



PSP: TSX Venture Exchange  
www.pacsafety.com

# Investor Report

## Quarter Three Fiscal 2005

For the Third Quarter and Year to Date Results  
March 31, 2005 with Comparative Results for 2004

## Message to Shareholders

### Review

One year ago we reported a significant milestone in PSP's history: the award of a \$20 million contract for the Fragmentation Protective Vest contract ("FPV") with the Canadian Department of National Defence ("DND"). This quarter we are proud to report another milestone: PSP's largest shipment volume in any one month in our history.

In March 2005 we shipped \$3.7 million which included our first delivery of fragmentation protective vests with revenue of over \$2.0 million. Sales for the quarter topped \$5.3 million and is testament to our commitment for returning the Company to strong revenue growth and consistent profitability. Production of the FPV is now underway after months of our staff's hard work and persistence. As previously reported, although production of the FPV was delayed by design changes requested by DND, these changes resulted in an increase in the contract of \$2.6 million. We are now on track with our shipments of the FPV and should see steady revenue streams for the next two years from this contract alone. Progress on the Horizon 1 Chemical Warfare Protective Coverall ("H1") project, our second DND contract valued at \$24 million, is advancing ahead of schedule. We are in trial production at the date of this report and expect to begin full production in May 2005. With these two contracts in production comes the achievement of many of the Company's strategic objectives, the single most important being the return to profitability.

In February, we signed an agreement with ArmorWorks LLC, a leading U.S. manufacturer of hard body armor and vehicle armor, to manufacture and distribute ArmorWorks' patented "T-Flex" ballistic material. We are pleased to report we are progressing very well with this project. The second agreement we signed with ArmorWorks LLC is a co-distribution agreement whereby PSP and ArmorWorks will market and distribute each other's products in their respective markets. We continue to work closely with AmorWorks to bid jointly on shared opportunities both domestically and internationally.

In quarter three we also saw the completion of our second "bought deal" equity financing with Acumen Capital Partners Ltd. The Company raised gross proceeds of \$4.8 million with limited dilution to our current shareholders. These funds will be used for working capital and to fund current projects already in progress.

The significant role of technology in PSP's strategic plan has created the need to hire a Chief Technology Officer (CTO). The CTO will be responsible for monitoring new technologies, assessing their potential to become new products and overseeing the selection of those research projects which will add value to the Company. Our search continues to find the right candidate who will be capable of advancing our technological growth.

Locally, PSP was recognized by The Okanagan Science & Technology Council (OSTEC) as "Innovative Organization of the Year." OSTEC is an organization that fosters an environment that supports science and technology initiatives. Its mission statement is to "foster the development of the region as a globally competitive centre of excellence in the research, development and application of science, technology and innovation." Recognition such as this proves our commitment to creating new product development initiatives and staying abreast with current technological trends.

### The Future

After 21 years in business we have built a solid foundation from which we can continue to grow. Our strength comes from our commitment to our core values of integrity, teamwork, quality, innovation and effective communication, all of which provide an opportunity to excel. Our successful completion of previous smaller contracts for both the FPV and H1 positioned PSP well in our bid for winning the large DND contracts and proves the government's confidence in our abilities. From where we stand today, with the prospect of consistent shipment volumes in subsequent months, we are poised to add new product offerings to new and existing markets which will not only significantly grow the top and bottom line but also ensure the long-term strength of the Company.

Sincerely,

A handwritten signature in black ink, appearing to be "Brad Field", written in a cursive style.

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 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 third quarter ended March 31, 2005. The information in this report includes information available to April 22, 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 nine months ended March 31, 2005 and March 31, 2004. It should be read in conjunction with the Company's unaudited interim financial statements and notes for the three months and nine months ended March 31, 2005, and the Company's unaudited consolidated interim financial statements for the three months and nine months ended March 31, 2004, 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 190 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

Our capability to deliver results comes from a strong foundation built on consistent values, practices and experiences. PSP has been in business for 21 years and continues to operate in a new global economy using the same tried and true principles of quality workmanship, excellent customer service, financial and corporate responsibilities and sound governance.

The team at PSP has proven we can deliver results. With our team of highly skilled and dedicated individuals we streamlined our manufacturing facilities and started delivering on our first major Canadian military contract, and this quarter, we returned the Company to profitability. The Company was also proactive in securing the necessary financial resources to ramp up capacity and purchase raw materials for the two government contracts as well as for developing future markets and products. We are well positioned to continue to deliver strong performance due to our financial strength, on-going commitment to technology and innovation, our skilled and flexible workforce and the proven leadership of our Executive Leadership Team.

Specifically, we have in place:

- Fully equipped manufacturing capacity in two locations - Kelowna, BC and Arnprior, ON
- Research and new product development facility in Brampton, ON
- Sufficient working capital to fund current operations and future growth
- Skilled, dedicated and trained workforce
- Leadership team with a proven track record

## OVERALL CORPORATE PERFORMANCE

SUMMARY OF OPERATIONS	THREE	THREE	NINE	NINE
	MONTHS ENDED MARCH 31, 2005	MONTHS ENDED MARCH 31, 2004	MONTHS ENDED MARCH 31, 2005	MONTHS ENDED MARCH 31, 2004
SALES	\$ 5,367,417	\$ 2,398,678	\$ 10,694,084	\$ 9,130,882
COST OF SALES	3,924,244	1,701,810	7,952,785	6,448,575
GROSS MARGIN	1,443,173	696,868	2,741,299	2,682,307
EXPENSES	1,253,929	1,007,807	3,753,051	2,756,091
INTEREST ON LONG-TERM DEBT	143,769	143,188	440,568	399,029
TOTAL EXPENSES	1,397,698	1,150,995	4,193,619	3,155,120
NET INCOME (LOSS) BEFORE INCOME TAXES	45,475	(454,127)	(1,452,320)	(472,813)
INCOME TAXES EXPENSE (RECOVERY)	14,855	(158,749)	(518,634)	(165,346)
INCOME (LOSS)	\$ 30,620	\$ (295,378)	\$ (933,686)	\$ (307,467)
BASIC INCOME (LOSS) PER SHARE	\$ 0.002	\$ (0.024)	\$ (0.058)	\$ (0.025)
WEIGHTED AVERAGE COMMON SHARES ISSUED AND OUTSTANDING	18,543,195	12,372,523	16,045,391	12,348,072

CASH FLOW	THREE	THREE	NINE	NINE
	MONTHS ENDED MARCH 31, 2005	MONTHS ENDED MARCH 31, 2004	MONTHS ENDED MARCH 31, 2005	MONTHS ENDED MARCH 31, 2004
Cash flow from continuing operations	\$ (1,193,126)	\$ 122,212	\$ (2,346,892)	\$ (780,227)
Investing activities and capital expenditures	\$ (358,538)	\$ (115,872)	\$ (898,238)	\$ (632,574)
Financing activities	\$ 4,212,315	\$ (20,513)	\$ 6,708,992	\$ 338,169
	\$ 2,660,651	\$ (14,173)	\$ 3,463,862	\$ (1,074,632)

## FINANCIAL POSITION

AS AT	MARCH 31, 2005	(AUDITED)	MARCH 31, 2004
		JUNE 30, 2004	
Cash and cash equivalents (bank indebtedness)	\$ 2,342,796	\$ (1,121,066)	\$ (817,013)
Working capital	\$ 6,874,405	\$ 1,348,455	\$ 1,666,802
Long-term debt (long-term portion only)	\$ 3,815,000	\$ 4,062,000	\$ 4,242,001
Shareholders' equity	\$ 9,673,757	\$ 3,359,652	\$ 3,595,713

## 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

	Q3 2005	Q2 2005	Q1 2005	Q4 2004	Q3 2004	Q2 2004	Q1 2004	Q4 2003
Sales	\$5,367,417	\$2,938,423	\$2,388,244	\$3,429,766	\$2,398,678	\$2,701,610	\$4,030,594	\$2,205,527
Net income (loss)	\$30,620	\$(581,749)	\$(382,557)	\$(342,442)	\$(295,378)	\$(239,140)	\$227,051	\$(411,489)
Basic earnings (loss) per share <sup>(1)(2)</sup>	\$0.002	\$(0.035)	\$(0.030)	\$(0.027)	\$(0.024)	\$(0.019)	\$0.018	\$(0.033)

## 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)(2)</sup>	\$(0.050)	\$(0.025)	\$0.025

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

(2) Basic earnings (loss) per share is calculated using the weighted average shares outstanding during the period.

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

The Company reported income after taxes of \$30,620 for the quarter ended March 31, 2005 compared to a loss after taxes of \$295,378 in the same quarter last year. This profit represents an increase of \$325,998 and is a direct result of the record breaking shipment volumes in March. For the nine months ended March 31, 2005, the Company reported a loss after taxes of \$933,686 compared to a loss after taxes of \$307,467 for the same period in fiscal 2004. The decrease of \$626,219 is due mainly to the costs incurred to get the Fragmentation Protective Vest ("FPV") contract into production. As the contract is now in production, we expect to see a steady stream of revenue which will result in a profitable bottom line.

### **SALES**

PSP recorded \$5.4 million in sales for the quarter ended March 31, 2005, which represents an increase of \$3.0 million, a 123.8% increase over last year's third quarter. During the quarter, PSP delivered its first shipment of FPV's to Canada's Department of National Defence. In March alone, the Company shipped \$3.7 million which was the highest amount shipped in one month in the history of the Company.

### **GROSS MARGIN**

Gross margin for quarter three was 26.9% of revenue compared to 29.1% of revenue in the same period last year. The 2% decrease in gross margin is directly attributable to the costs generated in getting the FPV contract into production. 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. With these strategies in place and a steady stream of revenue, we expect to see our gross margin increase consistently in the upcoming quarters.

### **EXPENSES**

#### **Sales and Marketing**

Sales and marketing expenses were \$520,615 compared to \$457,698 in the same quarter last year, an increase of \$62,917 or 13.7%. 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. Our commitment to expanding into new markets has resulted in increased travel costs and the hiring of sales representatives outside of Canada. Year to date sales and marketing expenditures increased to \$1,435,168 from \$1,067,412 in the same nine month period last year.

#### **Research and Development**

Research and development expenditures totalled \$136,539 for the quarter compared to \$133,137 in quarter three last year. In some cases, research and development expenses incurred on behalf of the federal government are recoverable after the project is complete. The net increase of \$3,402 reflects PSP's commitment to provide complete solutions to our customers. Over the past year, PSP has expanded the research and development team, which has resulted in increased salaries and wages. The Company has also supported the team by sending members to international tradeshows to stay current with recent developments and trends.

#### **General and Administration**

General and administration expenditures increased \$152,699 to \$512,137 compared to \$359,438 in the same quarter last year. An increase in administration staff and the use of outside consultants to assist in recovering eligible tax credits is partly responsible for this increase. Outside consultants were also engaged to provide maintenance and upgrades to the Company's extensive network system, ensuring that all PSP locations and employees enjoy state of the art technology and access the Company's information systems. Expenses were also incurred by the management team for travel to the US in order to proceed with initiatives regarding expansion into this market. Changes in generally accepted accounting principles require the Company to expense all stock options granted to employees, management and board members. During the quarter, \$24,000 was expensed relating to options granted in late November and vesting over a one year period.

Amortization of property, plant and equipment decreased \$2,159 to \$27,660 compared to \$29,819 in the same quarter last year. Amortization of other assets increased \$34,981 to \$54,442 compared to \$19,461 in quarter three of last year. This is due to increasing the amortization of product development costs related to new product lines. Amortization of FPV costs was recorded in March and accounts for approximately one-half of the increase over this period last year. 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 \$5,718 to \$2,536 compared to \$8,254 in quarter three of fiscal 2004. The decrease in this expenditure is due to not using the Company's operating line this quarter.

Interest on long-term debt increased \$581 to \$143,769 compared to \$143,188 in quarter three of fiscal 2004. The net change is due to the increase in the accrual of bonus interest to \$27,000 per quarter, from \$15,000 and the lower interest relating to the pay-out of leases and the lower outstanding balance on the floating rate debt.

#### **Income Taxes**

Income taxes were calculated at an effective rate of 36% for the year ended March 31, 2005.

## RESULTS OF OPERATIONS

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

The Company generated an operating income of \$189,244, or \$0.010 per share, compared to an operating loss of \$310,939, or \$0.025 per share in quarter three, fiscal 2004.

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

For the quarter ended March 31, 2005, EBITDA was \$321,361 compared to \$(218,535) for the quarter ended March 31, 2004. Year to date EBITDA was \$(654,668) compared to \$190,894 for the same nine-month period in 2004.

### Income (Loss) After Taxes

Income after taxes for the quarter ended March 31, 2005 was \$30,620, or \$0.002 per share, compared to a loss of \$295,378, or \$0.024 per share in quarter three, fiscal 2004.

### Cash Flow

Cash flow used in operating activities was \$1,193,126 compared to \$122,212 in cash generated in quarter three, 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. \$358,538 was used for investments in new product development, intangible assets and property, plant and equipment compared to \$115,872 used 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 military contracts. Financing activities increased cash by \$4,212,315 compared to \$20,513 used in quarter three, fiscal 2004. The proceeds from financing activities relate to the net proceeds of a \$4.8 million financing which closed January 6, 2005, and is being used to provide working capital and fund future growth. There were no other significant changes over the quarter.

## LIQUIDITY AND CAPITAL RESOURCES

### Working Capital

PSP's liquidity was significantly enhanced in quarter three as the Company raised \$4.8 million through a second equity offering. At March 31, 2005, PSP's working capital position was \$6.9 compared to \$1.7 at March 31, 2004. PSP has enough working capital to meet current commitments and deliver future orders and will generate significant cash flow from operations based on current orders in place.

### 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. The amount drawn on the bank operating line decreased to zero compared to \$930,047 at March 31, 2004.

At March 31, 2005, the Company did not comply with its capital purchases covenant. The Company has exceeded the \$200,000 limit on the acquisition of new capital equipment. Purchases of capital equipment were required to produce the large government contracts currently in the order book. The lenders of the long-term debt have provided the Company with letters waiving the default for fiscal 2005.

### Accounts Receivable

The \$4.6 million accounts receivable balance is significantly higher at March 31, 2005 due to \$3.7 million in shipments in the month of March, which included shipments of the FPV contract in excess of \$2.0 million.

### Inventory

At March 31, 2005 inventory increased \$946,477 to \$2,487,518 compared to \$1,541,041 at March 31, 2004. A significant portion of this increase relates to the purchase of raw materials for the Fragmentation Protective Vest contract.

### Investment Tax Credits Receivable

\$263,994 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 these years have been assessed as filed and a refund will be issued in accordance with applicable tax regulations.

### Future Income Taxes Recoverable

At March 31, 2005, 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 \$986,825 at March 31, 2005 (June 30, 2004 - \$468,369, March 31, 2004 - \$436,258). This has been recorded as a current asset as forecasts based on the current order book and shipment schedule of the Fragmentation Protective Vest contract for the Canadian military will provide enough taxable income to use the loss carry forwards in the next year.

### 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 invested \$358,538 in property, plant and equipment and other assets. A significant portion of these charges relate to the Fragmentation Protective Vest contract and are being amortized based on shipment forecasts. The main increase in costs is related to the continued ramp up in January and February for the production of the large contracts.

## LONG-TERM DEBT

There were no other significant changes in long-term debt during the quarter other than regular payments of principal and interest.

## EQUITY INSTRUMENTS

PSP issued 22,810 shares to employees of the Company under its fifth Employee Share Ownership Plan for net proceeds of \$52,005. Also during the quarter, 84,400 whole common share purchase warrants were exercised in exchange for 84,400 common shares at an exercise price of \$0.85 per warrant for cash proceeds of \$71,740. There were no new stock options issued during the quarter. Currently there are 829,500 options outstanding with a weighted average exercise price of \$0.65. This represents nearly 4% of PSP's issued and outstanding common shares.

During the third quarter, 1,750,000 Units of the Company were issued for gross proceeds of \$4.8 million. Each Unit consists of one common share and one-half common share purchase warrant. The proceeds were allocated as \$4,243,005 for 1,750,000 common shares issued and \$569,495 for 874,999 warrants issued. \$563,892 in costs related to this financing were recorded as a reduction of share capital. Due to a new accounting policy, \$85,952 was recorded as an increase in share capital related to compensation based on outstanding stock options. At March 31, 2005, PSP's issued and outstanding shares totalled 18,703,792 (June 30, 2004 - 12,557,275, March 31, 2004 - 12,337,275) of the 100,000,000 authorized to be issued.

## Comparison of Expected and Actual Use of Proceeds of Equity Financing

The Company completed a \$4.8 million equity financing during the third quarter of fiscal 2005. The following schedule shows the expected and actual use of proceeds.

	Expected	Actual	Variance
Working capital	\$4,236,000	\$4,236,000	\$-
Financing costs	\$564,000	\$564,000	\$-
	\$4,800,000	\$4,800,000	\$-

## 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

During the quarter the Company paid \$54,255 (three months ended March 31, 2004 - \$22,200) and a total of \$105,758 (nine months ended March 31, 2004 - \$46,867) 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.

Also during the quarter, two officers of the Company participated in the private placement equity financing. Of the 1,750,000 Units purchased, 15,000 Units were purchased by management for gross proceeds of \$60,875.

In February 2005, 5,000 common shares were issued on the exercise of 5,000 whole common share purchase warrants by an officer of the Company for gross proceeds of \$4,250.

## 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

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.

- At March 31, 2005 the Company had \$2,197,000 (June 30, 2004 - \$2,374,000, March 31, 2004 - \$2,458,000) of long-term floating rate debt.
- At March 31, 2005 the Company had zero (June 30, 2004 - \$1,171,392, March 31, 2004 - \$930,047) of current floating rate debt.
- At March 31, 2005 the Company had \$3,303,218 in accounts receivable due from one customer.
- At March 31, 2005 the Company had \$2,342,796 in cash on deposit with one financial institution.
- At March 31, 2005 the Company held two secured letters of credit with its financial institution in the amounts of C\$650,000 and US\$750,000.
- Foreign currency exchange rate risk management - a significant portion of the Company's sales and purchases 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.

## **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 if 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 has started to realize steady revenue and profitability growth in this quarter.

## **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)**

<b>AS AT</b>	<b>MARCH 31, 2005</b>	<b>(AUDITED) JUNE 30, 2004</b>	<b>MARCH 31, 2004</b>
<b>ASSETS</b>			
<b>CURRENT ASSETS</b>			
Cash and cash equivalents	\$ 2,342,796	\$ 50,326	\$ 113,034
Accounts receivable	4,590,892	1,649,554	1,612,481
Inventory	2,487,518	1,397,916	1,541,041
Prepaid expenses and deposits	364,313	270,261	411,571
Investment tax credits receivable	263,994	201,000	-
Future income taxes recoverable	986,825	468,369	436,258
<b>Total Current Assets</b>	<b>11,036,338</b>	<b>4,037,426</b>	<b>4,114,385</b>
<b>PROPERTY, PLANT AND EQUIPMENT</b>	<b>3,070,875</b>	<b>2,813,461</b>	<b>2,862,222</b>
<b>OTHER ASSETS</b>	<b>282,602</b>	<b>350,992</b>	<b>510,055</b>
<b>INTANGIBLE ASSETS</b> (note 4)	<b>674,364</b>	<b>322,233</b>	<b>221,256</b>
<b>GOODWILL</b> (note 4)	<b>2,834,353</b>	<b>2,834,353</b>	<b>2,834,353</b>
<b>TOTAL ASSETS</b>	<b>\$ 17,898,532</b>	<b>\$ 10,358,465</b>	<b>\$ 10,542,271</b>
<b>LIABILITIES</b>			
<b>CURRENT LIABILITIES</b>			
Bank indebtedness	\$ -	\$ 1,171,392	\$ 930,047
Accounts payable and accrued liabilities	3,609,228	1,128,190	1,275,067
Deferred revenue	179,705	23,356	4,941
Current portion of long-term debt	373,000	366,033	237,528
<b>Total Current Liabilities</b>	<b>4,161,933</b>	<b>2,688,971</b>	<b>2,447,583</b>
<b>LONG-TERM DEBT</b>	<b>3,815,000</b>	<b>4,062,000</b>	<b>4,242,001</b>
<b>FUTURE INCOME TAXES PAYABLE</b>	<b>247,842</b>	<b>247,842</b>	<b>256,974</b>
<b>TOTAL LIABILITIES</b>	<b>8,224,775</b>	<b>6,998,813</b>	<b>6,946,558</b>
<b>SHAREHOLDERS' EQUITY</b>			
<b>EQUITY INSTRUMENTS</b> (note 5)	<b>11,781,689</b>	<b>4,453,967</b>	<b>4,383,627</b>
<b>DEFICIT</b>	<b>(2,107,932)</b>	<b>(1,094,315)</b>	<b>(787,914)</b>
<b>TOTAL SHAREHOLDERS' EQUITY</b>	<b>9,673,757</b>	<b>3,359,652</b>	<b>3,595,713</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$ 17,898,532</b>	<b>\$ 10,358,465</b>	<b>\$ 10,542,271</b>

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 RETAINED EARNINGS (DEFICIT)**  
**(UNAUDITED)**

	<b>THREE MONTHS ENDED MARCH 31, 2005</b>	<b>THREE MONTHS ENDED MARCH 31, 2004</b>	<b>NINE MONTHS ENDED MARCH 31, 2005</b>	<b>NINE MONTHS ENDED MARCH 31, 2004</b>
<b>SALES</b>	<b>\$ 5,367,417</b>	<b>\$ 2,398,678</b>	<b>\$ 10,694,084</b>	<b>\$ 9,130,882</b>
<b>COST OF SALES</b>				
Amortization of property, plant and equipment	50,015	43,124	139,696	124,313
Materials, labour and manufacturing overhead	3,874,229	1,658,686	7,813,089	6,324,262
Total Cost of Sales	3,924,244	1,701,810	7,952,785	6,448,575
<b>GROSS MARGIN</b>	<b>1,443,173</b>	<b>696,868</b>	<b>2,741,299</b>	<b>2,682,307</b>
<b>EXPENSES</b>				
Sales and marketing	520,615	457,698	1,435,168	1,067,412
Research and development	136,539	133,137	433,739	389,725
General administration	512,137	359,438	1,643,683	1,120,421
Amortization of property, plant and equipment	27,660	29,819	92,634	81,944
Amortization of other assets	54,442	19,461	124,754	58,421
Interest on operating line	2,536	8,254	23,073	38,168
Total Expenses	1,253,929	1,007,807	3,753,051	2,756,091
<b>INCOME (LOSS) BEFORE INTEREST ON LONG-TERM DEBT AND INCOME TAXES</b>	<b>189,244</b>	<b>(310,939)</b>	<b>(1,011,752)</b>	<b>(73,784)</b>
<b>INTEREST ON LONG-TERM DEBT</b>				
Periodic interest on long-term debt	116,769	128,188	359,568	354,029
Bonus interest on subordinated debenture	27,000	15,000	81,000	45,000
<b>TOTAL INTEREST ON LONG-TERM DEBT</b>	<b>143,769</b>	<b>143,188</b>	<b>440,568</b>	<b>399,029</b>
<b>INCOME (LOSS) BEFORE INCOME TAXES</b>	<b>45,475</b>	<b>(454,127)</b>	<b>(1,452,320)</b>	<b>(472,813)</b>
<b>INCOME TAXES (RECOVERY)</b>				
Future	14,855	(120,954)	(518,634)	(176,810)
Current	-	(37,795)	-	11,464
Total Income Taxes (Recovery)	14,855	(158,749)	(518,634)	(165,346)
<b>INCOME (LOSS)</b>	<b>30,620</b>	<b>(295,378)</b>	<b>(933,686)</b>	<b>(307,467)</b>
<b>DEFICIT, BEGINNING</b>	<b>(2,138,552)</b>	<b>(492,536)</b>	<b>(1,094,315)</b>	<b>(480,447)</b>
<b>CHANGE IN ACCOUNTING POLICY (Note 2)</b>	<b>-</b>	<b>-</b>	<b>(79,931)</b>	<b>-</b>
<b>DEFICIT, ENDING</b>	<b>\$ (2,107,932)</b>	<b>\$ (787,914)</b>	<b>\$ (2,107,932)</b>	<b>\$ (787,914)</b>
<b>BASIC EARNINGS (LOSS) PER SHARE</b>	<b>\$ 0.002</b>	<b>\$ (0.024)</b>	<b>\$ (0.058)</b>	<b>\$ (0.025)</b>
<b>WEIGHTED AVERAGE COMMON SHARES ISSUED AND OUTSTANDING</b>	<b>18,543,195</b>	<b>12,372,523</b>	<b>16,045,391</b>	<b>12,348,072</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 MARCH 31, 2005</b>	<b>THREE MONTHS ENDED MARCH 31, 2004</b>	<b>NINE MONTHS ENDED MARCH 31, 2005</b>	<b>NINE MONTHS ENDED MARCH 31, 2004</b>
<b>OPERATING ACTIVITIES</b>				
Cash receipts from customers	\$ 2,924,422	\$ 2,870,591	\$ 7,846,101	\$ 8,612,756
Cash paid to suppliers and employees	(4,058,246)	(2,651,617)	(9,870,355)	(9,129,438)
Interest paid	(59,302)	(151,442)	(322,638)	(437,197)
Income taxes recovered	-	54,680	-	173,652
<b>CASH FLOW FROM OPERATING ACTIVITIES</b>	<b>(1,193,126)</b>	<b>122,212</b>	<b>(2,346,892)</b>	<b>(780,227)</b>
<b>INVESTING ACTIVITIES</b>				
Purchase of property, plant and equipment	(261,301)	(84,810)	(491,244)	(480,495)
Proceeds from the sale of property, plant and equipment	-	-	1,500	-
Investment in new product development	(684)	(23,677)	(37,804)	(109,097)
Investment in intangible assets	(96,553)	(7,385)	(370,690)	(42,982)
<b>CASH FLOW FROM INVESTING ACTIVITIES</b>	<b>(358,538)</b>	<b>(115,872)</b>	<b>(898,238)</b>	<b>(632,574)</b>
<b>FINANCING ACTIVITIES</b>				
Proceeds of long-term debt	-	-	-	500,000
Repayment of long-term debt	(18,000)	(22,866)	(240,033)	(175,330)
Costs related to financing	(747,741)	(1,413)	(1,036,891)	(1,413)
Costs related to Employee Share Ownership Plan	(903)	-	(1,903)	-
Proceeds from the issue of capital stock	4,978,959	3,766	7,987,819	14,912
<b>CASH FLOW FROM FINANCING ACTIVITIES</b>	<b>4,212,315</b>	<b>(20,513)</b>	<b>6,708,992</b>	<b>338,169</b>
<b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>2,660,651</b>	<b>(14,173)</b>	<b>3,463,862</b>	<b>(1,074,632)</b>
<b>CASH AND CASH EQUIVALENTS (BANK INDEBTEDNESS), BEGINNING</b>	<b>(317,855)</b>	<b>(802,840)</b>	<b>(1,121,066)</b>	<b>257,619</b>
<b>BANK INDEBTEDNESS, ENDING</b>	<b>\$ 2,342,796</b>	<b>\$ (817,013)</b>	<b>\$ 2,342,796</b>	<b>\$ (817,013)</b>
<b>REPRESENTED BY:</b>				
Cash and cash equivalents	\$ 2,342,796	\$ 113,034	\$ 2,342,796	\$ 113,034
Bank indebtedness	-	(930,047)	-	(930,047)
<b>TOTAL BANK INDEBTEDNESS</b>	<b>\$ 2,342,796</b>	<b>\$ (817,013)</b>	<b>\$ 2,342,796</b>	<b>\$ (817,013)</b>
<b>NON-CASH TRANSACTIONS</b>				
Stock-based financing costs	\$ (119,909)	\$ -	\$ (303,758)	\$ -
Stock-based compensation	(33,050)	-	(138,965)	-
Increase in share capital	152,959	-	442,723	-
Decrease in inventory	-	-	(22,720)	-
Increase in other assets	-	-	22,720	-
Increase (decrease) in property, plant and equipment due to reallocation of deposit on equipment	-	(31,191)	47,700	(31,191)
Increase (decrease) in prepaid expenses	-	31,191	(47,700)	31,191
	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>

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

**PACIFIC SAFETY PRODUCTS INC.**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE THIRD QUARTER AND YEAR TO DATE RESULTS ENDED MARCH 31, 2005 WITH COMPARATIVE**  
**RESULTS FOR 2004**  
**(UNAUDITED)**

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**1. SIGNIFICANT ACCOUNTING POLICIES**

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**Basis of Presentation**

The accompanying unaudited financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. 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.

**Deferred contract costs**

Deferred contract costs related to costs incurred to secure material contracts are recorded at out of pocket expenses. Amortization for deferred contract costs commences in the period that the contract commences commercial production. The costs are amortized based on the forecasted revenue shipments over the life of the contract. In the event the contract is terminated, the remaining costs will be expensed in the period of termination.

**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 because a portion of its long-term debt and operating line is based on a floating interest rate. Unless otherwise noted, the fair value of these financial instruments approximates the carrying values.

**2. CHANGE IN ACCOUNTING POLICY**

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Effective July 1, 2004, the Company adopted the new provisions of the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3870 "Stock-Based Compensation and other Stock-Based Payments" which now requires companies to adopt the fair value based method for all stock-based payments granted on or after January 1, 2002. As a result, the Company is required to expense stock options issued to employees, directors and non-employees. Previously, the Company was only required to disclose the pro forma effect of any stock options issued to employees and directors in the notes to the financial statements. This change has been applied retroactively resulting in an adjustment to retained earnings of \$79,931.

**3. BANK COVENANTS**

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The Company has an agreement with its lenders to adhere to certain conditions until such time as all debts and liabilities have been discharged in full. At March 31, 2005, the Company was not in compliance with the capital expenditures condition as set out by its lenders. The Company has exceeded the \$200,000 limit on the acquisition of new capital equipment. Purchases of capital equipment were required to produce the large government contracts currently in the order book. The lenders of the long-term debt have provided the Company with letters waiving the default for fiscal 2005.

**PACIFIC SAFETY PRODUCTS INC.**  
**NOTES TO THE FINANCIAL STATEMENTS**  
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4. GOODWILL AND INTANGIBLE ASSETS	March 2005		(Audited) June 2004		March 2004
	Cost	Accumulated Amortization	Net Book Value	Net Book Value	Net Book Value
Deferred organization costs	\$ 78,634	\$ 65,154	\$ 13,480	\$ 17,736	\$ 12,215
Patents	118,556	10,071	108,485	79,893	40,432
Trademarks	34,528	13,410	21,118	18,343	17,468
Deferred financing costs	170,259	49,291	120,968	142,128	156,397
Deferred marketing costs	96,005	44,611	51,394	64,133	-
Deferred contract costs	375,645	16,726	358,919	-	-
	873,627	199,263	674,364	322,233	226,512
Goodwill	3,275,962	441,609	2,834,353	2,834,353	2,834,353
	\$ 4,149,589	\$ 640,872	\$ 3,508,717	\$ 3,156,586	\$ 3,060,865

**5. EQUITY INSTRUMENTS**

**Authorized**

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

**Issued**

	Number of Shares	Amount
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
Issuance of shares (d)	4,000,000	1,868,819
Issuance of warrants (d)	-	931,182
Issuance of warrants (e)	-	69,841
Issuance of shares (f)	92,000	40,150
Less: Financing costs	-	(468,134)
Stock-based compensation	-	202,696
Balance, September 30, 2004	16,649,275	7,098,521
Issuance of shares (b)	57,470	15,518
Issuance of shares (g)	133,500	77,966
Issuance of shares (h)	6,337	5,387
Less: Financing costs	-	(4,865)
Stock-based compensation	-	90,049
Less: Issuing costs	-	(1,000)
Balance, December 31, 2004	16,846,582	7,281,576
Issuance of shares (i)	84,400	71,740
Issuance of shares (j)	1,750,000	4,243,005
Issuance of warrants (j)	-	569,494
Issuance of warrants (k)	-	42,712
Less: Financing costs	-	(563,892)
Stock-based compensation	-	85,952
Issuance of shares (l)	22,810	52,005
Less: Issuing costs	-	(903)
Balance, March 31, 2005	18,703,792	11,781,689

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.

**PACIFIC SAFETY PRODUCTS INC.**  
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**5. EQUITY INSTRUMENTS (continued)**

- (a) In fiscal 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 fiscal 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 fiscal 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.
- (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.
- (f) During the first quarter of fiscal 2005, 92,000 common shares were issued at a weighted average price of \$0.44 per share through the exercise of employees' stock options.
- (g) During the second quarter of fiscal 2005, 133,500 common shares were issued at a weighted average price of \$0.47 per share through the exercise of employees' stock options.
- (h) 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.
- (i) During the third quarter of fiscal 2005, 84,400 common shares were issued through the exercise of whole share purchase warrants for cash proceeds of \$71,740.
- (j) During the third quarter of fiscal 2005, the Company completed a private placement for 1,750,000 Units. Each Unit cost \$2.75 and consisted of 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.
- (k) During the third quarter of fiscal 2005, the Company issued a Compensation Option to the underwriter to purchase 131,250 Units at \$2.75 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 \$3.75 and expires on January 9, 2006. The cost of the Compensation Option Units, in the amount of \$119,909 is included in financing costs. Of this total, \$42,712 was allocated to the issuance of warrants and the remaining \$77,197 was allocated to stock based compensation. These options expire on January 9, 2006.
- (l) In January 2005, the Company offered its fifth employee share ownership plan. Under the plan, employees were entitled to purchase up to 300,000 common shares at \$2.28 per share, which was the trading price at the time of offering. 54,790 shares were subscribed for, of which 22,810 were issued in January 2005 and 31,980 will be issued in December 2005.

**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 members' 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 service ceases. 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 March 31, 2005, the Company had 829,500 stock options outstanding with exercise prices ranging from \$0.27 to \$1.95. Of the options outstanding at March 31, 2005, 100,000, with a weighted average exercise price of \$1.20, do not fully vest until September 30, 2005.

	<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	-	30,000	100,000	105,000	235,000	\$ 1.75
Expired	-	(30,000)	-	-	(30,000)	\$ 2.90
Exercised (f), (g)	(151,000)	(10,000)	-	(64,500)	(225,500)	\$ 0.47
<b>Balance, March 31, 2005</b>	-	-	<b>470,000</b>	<b>359,500</b>	<b>829,500</b>	<b>\$ 0.65</b>
<b>Weighted Average Exercise Price</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 0.53</b>	<b>\$ 0.80</b>	<b>\$ 0.65</b>	
<b>Weighted Average Remaining Contractual Life (years)</b>	-	-	<b>3.02</b>	<b>3.77</b>	<b>3.34</b>	

**PACIFIC SAFETY PRODUCTS INC.**  
**NOTES TO THE FINANCIAL STATEMENTS**  
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**5. EQUITY INSTRUMENTS (continued)**

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**

In quarter one, 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. Each whole common share purchase warrant is exercisable at \$0.85 and expires September 23, 2005. In the third quarter of fiscal 2005, the Company completed a second private placement by issuing 1,750,000 Units at \$2.75 per Unit. Each Unit consists of one common share and one-half common share purchase warrant. Each whole common share purchase warrant from this placement is exercisable at \$3.75 and expires January 9, 2006.

Expiry date	Note	Exercise Price	Issued	Exercised	Expired/ Cancelled	March 31, 2005
September 23, 2005	4(d)	\$ 0.85	1,999,998	(90,737)	-	1,909,261
January 9, 2006	4(h)	\$ 3.75	874,999	-	-	874,999
<b>Warrants outstanding</b>		<b>\$ -</b>	<b>2,874,997</b>	<b>(90,737)</b>	<b>-</b>	<b>2,784,260</b>

<b>Equity Instruments Outstanding</b>	<b>March 31, 2005</b>	<i>(Audited)</i> <b>June 30, 2004</b>	<b>March 31, 2004</b>
Common shares, issued and outstanding	18,703,792	12,557,275	12,377,275
Stock options	829,500	850,000	1,039,000
Warrants	2,784,260	-	-
Compensation Units - shares	431,250	-	-
Compensation Units - warrants	215,625	-	-
Employee Share Ownership Plan	31,980	57,470	57,470
<b>Fully diluted equity instruments</b>	<b>22,996,407</b>	<b>13,464,745</b>	<b>13,473,745</b>

**6. ECONOMIC DEPENDENCE**

Included in revenue for the quarter were sales of \$3.54 million to various Canadian federal government agencies administered through Public Works and Government Services Canada. This represents 66% of total third quarter sales.

**7. CONTINGENCIES AND COMMITMENTS**

The Company has commitments to certain of its suppliers for purchase orders extending over a two-year period. The commitments total approximately \$23.5 million and are related to the purchase of raw materials for the two major government contracts.

The Company is committed to following a shipment schedule as set out in one specific contract. If the Company does not adhere to this schedule they will be penalized 2% of the unit price of the delinquent item for each calendar day of delay. The penalty shall not exceed 10% of the contract price. The Company is mitigating this exposure by shipping the product on or ahead of schedule.

**8. RELATED PARTY TRANSACTIONS**

During the quarter the Company paid \$54,255 (three months ended March 31, 2004 - \$22,200) and a total of \$105,758 (nine months ended March 31, 2004 - \$46,867) 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.

**PACIFIC SAFETY PRODUCTS INC.  
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**8. RELATED PARTY TRANSACTIONS (continued)**

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Also during the quarter, two officers of the Company participated in the private placement equity financing. Of the 1,750,000 Units purchased, 15,000 Units were purchased by management for gross proceeds of \$60,875.

In February 2005, 5,000 common shares were issued on the exercise of 5,000 whole common share purchase warrants by an officer of the Company for gross proceeds of \$4,250.

**9. FINANCIAL INSTRUMENTS**

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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 March 31, 2005 the Company had \$2,197,000 (June 30, 2004 - \$2,374,000, March 31, 2004 - \$2,458,000) of long-term floating rate debt.
- (b) At March 31, 2005 the Company had zero (June 30, 2004 - \$1,171,392, March 31, 2004 - \$930,047) of current floating rate debt.
- (c) At March 31, 2005 the Company had \$3,303,218 in accounts receivable due from one customer.
- (d) At March 31, 2005 the Company had \$2,342,796 in cash on deposit with one financial institution.
- (e) At March 31, 2005 the Company held two secured letters of credit with its financial institution in the amounts of C\$650,000 and US\$750,000.
- (f) Foreign currency exchange rate risk management - a significant portion of the Company's sales and purchases 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.

**10. SUBSEQUENT EVENTS**

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Subsequent to quarter end, the Company issued 30,000 stock options to a member of senior management. The options can be exercised at \$1.43 and expire on April 13, 2010. The options vest one year after issuance.

Also subsequent to quarter end, the Company entered into a commitment agreement to purchase \$180,000 of equipment for a specific contract. The Company has cash on hand to cover this commitment and its lenders have provided letters waiving the default of the capital expenditures condition for fiscal 2005.



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