estimates.

**Net Income (Loss) Per Share**

Basic net income (loss) per share is calculated by dividing the net income (loss) for the period by the weighted average number of common shares outstanding during the period. The Company uses the treasury stock method for calculating the dilutive effect of the outstanding stock options and other dilutive securities. Under the treasury stock method, the weighted average number of common shares outstanding used for the calculation of diluted loss per share assumes that the proceeds to be received on the exercise of dilutive share options and warrants are used to repurchase common shares at the average market price during the period. The fully diluted net income (loss) per share has not been presented, as it does not differ materially from basic income (loss) per share.

**Financial Instruments**

The Company carries a number of financial instruments. It is management's opinion that the Company is not exposed to a significant concentration of credit risk arising from these financial instruments. The Company is exposed to currency risk arising from these financial instruments as a substantial number of transactions are denominated in Canadian dollars and United States dollars. The Company is exposed to interest rate risk as a portion of its long-term debt and its operating line are based on a floating interest rate. Unless otherwise noted, the fair value of these financial instruments approximates the carrying values.

<b>2. GOODWILL AND INTANGIBLE ASSETS</b>	<b>December 2004</b>			<b>June 2004</b>	<b>December 2003</b>
	<b>Cost</b>	<b>Accumulated Amortization</b>	<b>Net Book Value</b>	<b>Net Book Value</b>	<b>Net Book Value</b>
Deferred organization costs	\$ 78,634	\$ 63,735	\$ 14,899	\$ 17,736	\$ 12,215
Patents	110,616	8,394	102,222	79,893	40,432
Trademarks	30,572	11,764	18,808	18,343	17,468
Deferred financing costs	170,259	42,238	128,021	142,128	156,397
Deferred marketing costs	95,541	36,270	59,271	64,133	-
Deferred contract costs	291,451	-	291,451	-	-
	777,073	162,401	614,672	322,233	226,512
Goodwill	3,275,962	441,609	2,834,353	2,834,353	2,834,353
	<b>\$ 4,053,035</b>	<b>\$ 604,010</b>	<b>\$ 3,449,025</b>	<b>\$ 3,156,586</b>	<b>\$ 3,060,865</b>

**PACIFIC SAFETY PRODUCTS INC.**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE SECOND QUARTER AND YEAR TO DATE RESULTS ENDED DECEMBER 31, 2004 WITH COMPARATIVE**  
**RESULTS FOR 2003**  
**(UNAUDITED)**

**3. EQUITY INSTRUMENTS**

**Authorized**

The authorized share capital of the Company consists of 100,000,000 voting common shares without par value.

<b>Issued</b>	<b>Number of Shares</b>	<b>Amount</b>
Balance, June 30, 2003	12,331,480	\$ 4,370,128
Issuance of shares (a)	31,845	11,146
Issuance of shares (b)	13,950	3,766
Issuance of shares (c)	180,000	70,350
Less: Issuing costs	-	(1,423)
Balance, June 30, 2004	12,557,275	4,453,967
<b>Issuance of shares (b)</b>	<b>57,470</b>	<b>15,518</b>
<b>Issuance of shares (d)</b>	<b>4,000,000</b>	<b>1,868,819</b>
<b>Issuance of warrants (d)</b>		<b>928,231</b>
<b>Issuance of warrants (e)</b>	-	<b>69,841</b>
<b>Issuance of shares (f)</b>	<b>225,500</b>	<b>118,116</b>
<b>Issuance of shares (g)</b>	<b>6,337</b>	<b>8,337</b>
<b>Less: Financing costs</b>	-	<b>(472,999)</b>
<b>Stock-based compensation</b>	-	<b>292,745</b>
<b>Less: Issuing costs</b>	-	<b>(1,000)</b>
<b>Balance, December 31, 2004</b>	<b>16,846,582</b>	<b>\$ 7,281,575</b>

The fair value of warrants was estimated using the Black-Scholes option-pricing model with the following assumptions: dividend yield (nil), expected volatility (0.31), risk-free interest rate (5%), and weighted average life of one year.

- (a) In 2003, the Company offered its third employee share ownership plan. Under the plan, employees were entitled to purchase up to 300,000 common shares at \$0.35 per share, which was the trading price at the time of offering. 44,391 shares were subscribed for of which 12,546 were issued in January 2003 and 31,845 were issued in December 2003.
- (b) In 2004, the Company offered its fourth employee share ownership plan. Under the plan, employees were entitled to purchase up to 300,000 common shares at \$0.27 per share, which was the trading price at the time of offering. 71,420 shares were subscribed for, of which 13,950 were issued in January 2004 and 57,470 were issued in December 2004.
- (c) In 2004, 180,000 common shares were issued at a weighted average price of \$0.48 per share through the exercise of employees' stock options.
- (d) During the first quarter of fiscal 2005, the Company completed a private placement for 4,000,000 Units. Each Unit cost \$0.70 and consisted of one common share and one-half common share purchase warrant. Each whole common share purchase warrant is exercisable at \$0.85 and expires on September 23, 2005. The common shares in the Units and the shares issuable on exercise of the warrants are subject to a four-month hold period expiring January 23, 2005.
- (e) During the first quarter of fiscal 2005, the Company issued a Compensation Option to the underwriter to purchase 300,000 Units at \$0.70 per Unit. Each Compensation Option Unit consists of one common share and one-half common share purchase warrant. Each whole common share purchase warrant is exercisable at \$0.85 and expires on September 23, 2005. The cost of the Compensation Option Units, in the amount of \$183,849, is included in financing costs. Of this total, \$69,841 was allocated to the issuance of warrants and the remaining \$114,008 was allocated to stock based compensation. These options expire on September 23, 2005. The common shares in the Units and the shares issuable on exercise of the warrants are subject to a four-month hold period expiring January 23, 2005.
- (f) During the first two quarters of fiscal 2005, 225,500 common shares were issued at a weighted average price of \$0.47 per share through the exercise of employee's stock options.
- (g) During the second quarter of fiscal 2005, 6,337 common shares were issued through the exercise of whole share purchase warrants for cash proceeds of \$5,386 and a non-cash value of \$2,951.

**Stock Options**

The Company has a stock option plan that provides options to purchase common shares of the Company for its management, executive officers and members of the Board of Directors. These options expire five years after the issue date or 30 days after the executive officer's or manager's services to the corporation cease. Board of Directors member's options expire 90 days after termination or resignation. On August 28, 2004, the Board of Directors approved an amendment to the stock option plan to align the expiration date of future stock options granted to 60 days after the employee's or Board member's services cease. The exercise price for these stock options is set at the average closing price over the previous 20 day trading period and the options are fully vested for employees when issued. At December 31, 2004, the Company had 829,500 stock options outstanding with exercise prices ranging from \$0.27 to \$1.95. Of the options outstanding at December 31, 2004, 100,000, with a weighted average exercise price of \$1.20, do not fully vest until September 30, 2005.

**PACIFIC SAFETY PRODUCTS INC.**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE SECOND QUARTER AND YEAR TO DATE RESULTS ENDED DECEMBER 31, 2004 WITH COMPARATIVE**  
**RESULTS FOR 2003**  
**(UNAUDITED)**

**3. EQUITY INSTRUMENTS (continued)**

	<i>Management And Employees</i>	<i>Senior Management</i>	<i>Executive Officers</i>	<i>Board of Directors</i>	<i>Total</i>	<i>Weighted Average Exercise Price</i>
Balance, June 30, 2004	151,000	10,000	370,000	319,000	850,000	\$ 0.38
Issued	-	-	100,000	105,000	205,000	\$ 1.58
Exercised	(151,000)	(10,000)	-	(64,500)	(225,500)	\$ 0.47
<b>Balance, December 31, 2004</b>	-	-	470,000	359,500	829,500	\$ 0.65
<b>Weighted Average Exercise Price</b>	\$ -	\$ -	\$ 1.20	\$ 0.80	\$ 0.65	
<b>Weighted Average Remaining Contractual Life (years)</b>	-	-	3.26	4.01	3.59	

The fair value of stock options in previous years was estimated using the Black-Scholes option-pricing model with the following assumptions: dividend yield (nil), expected volatility (0.09), risk-free interest rate (5.0%), and weighted average life of five years. The fair value of stock options in the current quarter was estimated using the Black-Scholes option-pricing model with the following assumptions: dividend yield (nil), expected volatility (0.31), risk-free interest rate (5%), and weighted average life of one year.

**Common Share Purchase Warrants**

During the first quarter of fiscal 2005, the Company completed a private placement by issuing 4,000,000 Units at \$0.70 per Unit. Each Unit consists of one common share and one-half common share purchase warrant. There are 1,993,661 whole common share purchase warrants outstanding at December 31, 2004. Each whole common share purchase warrant is exercisable at \$0.85 and expires September 23, 2005.

Expiry date	Note	Exercise Price	Issued	Exercised	Expired/ Cancelled	December 31, 2004
September 23, 2005	3(d)	\$ 0.85	1,999,998	(6,337)	-	1,993,661

<i>Equity Instruments Outstanding</i>	<i>DECEMBER 31, 2004</i>	<i>JUNE 30, 2004</i>	<i>DECEMBER 31, 2003</i>
Issued and outstanding	16,846,582	12,557,275	12,363,325
Stock options	829,500	850,000	744,000
Warrants	1,993,661	-	-
Compensation Units - shares	300,000	-	-
Compensation Units - warrants	150,000	-	-
Employee Share Ownership Plan	-	57,470	-
<b>Fully diluted equity instruments</b>	<b>20,119,743</b>	<b>13,464,745</b>	<b>13,107,325</b>

**4. CONTINGENCIES AND COMMITMENTS**

The Company entered into an agreement with its bank to secure an irrevocable standby letter of credit ("LOC") in the amount of \$904,800 CAD. The LOC is secured by cash drawn on the Company's operating line. This LOC is issued in connection with the Horizon 1 protective coverall contract as a security for payment to a certain supplier of raw materials.

The Company has commitments to certain of its suppliers for purchase orders extending over a two-year period. The commitments total approximately \$25 million and are related to the purchase of raw materials for the two major government contracts.

**PACIFIC SAFETY PRODUCTS INC.  
NOTES TO THE FINANCIAL STATEMENTS  
FOR THE SECOND QUARTER AND YEAR TO DATE RESULTS ENDED DECEMBER 31, 2004 WITH COMPARATIVE  
RESULTS FOR 2003  
(UNAUDITED)**

---

**5. RELATED PARTY TRANSACTIONS**

---

During the year the Company has paid \$51,503 (six months ended December 31, 2003 - \$24,667) in fees to a board member and an organization related to a member of the Board of Directors. These fees were charged to general administration expense as legal fees or capitalized as other assets on the balance sheet. These transactions were all in the normal course of operations and are measured at the exchange value (the amount of consideration established and agreed to by the related parties), which approximates the arm's length equivalent value.

In December, 6,337 common shares were issued on the exercise of 6,337 whole common share purchase warrants by a member of the Board of Directors for proceeds of \$5,386.

**6. FINANCIAL INSTRUMENTS**

---

The Company holds various forms of financial instruments. The nature of these instruments and the Company's operations expose the Company to interest rate risk and foreign currency risk. The Company manages its exposure to these risks by operating in a manner that minimizes its exposure to the extent practical.

- (a) At December 31, 2004 the Company had \$2,242,000 (June 30, 2004 - \$2,416,000, December 31, 2003 - \$2,458,000 ) of long-term floating rate debt.
- (b) At December 31, 2004 the Company had \$1,011,078 (June 30, 2004 - \$882,038, December 31, 2003 - \$882,038) of current floating rate debt.
- (c) At December 31, 2004 the Company had \$855,370 in accounts receivables due from two individual customers.
- (d) At December 31, 2004 the Company had \$693,223 in cash on deposit with one financial institution.
- (e) At December 31, 2004 the Company held two secured Letters of Credit with Scotiabank in the amounts of \$650,000 CAD and \$750,000 USD.
- (f) Foreign currency exchange rate risk management - A significant portion of the Company's sales are denominated in foreign currencies and, accordingly, the related financial assets and liabilities are subject to fluctuations in exchange rates. The Company manages its exposure to foreign currency fluctuations by maintaining foreign currency bank accounts and receivables to offset foreign currency payables and planned expenditures.

**7. SUBSEQUENT EVENTS**

---

On January 6, 2005, the Company completed its second bought deal private placement with Acumen Capital Partners ("Acumen") for gross proceeds of \$4.8 million. Acumen placed 1,750,000 Units of the Company for \$2.75 per unit. Each Unit consists of one common share of PSP and one-half common share purchase warrant. Each whole common share purchase warrant will entitle the holder to acquire one common share of PSP at a price of \$3.75 per share. These warrants will expire on January 9, 2006. The Company paid Acumen underwriting fees in cash and in options to purchase Compensation Options Units at \$2.75 per Unit. Each Compensation Option Unit allows Acumen to purchase one common share and one half common share purchase warrant. Each whole common share purchase warrant is exercisable at \$3.75 and expires on January 9, 2006.



*Pacific Safety Products Inc.*  
Trading Symbol - PSP: TSX Venture Exchange  
2821 Fenwick Road  
Kelowna, British Columbia, CANADA V1X 5E4

Shawn VanderMeer, CA  
Chief Financial Officer and Vice President, Finance and Administration

E-Mail	svandermeer@pacsafety.com or ir@pacsafety.com
Web site	www.pacsafety.com
Toll Free Phone	1.888.PSP.ARM (777.2767)
Phone	250.491.0911
Fax	250.491.0930