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Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 or Regulation S-K (Sec. 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. Yes  No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2). Yes  No

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.) Yes  No

The aggregate market value of the voting stock held by non-affiliates of the registrant as of March 6, 2007 was \$59,951,650 based on the average bid and asked price on that date. The number of registrant's Common Shares outstanding as of March 6, 2007 was 25,020,953.

Documents incorporated by reference and the Part of the Form 10-K into which the document is incorporated are as follows: Registrant's definitive proxy statement for its Annual Meeting of Stockholders, to be held on June 4, 2007, which will be filed with the Securities and Exchange Commission on or before April 30, 2007 (incorporated by reference under Part III).

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ALPHA PRO TECH, LTD.

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**PART I**

**CAUTIONARY STATEMENTS REGARDING FORWARD-LOOKING INFORMATION**

This Annual Report on Form 10-K contains forward-looking statements that are made pursuant to the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements involve risks, uncertainties and assumptions as described from time to time in registration statements, annual reports and other periodic reports and filings of the Company filed with the Securities and Exchange Commission. All statements, other than statements of historical facts, which address the Company's expectations of sources of capital or which express the Company's expectation for the future with respect to financial performance or operating strategies, can be identified as forward-looking statements. As a result, there can be no assurance that the Company's future results will not be materially different from those described herein as believed, anticipated, estimated or expected, which reflect the current views of the Company with respect to future events. We caution readers that these forward-looking statements speak only as of the date hereof. The Company hereby expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any such statements to reflect any change in the Company's expectations or any change in events, conditions or circumstances on which such statement is based.

**ITEM 1. BUSINESS**

**GENERAL**

ALPHA PRO TECH, LTD. (the Company or Alpha Pro Tech, we, our or us) was incorporated in the State of Delaware on July 1, 1994 as a successor to a business that was organized in 1983. Our executive offices are located at 60 Centurian Drive, Suite 112, Markham Ontario, Canada L3R 9R2, and our telephone number is (905) 479-0654. Our website is located at [www.alphaprotech.com](http://www.alphaprotech.com). Information contained on our website is not part of this report.

**BUSINESS**

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

In 2005, we commenced sales from a new business segment, Alpha ProTech Engineered Products, Inc., ( Engineered Products ) a wholly-owned subsidiary of Alpha Pro Tech. This segment consists of a line of construction supply weatherization products as well as paint with antimicrobials. The construction supply weatherization products consist of house wrap and a synthetic roof underlayment. The paint products with antimicrobials are designed to inhibit growth of bacteria, fungi and algae on coated surfaces in hospitals, surgical rooms and cleanrooms and associated controlled environments.

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

Our products as classified above are grouped into four business segments. The Disposable Protective Apparel segment, consisting of disposable protective apparel; the Infection Control segment, consisting of face masks and eye shields; the Extended Care segment, consisting of extended care products, namely medical bed pads and pet beds;

and the Engineered Products segment, consisting of construction weatherization products such as house wrap and synthetic roof underlayment as well as a line of antimicrobial paint.

Our target markets are pharmaceutical manufacturing, bio-pharmaceutical manufacturing and medical device manufacturing, lab animal research, high technology electronics manufacturing which includes the semi-conductor market, as well as hospitals, long term care facilities and dentists, the pet consumer market for pet products and builders, contractors and re-roofers for the construction weatherization market.

Our principle strategy focuses on developing, producing and marketing differentiated innovative high value products which protect people, products and environments. As an example, our Disposable Protective Apparel segment in 2006 introduced Comfortech , a new material that we have been developing over the past two years and anticipate significant market share gains relative to the competition. This material is stronger, cleaner and has a higher vapor transmission rate than the market leader. Also, during the second quarter of 2006 we brought to market Comfortech - Certified, an entirely new class of products designed to dramatically decrease the risk of bioburden contamination in our target markets.

Our key sales growth strategies are based on a strategy of communicating directly with end users and developing innovative products to suit individual end users true needs.

Our Disposable Protective Apparel, Infection Control and Extended Care segment products are used primarily in clean-rooms, laboratories, industrial safety manufacturing environments, hospitals, dental offices and pet dealers and distributors and are distributed principally in the United States through a network presently consisting of 11 major distributors, 667 additional distributors, 5 independent sales representatives and a sales and marketing force of 11 people.

Our Engineered Products segment products are used primarily in the construction industry and are distributed principally in the United States by Perma R Products. In early 2007, we mutually agreed with Perma R Products to move forward on a non-exclusive basis which will broaden our distribution channel and market opportunities.

We will be adding many additional distributors in the coming year as well as independent sales representatives. In addition, we have an in-house sales team of 4 people which will be increased as deemed necessary.

## PRODUCTS

Our principal product groups and products include the following:

### Disposable Protective Apparel:

- \* Shoecovers
- \* Bouffant caps
- \* Gowns
- \* Coveralls
- \* Lab coats
- \* Frocks

### Infection Control:

- \* Face masks
- \* Eye shields

### Extended Care:

- \* Unreal Lambskin
- \* Medi-Pads
- \* Hospital pads
- \* Wheelchair accessories

- \* Bedrail pads
- \* Knee and Elbow protectors
- \* Pet beds
- \* Pet toys

Engineered Products:

- \* House wrap
- \* Synthetic roof underlayment
- \*Antimicrobial paint

### **Disposable Protective Apparel**

The disposable protective apparel product line was established in 1994. The products manufactured include many different styles of shoe covers, bouffant caps, gowns, coveralls, lab coats, frocks, and other miscellaneous products. The vast majority of these products are manufactured by a third party subcontractor in China and to a much lesser extent a third party subcontractor in Mexico.

### **Infection Control Products (Mask and Eye Shields)**

Our face masks come in a wide variety of filtration efficiencies and styles. Our patented Positive Facial Lock® feature provides a custom fit to the face to prevent blow-by for better protection. The term blow-by is used to describe the potential for infectious material entering or escaping a facemask without going through the filter, as a result of gaps or openings in the face mask. Our Magic Arch™ feature holds the mask away from the nose and mouth, creating a comfortable breathing chamber. One of our masks that incorporates both the Positive Facial Lock® feature and the Magic Arch™ feature is the N-95 Particulate Respirator facemask which was recommended by the Center for Disease Control to combat the spread of Severe Acute Respiratory Syndrome (SARS) during the outbreak of 2003.

All of the eye shields are made from an optical-grade polyester film, and have a permanent anti-fog feature. This provides the wearer with extremely lightweight, distortion-free protection that can be worn for hours and will not fog up from humidity and/or perspiration. An important feature of all eye and face shields is that they are disposable. This eliminates a chance of cross infection between patients and saves hospitals the expense of sterilization after every use.

### **Extended Care Products**

The Extended Care product line consists of a line of Unreal Lambskin® products for the medical market. The Unreal Lambskin® (synthetic lambskin) is used to produce medical bed pads, which prevent decubitus ulcers or bedsores on long term care patients. The Unreal Lambskin® is also used to manufacture bedrail pads, knee and elbow protectors, as well as wheelchair accessories.

Included in the extended care product line is a line of pet products. The Pet Product line uses our existing Unreal Lambskin® raw material to manufacture pet products. The Unreal Lambskin® is used to produce retail pet beds and pet toys.

### **Engineered Products**

In 2005 we commenced sales from a new business segment, Alpha ProTech Engineered Products, Inc., a wholly-owned subsidiary of Alpha Pro Tech. This segment consists of a line of construction supply weatherization products as well as a line of paint with antimicrobials.

The construction supply weatherization products consist of house wrap and synthetic roof underlayment. Our paint with antimicrobials is designed to inhibit growth of bacteria, fungi and algae on the painted surfaces in pharmaceutical and other cleanrooms, hospitals, surgical rooms and associated controlled environments.

This line of products is a natural extension of our core capabilities: creating proprietary products designed to protect people and environments. The house wrap offers a weather resistant barrier designed to lower energy consumption



costs. The proprietary synthetic roof underlayment is designed to resist the environment, as opposed to conventional roofing underlayment that is prone to rapid degradation and mold growth.

The usage of these two construction supply weatherization products offers great advantages in decreasing the time it takes to construct a home as well as offering cost reduction. The house wrap offers a weather resistive barrier and, to the home owner, years of lower energy consumption. The proprietary synthetic roof underlayment has the ability to resist the environment, as opposed to conventional organic roofing underlayment that is prone to rapid degradation and mold growth.

Our paint with antimicrobials, which is designed to inhibit growth of bacteria, fungi and algae on painted surfaces in cleanroom environments, has been tested at Nelson Laboratories, Inc., a privately owned testing lab specializing in microbiology, and confirmed by a leading university for its containment ability to inhibit micro-organisms. This product fulfills a key need in cleanrooms and hospitals and in addition it reduces operational costs while preserving environmental safety. We have an exclusive licensing agreement for the proprietary antimicrobial formulation to be used in the paint. In addition to our paint with antimicrobials, we have also developed a line of sealants with antimicrobials to be used for mold remediation.

## MARKETS

Our products are sold to the following markets: Disposable protective apparel as well as the infection control products (masks and shields) are sold to the industrial market, cleanroom market, medical and dental markets; Unreal Lambskin® medical bed pads are sold to the extended care market; Pet beds and pet toys are sold to the pet distributors and retailers; Construction weatherization products are sold to construction supply and roofing distributors.

Our target markets are pharmaceutical manufacturing, bio-pharmaceutical manufacturing and medical device manufacturing, lab animal research, high technology electronics manufacturing which includes the semi-conductor market, as well as hospitals, long term care facilities and dentists, the pet consumer market for pet products and builders, contractors and re-roofers for the construction weatherization market.

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

## DISTRIBUTION

We rely for the sale of our products primarily on a network of independent distributors which includes the following:

- \* VWR International
- \* Perma R Products
- \* Cardinal Healthcare
- \* Medline Industries
- \* O Mara Products, Inc.
- \* Blain Supply
- \* Owens and Minor
- \* Hagemeyer
- \* Benchmark Products
- \* Henry Schein, Inc.
- \* Quest

These United States distributors, to the best of our knowledge, all sell competing products.



Sales to our largest distributor, VWR International, represented 45.1% of total sales for 2006, 53.1% for 2005, and 63.7% for 2004. We have had a contractual relationship with this distributor since 1995 and effective January 1, 2006 signed a new multiple year contract which provides optional extensions beyond the initial term of the agreement. Previously, this distributor had exclusive rights to sell and distribute Alpha Pro Tech's Critical Cover® trade named disposable protective apparel products, and exclusive rights to sell and distribute Alpha Pro Tech branded products to domestic and international clean room and industrial customers. Under terms of the new contract, this distributor has the exclusive right to sell and distribute Alpha Pro Tech's Critical Cover® trade named disposable protective apparel products, but non-exclusive rights to sell and distribute Alpha Pro Tech branded products. The loss of this distributor would have a material adverse effect on our business.

In early 2005, Alpha ProTech Engineered Products, Inc. signed two 3 year mutually exclusive agreements with Perma-R Products, Inc. As part of the agreements, Perma-R was responsible for all sales & marketing of Alpha Pro Tech's house wrap and synthetic roof underlayment products. They agreed to minimum sales of \$5 million per year of house wrap and minimum sales of \$3 million per year of synthetic roof underlayment. In 2005 this distributor did not meet the minimums for either house wrap or synthetic roof underlayment. In 2006 they purchased \$5.1 million of house wrap, meeting their contractual minimum requirement of \$5.0 million but did not meet the minimum for synthetic roof underlayment. In early 2007, we mutually agreed to move forward on a non-exclusive basis. We believe that this will broaden our market opportunities for synthetic roof underlayment and house wrap. Sales through this distributor represented the vast majority of total Engineered Products segment sales for both 2006 and 2005.

We do not generally have backlog orders, as orders are usually placed for shipment and shipped within 30 days. We anticipate no problem in fulfilling orders as they are placed.

## MANUFACTURING

Our mask production facility is located in a 34,500 square foot building at 236 North 2200 West, Salt Lake City, Utah.

An 18,000 square foot facility located at 951 Todd Drive, Janesville, Wisconsin is used to manufacture our Extended Care products and consumer products including a line of pet beds and pet toys.

Our disposable protective apparel facility is located in a 60,000 square foot facility located at 1287 West Fairway Drive in Nogales, Arizona which is used for cutting, warehousing and shipping. The majority of these products are manufactured by a third party subcontractor in China and to a much lesser extent a third party subcontractor in Mexico. These goods are manufactured pursuant to our specifications and quality assurance guidelines. Certain proprietary products are being made in China using material supplied by us.

We have a 36,000 square foot material coating and automated shoecover facility located at 2224 Cypress Street, Valdosta, Georgia.

Our wholly-owned subsidiary, Alpha ProTech Engineered Products, Inc., which manufactures and distributes a line of construction weatherization products, primarily house wrap and synthetic roof underlayment as well as a line of antimicrobial paint, is located in a 50,000 square foot facility at 301 S. Blanchard St., Valdosta, Georgia. The house wrap and the synthetic roof underlayment is manufactured by a company in India in which the company has a 41.66% ownership.

In June 2005, Alpha ProTech Engineered Products, Inc. entered into a 41.66% joint venture with Maple Industries and Associates (Maple), a manufacturer in India, for the production of house wrap and synthetic roof underlayment products. The name of the joint venture is Harmony Plastics Private Limited (Harmony). Harmony's start up funding was utilized to purchase an existing 33,000 square-foot manufacturing facility in India; this facility includes manufacturing equipment necessary to produce synthetic roof underlayment. Harmony has also built a new 60,000 square-foot facility for the manufacturing of house wrap and other building products.

We have multiple suppliers of the materials used to produce our products. In that regard, we currently have no problems, and do not anticipate any problems, with respect to the sources and availability of the materials needed to produce our products. Our business is not subject to significant seasonal considerations. It is necessary for us to have adequate finished inventory in stock, and we generally maintain a two-to-three month supply of product.

## COMPETITION

We face substantial competition from numerous companies, including many companies with greater marketing and financial resources. Our major competitor in the medical and dental markets is Kimberly Clark of Fort Worth, Texas. Other large competitors include 3M Company, Johnson & Johnson, White Knight/Precept, Cardinal Health, Inc., and Medline Industries Inc. Our major competitors in the industrial and cleanroom market are Kimberly Clark, 3M Company, Kappler USA and Dupont. In the extended care market, Skil-care, Glenoit Mills and JT Posey Co. are our principal competitors, and in the pet products market, principal competitors include Flexmat Corporation and Lazy Pet Company. Our major competitors in the construction supply weatherization market are Dupont for house wrap and WR Grace and Interwrap for roof underlayment. The antimicrobial paint market, which inhibits the growth of bacteria, is a relatively new market and currently has limited competition.

Cardinal Health, Inc. and Medline Industries Inc. are also distributors of our products.

## REGULATORY REQUIREMENTS

We are not required to obtain regulatory approval from the U.S. Food and Drug Administration ( FDA ) with respect to the sale of our products. Our products are, however, subject to prescribed good manufacturing practices as defined by the FDA and our manufacturing facilities are inspected by the FDA every two years to ensure compliance with such good manufacturing practices. We are marketing a N-95 Particulate Respirator face mask that meets the Occupational Safety and Health Administration ( OSHA ) respirator guidelines and which has been approved by the National Institute for Safety and Health ( NIOSH ). This product is designed to help prevent the inhaling of the tuberculosis virus.

The antimicrobial agent in our paint consists of a class of chemicals that is strictly regulated by the Environmental Protection Agency ( EPA ). The antimicrobial agent complies with the EPA Treated Article Exemption Rule.

We do not anticipate that any federal, state or local requirements which have been or may be enacted or adopted regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, will have any material effect on the capital expenditures, earnings or competitive position of our business.

## PATENTS AND TRADEMARKS

### Patents

Our policy is to protect our intellectual property rights, products, designs and processes through the filing of patents in the United States and where appropriate in Canada and other foreign countries. At present, we have 14 United States patents relating to our MEDS, Add-A-Mask, Coverall, 1/2 Coverall, Combo Cone, Combo, Positive Facial Lock and Shieldmate products, synthetic roof underlayment, as well as a United States design and process patent on our automated shoecover product and on our fluid-impervious, non-slip fabric for our Aqua Trak shoecover. In addition, we have a United States patent on a method to fold and put on sterile garments. We believe that our patents may offer a competitive advantage, but there can be no assurance that any patents, issued or in process, will not be circumvented or invalidated. We also rely on trade secrets and proprietary know-how to maintain and develop our commercial position.

The various United States patents issued have remaining durations of approximately 5 to 17 years before expiration.

## Trademarks

Many of our products are sold under various trademarks and trade names, including Alpha Pro Tech. We believe that many of our trademarks and trade names have significant recognition in our principal markets and we take customary steps to register or otherwise protect our rights in our trademarks and trade names.

## EMPLOYEES

As of February 14, 2007, we had 152 employees, including 17 people at our head office in Markham, Ontario, Canada; 19 people at our facemask production facility in Salt Lake City, Utah, 17 people at our Extended Care and pet beds production facility in Janesville, Wisconsin; 27 people at our cutting, warehouse and shipping facility in Nogales, Arizona; 22 people at our coating and automated shoecover facility in Valdosta, Georgia; 22 people at our Engineered Products facility in Valdosta, Georgia; 12 people on our sales team, a 3 person marketing staff and 13 people in China.

None of our employees are subject to collective bargaining agreements.

## AVAILABLE INFORMATION

We file annual, quarterly and current reports and other information with the Securities and Exchange Commission ( SEC ). These materials can be inspected and copied at the SEC's Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of these materials may also be obtained by mail at prescribed rates from the SEC's Public Reference Room at the above address. Information about the Public Reference Room can be obtained by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. The address of the SEC's Internet site is <http://www.sec.gov>.

We make available free of charge on our Internet website (<http://www.alphaprotech.com>) our most recent Annual Report on Form 10-K, our most recent Quarterly Report on Form 10-Q, any current reports on Form 8-K filed since our most recent Annual Report on Form 10-K and any amendments to such reports as soon as reasonably practicable following the electronic filing of such report with the SEC. The past two years of news releases are also made available on our website. In addition, we provide electronic or paper copies of our filings free of charge upon request.

## ITEM 2. PROPERTIES

The Company's Head Office is located at 60 Centurian Drive, Suite 112, Markham, Ontario L3R 9R2. The approximate monthly costs are \$3,100 under a lease expiring February 28, 2009. Working out of the head office are the President, Alexander Millar, Chief Executive Officer, Sheldon Hoffman and Chief Financial Officer, Lloyd Hoffman.

We manufacture our surgical face masks at 236 North 2200 West, Salt Lake City, Utah. The monthly rental is \$12,000 for 34,500 square feet. This lease expires on July 31, 2007.

A second manufacturing facility is located at 951 Todd Drive, Janesville, Wisconsin. This 18,000 square foot facility is leased for \$7,500 monthly, which includes taxes and utilities. The lease expires August 31, 2008. Our line of extended care and consumer pet bed products is manufactured at this facility.

The Apparel Division has its cutting operation, warehousing, and shipping facility at 1287 Fairway Drive, Nogales, Arizona. The monthly rental is \$15,500 for 60,000 square feet. This lease expires December 31, 2008.

The Coating and Automated Shoecover Division has its facility at 2224 Cypress Street, Valdosta, Georgia. The monthly rental is \$5,600 for 36,000 square feet. This lease expires May 30, 2010.

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Our wholly-owned subsidiary, Alpha ProTech Engineered Products, Inc. is located at 301 S. Blanchard St. Valdosta, Georgia. The monthly rental is \$12,000 for 50,000 square feet. This lease expires October 31, 2009.

We believe that these arrangements are adequate for our present needs and that other premises, if required, are readily available.

### ITEM 3. LEGAL PROCEEDINGS

There are no pending legal proceedings against the Company.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matter was submitted to a vote of security holders during the fourth quarter of 2006.

## PART II

### ITEM 5. MARKET PRICE OF AND DIVIDENDS ON THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

#### Market Information

The Common Shares of the Company trade on the American Stock Exchange (Amex) under the symbol APT.

The high and low range of bid prices for the Common Shares of the Company traded on the American Stock Exchange (Amex) for the quarters indicated was as follows:

		Low	High
2005	First Quarter	\$ 1.71	\$ 2.24
	Second Quarter	1.85	2.05
	Third Quarter	1.87	2.93
	Fourth Quarter	2.40	3.35
2006	First Quarter	\$ 2.19	\$ 3.19
	Second Quarter	2.09	2.59
	Third Quarter	1.88	2.41
	Fourth Quarter	2.15	3.00
2007	First Quarter (through March 6, 2007)	\$ 2.50	\$ 3.35

As of March 6, 2007 there were 370 shareholders of record, and approximately 3,288 beneficial owners.

#### Dividend Policy

The holders of the Company's Common Shares are entitled to receive such dividends as may be declared by the Board of Directors of the Company from time to time to the extent that funds are legally available for payment thereof. The Company has never declared nor paid any dividends on any of its Common Shares. It is the current policy of the Board of Directors to retain any earnings to provide for the development and growth of the Company. Consequently, the Company has no intention to pay cash dividends in the foreseeable future.

COMPARISON OF CUMULATIVE TOTAL RETURN OF ONE OR MORE

COMPANIES, PEER GROUPS, INDUSTRY INDEXES AND/OR BROAD MARKETS

COMPANY/INDEX/MARKET	FISCAL YEAR ENDING					
	12/31/2001	12/31/2002	12/31/2003	12/31/2004	12/30/2005	12/29/2006
Alpha Pro Tech Ltd.	100.00	95.45	264.77	221.59	264.77	318.18
Surgical Appliances & Supplies	100.00	108.66	163.39	194.87	186.36	206.66
NASDAQ Market Index	100.00	69.75	104.88	113.70	116.19	128.12

The above graph compares the five-year cumulative return of the Company during the years 2002 through 2006 with the comparable return of two indices. The Industry Index represents the industry or line-of-business of the Company. The graph assumes \$100 invested on January 1, 2002. The comparison assumes that all dividends are reinvested.

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The Industry Index represents the Surgical Appliances and Supplies division comprised of 36 corporations, compiled from the SIC Code within which the Company is listed.

## ITEM 6. SELECTED FINANCIAL DATA

## Alpha Pro Tech, Ltd.

## Selected Financial Data

	Year Ended December 31,				
	2006	2005	2004	2003	2002
<b>Historical Consolidated Income Statements Data</b>					
Sales	\$ 37,338,000	\$ 31,095,000	\$ 24,841,000	\$ 26,961,000	\$ 21,789,000
Gross profit	17,320,000	14,147,000	12,286,000	13,660,000	10,523,000
Selling, general and administrative expenses	10,939,000	9,796,000	8,925,000	8,602,000	7,435,000
Depreciation and amortization	448,000	499,000	517,000	509,000	447,000
Equity in income (loss) of unconsolidated affiliate	60,000	(16,000)			
Gain (loss) on sale of assets			7,000		(3,000)
Interest income (expense)	36,000	24,000	7,000	(20,000)	(24,000)
Income before provision for income taxes	6,029,000	3,860,000	2,858,000	4,529,000	2,620,000
Provision for income taxes	2,290,000	1,410,000	1,011,000	1,518,000	955,000
Net income	\$ 3,739,000	\$ 2,450,000	\$ 1,847,000	\$ 3,011,000	\$ 1,665,000
Basic net income per share	\$ 0.15	\$ 0.10	\$ 0.08	\$ 0.13	\$ 0.07
Diluted net income per share	\$ 0.15	\$ 0.10	\$ 0.08	\$ 0.13	\$ 0.07
Basic weighted average shares outstanding	24,141,535	23,684,229	23,215,809	22,517,683	23,263,451
Diluted weighted average shares outstanding	25,129,198	25,247,236	24,624,613	24,059,508	23,770,248
<b>Historical Consolidated Balance Sheet Data</b>					
Current assets	\$ 22,297,000	\$ 16,874,000	\$ 15,348,000	\$ 12,756,000	\$ 9,222,000
Total assets	26,852,000	21,871,000	18,789,000	16,096,000	12,775,000
Current liabilities	2,679,000	2,576,000	2,437,000	2,495,000	2,172,000
Long-term liabilities	693,000	652,000	652,000	574,000	829,000
Shareholders' equity	23,480,000	18,643,000	15,700,000	13,027,000	9,774,000

## **ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

You should read the following discussion and analysis together with our selected five-year financial data, our consolidated financial statements and the notes to our consolidated financial statements, which appear elsewhere in this report.

### **Cautionary Statement for Forward-Looking Information**

Certain information set forth in this Annual Report on Form 10-K contains forward-looking statements within the meaning of federal securities laws. Forward-looking statements include statements concerning our plans, objectives, goals, strategies, future events, future revenues or performance, capital expenditures, financing needs, plans or intentions relating to potential acquisitions and other information that is not historical information. When used in this report, the words estimates, expects, anticipates, forecasts, plans, intends, believes and variations such words or similar expressions are intended to identify forward-looking statements. We may make additional forward-looking statements from time to time. All forward-looking statements, whether written or oral and whether made by us or on our behalf, are also expressly qualified by these cautionary statements.

### **Critical Accounting Policies**

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of net sales and expenses during the reported periods. We base estimates on past experience and on various other assumptions that are believed to be reasonable under the circumstances. The application of these accounting policies on a consistent basis enables us to provide timely and reliable financial information. Our critical accounting policies include the following:

**Inventories:** Inventories include freight-in, materials, labor and overhead costs and are stated at the lower of cost (computed on a standard cost basis, which approximates average cost) or market. Provision is made for slow-moving, obsolete or unusable inventory. We assess our inventory for estimated obsolescence or unmarketable inventory and write down the difference between the cost of inventory and the estimated market value based upon assumptions about future sales and supply on-hand, if necessary. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

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

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

**Stock Based Compensation:** The Company adopted Statement of Financial Accounting Standards No. 123R, Share-Based Payment (SFAS 123R) effective January 1, 2006, using the modified prospective application method. SFAS 123R requires companies to record compensation expense for the value of all outstanding and unvested share-based payments, including employee stock options and similar awards. As of December 31, 2005, the Company had no outstanding and unvested share-based awards. During the third quarter of 2006, 490,000 stock options were granted under the option plan. As a result, the Company recognized \$51,000 in share-based compensation expense in its



consolidated financial statements for the year ended December 31, 2006.

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

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

## OVERVIEW

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

In 2005, we commenced sales from a new business segment, Alpha ProTech Engineered Products, Inc. (Engineered Products), a wholly-owned subsidiary of Alpha Pro Tech. This segment consists of a line of construction supply weatherization products as well as a line of paint with antimicrobials. The construction supply weatherization products consists of house wrap and a synthetic roof underlayment. The line of paint with antimicrobials is designed to inhibit growth of bacteria, fungi and algae on the painted surfaces in hospitals, surgical rooms and cleanrooms and associated controlled environments. In addition to our paint with antimicrobials, we have also developed a line of sealants with antimicrobials to be used for mold remediation. The Engineered Products segment is expected to contribute significantly to revenue growth in 2007.

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

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

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

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

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

Consolidated sales for the year ended December 31, 2006 increased to \$37,338,000 from \$31,095,000 for the year ended December 31, 2005, representing an increase of \$6,243,000 or 20.1%.

Revenue for the Engineered Products segment for the year ended December 31, 2006 and 2005 was \$7,781,000 and \$4,713,000, respectively. This segment showed \$3.1 million or 65.1% growth in 2006 and is expected to grow significantly in 2007.

In 2005 we entered into two agreements with Perma R Products, Inc for the distribution of house wrap and synthetic roof underlayment. As part of these 3 year mutually exclusive agreements, they agreed to purchase a minimum of \$5 million per year in house wrap and \$3 million in synthetic roof underlayment. In early 2007, we mutually agreed to move forward on a non-exclusive basis. We believe that this opens up our market opportunities for synthetic roof underlayment and house wrap.

Infection Control segment sales for the years ended December 31, 2006 was \$6,944,000 compared to \$5,136,000 for the same period of 2005. This increase of \$1.8 million or 35.2% is primarily due to increased sales of our N-95 NIOSH approved Respirator mask due to concerns about Avian Flu.

Our Disposable Protective Apparel segment that services the pharmaceutical, cleanroom and industrial safety markets grew by 8.9% for the year ended December 31, 2006. Sales in the third and fourth quarter of 2006 were up 32.0% as compared to the same period of 2005. We expect growth in 2007 as the ComforTech® line of products continues to take hold and as we bring on new distributors.

In September 2006 we announced the signing of a new distribution contract with our largest Disposable Protective Apparel distributor. Under the terms of the multiple year contract that was effective January 1, 2006, they will retain the exclusive right to sell our private label Critical Cover® products and we will now have the right to sell Alpha Pro Tech branded products to other new distributors.

In 2006 we introduced a new line of Disposable Protective Apparel products under the name of ComforTech®. This has been a very successful produce launch and we have been encouraged by the success of this line of products. We expect sales in this segment to increase in 2007.

**RESULTS OF OPERATIONS**

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

	2006	2005	2004
Sales	100.0%	100.0%	100.0%
Gross profit	46.4	45.5	49.5
Selling, general and administrative	29.3	31.5	35.9
Income from operations	15.9	12.4	11.4
Income before provision for income taxes	16.1	12.4	11.5
Net income	10.0	7.9	7.4

**Fiscal 2006 compared to Fiscal 2005**

**Sales** Consolidated sales for the year ended December 31, 2006 increased to \$37,338,000 from \$31,095,000 for the year ended December 31, 2005, representing an increase of \$6,243,000 or 20.1%. We attribute the increase primarily to increased sales of construction supply weatherization products of \$3,068,000, to increased sales of disposable protective apparel products of \$1,739,000, and to increased infection control segment sales of \$1,808,000, partially offset by decreased sales from our Extended Care Unreal Lambskin® segment of \$372,000.

Sales for the Disposable Protective Apparel segment for the year ended December 31, 2006 increased by \$1,739,000 or 8.9% to \$21,183,000 compared to \$19,444,000 for the same period of 2005. The increase was primarily due to increased sales of approximately \$0.4 million to our largest distributor, and an approximate \$1.3 million increase due to other distributors that concentrate on the cleanroom and industrial safety industries.

Although Disposable Protective Apparel sales increased by only a modest 8.9% in 2006, the second half of 2006 was strong. Sales for the fourth quarter of \$6.4 million were up 73.8% from \$3.7 million in the fourth quarter of 2005. In addition, sales were up 20.9% in the third and fourth quarter of 2006 as compared to the first and second quarters of 2006 and were up 32.0% as compared to the third and fourth quarter of 2005.

In 2006 we introduced a new line of products under the name of ComforTech®, a new material that we developed over the past two years. In the latter half of 2006 we introduced a new category of the ComforTech® line, ComforTech® Certified. This is an entirely new class of products designed to decrease the risk of bioburden contamination in our target markets. As well, in 2007 we will be bringing to market the ComforTech® Sterile line of products. We expect growth in 2007 as the ComforTech® line of products continues to gain market share and as we bring on new distributors. We anticipate continued long-term growth from the Disposable Protective Apparel segment.

On September 19, 2006 we announced the signing of a new distribution contract with our largest distributor of Disposable Protective Apparel. Under the terms of the multiple year contract that was effective January 1, 2006, they will retain the exclusive right to sell our private label Critical Cover® products. In addition, we will now have the right to sell Alpha Pro Tech branded products to other new distributors. This new contract further strengthens our relationship with our largest distributor and will enable us to gain additional market share as we develop relationships with new distributors.

Infection Control segment sales for the year ended December 31, 2006 increased by \$1,808,000 or 35.2% to \$6,944,000 compared to \$5,136,000 for the same period of 2005. The increase is primarily due to increased sales of our N-95 NIOSH approved Respirator mask due to concerns about Avian Flu. We have significant manufacturing capacity for the N-95 Respirator mask in the event that demand surges, but unless the Avian Flu continues to be a worldwide concern, sales could soften in 2007.



The Engineered Products segment consists of a line of construction supply weatherization products (house wrap, synthetic roof underlayment) as well as a line of paint with antimicrobials. Engineered Products sales for the year ended December 31, 2006 increased by \$3,068,000 or 65.1% to \$7,781,000 as compared to \$4,713,000 for the same period of 2005. The breakdown of the Engineered Products sales is as follows for the year ended December 31, 2006: 67% house wrap, 33% synthetic roof underlayment. This compares to 74% house wrap, 25% synthetic roof underlayment and 1% antimicrobial paint for the year ended December 31, 2005. We expect the synthetic roof underlayment to continue to increase as a percentage of total Engineered Products sales.

Synthetic roof underlayment sales for the year ended December 31, 2006 increased by 113% as compared to the same period of 2005. This increase was facilitated in part by the fact that in October 2005, we received Notice of Acceptance from the Miami-Dade County Building Code Compliance Office for our Synthetic Roof Underlayment (AlphaProtector SUL) which is recognized as possessing stringent criteria for building products. Also, in December 2006, we announced that our synthetic roof underlayment had received the International Code Council (ICC-ES) approval. The ICC governs the International Building Code (IBC) which oversees most building departments around the country. These approvals significantly expand our synthetic roof underlayment opportunities as many construction supply companies require one or both of these certifications to sell our product.

In 2005 we entered into two agreements with Perma R Products, Inc for house wrap and synthetic roof underlayment. As part of these 3 year mutually exclusive agreements, they agreed to purchase a minimum of \$5 million per year in house wrap and \$3 million in synthetic roof underlayment. In 2005 they did not meet the annual minimums for either product. In 2006 they purchased \$5.1 million of house wrap, meeting their contractual minimum requirement of \$5.0 million but did not meet the minimum for synthetic roof underlayment. In early 2007, we mutually agreed with them to move forward on a non-exclusive basis. We believe that this will broaden our market opportunities for synthetic roof underlayment and house wrap.

We are very encouraged by the response to our Engineered Products product line and we expect significant growth from this segment in 2007 as we will be introducing a line of synthetic roof underlayment and house wrap under the names REX SynFelt and REX Wrap .

Sales from our Extended Care Unreal Lambskin® and other related products, which includes a line of medical bed pads as well as pet beds, decreased by \$372,000 or 20.6% to \$1,430,000 for the year ended December 31, 2006 from \$1,802,000 for the year ended December 31, 2005. The decrease of \$372,000 in sales is primarily the result of lower medical bed pad sales. Although pet bed sales are expected to improve somewhat in 2007, this segment is not expected to be a growth segment for the Company.

**Gross Profit** Gross profit increased by 22.4% to \$17,320,000 for the year ended December 31, 2006 from \$14,147,000 for the same period in 2005. Gross profit margin increased to 46.4% for the year ended December 31, 2006 from 45.5% for the same period in 2005.

Gross profit margin was up for the year primarily due to increased margin on the Engineered Products segment. Gross profit margin on this segment, although considerably lower than the overall company margin, did improve in each of the four quarters of 2006 and is expected to continue to improve into 2007.

**Selling, General and Administrative Expenses.** Selling, general and administrative expenses increased by \$1,143,000 or 11.7% to \$10,939,000 for the year ended December 31, 2006 from \$9,796,000 for the year ended December 31, 2005. As a percentage of net sales, selling, general and administrative expenses decreased to 29.3% for the year ended December 31, 2006 from 31.5% for the same period in 2005. The overall increase in selling, general and administrative expenses is primarily related to increased employee compensation expenses of \$980,000, increased marketing costs primarily related to Engineered Products of \$97,000 and increased rent for Engineered Products of \$71,000. We believe that we have built the infrastructure required to substantially grow our business and as our revenue grows our expenses are expected to continue to decrease as a percentage of sales.



The chief executive officer and president are each entitled to a bonus equal to 5% of the pre-tax profits of the Company. Total bonuses of \$670,000 were accrued for the year ended December 31, 2006 as compared to \$429,000 in the same period of 2005.

**Depreciation and Amortization.** Depreciation and amortization expense decreased by \$51,000 or 10.2% to \$448,000 for the year ended December 31, 2006 from \$499,000 for the same period in 2005. The decrease is primarily attributable to a reduction in depreciation for office equipment, computers and software, partially offset by increased depreciation for Engineered Products.

**Income from Operations.** Income from operations increased by \$2,081,000 or 54.0%, to \$5,933,000 for the year ended December 31, 2006 as compared to income from operations of \$3,852,000 for the year ended December 31, 2005. The increase in income from operations is due to an increase in gross profit of \$3,173,000 and a decrease in depreciation and amortization of \$51,000, partially offset by an increase in selling, general and administrative expenses of \$1,143,000.

**Net Interest.** For the year ended December 31, 2006, we had net interest income of \$36,000 compared to net interest income of \$24,000 for the year ended December 31, 2005. Interest expense decreased slightly to \$5,000 for the year ended December 31, 2006 compared to \$9,000 for the same period of 2005. Interest income increased by \$8,000 to \$41,000 for the year ended December 31, 2006 as compared to \$33,000 for the same period of 2005.

**Equity in income (loss) of unconsolidated affiliates.** On June 14, 2005 Alpha ProTech Engineered Products, Inc. entered into a joint venture with a manufacturer in India for the production of building products. Under terms of the joint venture agreement, a private company, Harmony Plastics Private Limited (Harmony), was created with ownership interests of 41.66% by Alpha ProTech Engineered Products, Inc. and 58.34% by Maple Industries and Associates. Alpha ProTech Engineered Products invested \$1,450,000 in the joint venture; \$508,000 for share capital and \$942,000 in a long term advance. Effective April 2006, interest of 3.5 % is paid on this advance. Contractually, half of this \$942,000 advance is to be repaid monthly over a six year term which commenced in July 2006 with the balance to be paid in the seventh year. However, we expect that this advance will be paid in advance of the contractual term as Harmony paid \$500,000 towards the advance in the second half of 2006.

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

Harmony commenced operations in August of 2005. For the year ended December 31, 2006, we recorded equity in income of unconsolidated affiliates of \$60,000 as compared to equity in loss of unconsolidated affiliates of \$16,000 for the same period of 2005.

**Income Before Provision for Income Taxes.** Income before provision for income taxes for the year ended December 31, 2006 was \$6,029,000 compared to \$3,860,000 for the year ended December 31, 2005, representing an increase of \$2,169,000 or 56.2%. The increase in income before provision for income taxes is due to an increase in gross profit of \$3,173,000, a decrease in depreciation and amortization of \$51,000 and an increase in net interest income of \$12,000 and a net change of \$76,000 from our unconsolidated affiliate (Harmony), partially offset by an increase in selling, general and administrative expenses of \$1,143,000,

**Provision for Income Taxes** The provision for income taxes for the year ended December 31, 2006 was \$2,290,000 compared to \$1,410,000 for the year ended December 31, 2005. The increase in income taxes is primarily due to





higher income before provision for income taxes in 2006. The effective tax rate was 38.0% for the year ended December 31, 2006 as compared to 36.5% for the same period in 2005.

**Net Income.** Net income for the year ended December 31, 2006 was \$3,739,000 compared to net income of \$2,450,000 for the year ended December 31, 2005, an increase of \$1,289,000 or 52.6%. The net income increase was primarily due to an increase in income before provision for income taxes of \$2,169,000, partially offset by an increase in income taxes of \$880,000. Net income as a percentage of sales for the year ended December 31, 2006 and 2005 was 10.0% and 7.9% respectively. Basic and diluted income per share for the year ended December 31, 2006 and 2005 was \$0.15 and \$0.10 respectively.

#### **Fiscal 2005 compared to Fiscal 2004**

**Sales.** Consolidated sales for the year ended December 31, 2005 increased to \$31,095,000 from \$24,841,000 for the year ended December 31, 2004, representing an increase of \$6,254,000 or 25.2%. We attribute the increase primarily to increased sales of disposable protective apparel products of \$1,661,000, to increased sales of construction supply weatherization products of \$4,695,000 and increased infection control segment sales of \$28,000, partially offset by decreased sales from our Extended Care Unreal Lambskin segment of \$130,000.

Sales for the Disposable Protective Apparel segment for the year ended December 31, 2005 were \$19,444,000 compared to \$17,783,000 for the same period of 2004. The Disposable Protective Apparel segment sales increase of \$1,661,000 or 9.3% was primarily due to increased sales of approximately \$0.7 million to our largest distributor, and an approximate \$1 million increase due to other distributors that concentrate on the cleanroom and industrial safety industries.

Although this segment increased by 9.3% in 2005, we were trending significantly higher through the first nine months of 2005. This fourth quarter decline in growth was due to a decrease in shipments to our largest distributor during the last three months of 2005. Although shipments declined in the fourth quarter of 2005, shipments to the distributor's end users remained fairly consistent with prior quarters. The decline in shipments to this distributor in the fourth quarter can be attributed to slowdown in orders from them to reduce their inventory levels, as well as sales to them in the fourth quarter of 2004 were stronger than normal. Orders from this distributor are expected to normalize during the latter part of the first quarter of 2006.

Infection Control segment sales for the year ended December 31, 2005 increased by \$28,000 or 0.5% to \$5,136,000 compared to \$5,108,000 for the same period of 2004. The Infection Control Segment would have been up by \$628,000 or 13.9% in 2005, excluding a \$600,000 international sale for N-95 respirator masks in the second quarter of 2004 that did not recur in 2005. From time to time, large orders could periodically occur that will influence this segment's revenue.

Mask sales in this segment were very strong in the fourth quarter of 2005 as concerns about Avian Flu heightened. Mask sales in the fourth quarter were up 36% as compared to the average for the first three quarters of 2005. We have significant manufacturing capacity for the N-95 Respirator mask in the event that demand surges.

The Engineered Products segment consists of a line of construction supply weatherization products (house wrap, synthetic roof underlayment) as well as a line of paint with antimicrobials. Engineered Products sales for the year ended December 31, 2005 was \$4,713,000 as compared to \$18,000 for the same period of 2004. The breakdown of the Engineered Products sales is as follows for the year ended December 31, 2005: 74% house wrap, 25% synthetic roof underlayment and 1% antimicrobial paint. In October 2005, we received Notice of Acceptance from the Miami-Dade County Building Code Compliance Office for our Synthetic Roof Underlayment (AlphaProtector<sup>®</sup> SUL) which is recognized as possessing stringent criteria for building products.

Sales from our Extended Care Unreal Lambskin and other related products, which includes a line of medical bed pads as well as pet beds, decreased by \$130,000 or 6.7% to \$1,802,000 for the year ended December 31, 2005 from



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\$1,932,000 for the year ended December 31, 2004. The decrease of \$130,000 in sales is primarily the result of lower medical bed pad sales.

**Gross Profit** Gross profit increased by 15.1% to \$14,147,000 for the year ended December 31, 2005 from \$12,286,000 for the same period in 2004. Gross profit margin decreased to 45.5% for the year ended December 31, 2005 from 49.5% for the same period in 2004.

Gross profit margin is down primarily related to lower margins on sales of our Engineered Products segment which continues to be impacted by routine startup expenses, and an overall lower gross margin composition than our other segments. Excluding Engineered Products, gross profit margin was 49.1% for the year ended December 31, 2005 compared to 49.5% for the same period of 2004. This gross profit margin is in line with the gross profit margin for 2004.

Gross profit on the Engineered Products segment was 25.1% for the year ended December 31, 2005 with no comparative number for the same period for 2004 as sales were only \$18,000. Gross profit by quarter in 2005 for Engineered Products is as follows: first quarter 20.6%, second quarter 25.2%, third quarter 28.2% and fourth quarter 25.1%.

**Selling, General and Administrative Expenses.** Selling, general and administrative expenses increased by \$871,000 or 9.8% to \$9,796,000 for the year ended December 31, 2005 from \$8,925,000 for the year ended December 31, 2004. As a percentage of net sales, selling, general and administrative expenses decreased to 31.5% for the year ended December 31, 2005 from 35.9% for the same period in 2004. The overall increase in selling, general and administrative expenses is primarily related to increased expenses for the Engineered Products segment of \$802,000.

Selling, general and administrative expenses for the year ended December 31, 2005 for the Engineered Products segment increased by \$802,000 to \$1,184,000 as compared to \$382,000 for the same period of 2004. As a percentage of net Engineered Products sales, selling, general and administrative expenses were 25.1% for the year ended December 31, 2005.

Excluding the 2005 Engineered Products segment increase of \$802,000, selling, general and administrative expenses for the year ended December 31, 2005 increased by \$69,000 or 0.8% to \$8,612,000 as compared to \$8,543,000 for the same period of 2004.

The increase of \$69,000 in selling, general and administrative expenses, excluding the Engineered Products segment, primarily consists of increased rent and utilities expense of \$92,000, increased insurance expense of \$47,000, increased professional fees and public company expenses of \$80,000, Sarbanes-Oxley Corporate Governance costs of \$91,000, increased expense for the executive bonus program of \$111,000, increased office expenses and miscellaneous expenses of \$54,000 and increased factory indirect expenses of \$55,000, partially offset by decreased payroll costs of \$213,000, decreased travel expense of \$86,000, decreased marketing and commission expenses of \$136,000 and decreased telecommunications expense of \$25,000.

The chief executive officer and president are each entitled to a bonus equal to 5% of the pre-tax profits of the Company. Total bonuses of \$429,000 were accrued for the year ended December 31, 2005 as compared to \$318,000 in the same period of 2004.

**Depreciation and Amortization.** Depreciation and amortization expense decreased by \$18,000 or 3.5% to \$499,000 for the year ended December 31, 2005 from \$517,000 for the same period in 2004. The decrease is primarily attributable to the closure of our facility located in Mexico during 2004.

**Income from Operations.** Income from operations increased by \$1,008,000 or 35.4%, to \$3,852,000 for the year ended December 31, 2005 as compared to income from operations of \$2,844,000 for the year ended December 31, 2004. The increase in income from operations is due to an increase in gross profit of \$1,861,000 and a decrease in

depreciation and amortization of \$18,000, partially offset by an increase in selling, general and administrative expenses of \$871,000.

**Net Interest.** For the year ended December 31, 2005, we had net interest income of \$24,000 compared to net interest income of \$7,000 for the year ended December 31, 2004. Interest expense decreased slightly to \$9,000 for the year ended December 31, 2005 compared to \$10,000 for the same period of 2004. Interest income increased by \$16,000 to \$33,000 for the year ended December 31, 2005 as compared to \$17,000 for the same period of 2004.

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

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

Harmony commenced operations in August of 2005. For the five months ended December 31, 2005, we recorded an equity loss in unconsolidated affiliate of \$16,000, consisting of our \$97,000 proportional ownership of Harmony s net income offset by an \$113,000 elimination of Harmony s profit related to inventory sold from Harmony to us which we had not yet sold to third parties.

**Income Before Provision for Income Taxes.** Income before provision for income taxes for the year ended December 31, 2005 was \$3,860,000 compared to \$2,858,000 for the year ended December 31, 2004, representing an increase of \$1,002,000 or 35.1%. The increase in income before provision for income taxes is due to an increase in gross profit of \$1,861,000, a decrease in depreciation and amortization of \$18,000 and an increase in net interest income of \$17,000, partially offset by an increase in selling, general and administrative expenses of \$871,000, a loss of \$16,000 from our unconsolidated affiliate (Harmony), as well as a gain on sale of assets of \$7,000 in 2004.

**Provision for Income Taxes** The provision for income taxes for the year ended December 31, 2005 was \$1,410,000 compared to \$1,011,000 for the year ended December 31, 2004. The increase in income taxes is due to higher income before provision for income taxes in 2005. The effective tax rate was 36.5% for the year ended December 31, 2005 as compared to 35.4% for the same period in 2004.

**Net Income.** Net income for the year ended December 31, 2005 was \$2,450,000 compared to net income of \$1,847,000 for the year ended December 31, 2004, an increase of \$603,000 or 32.6%. The net income increase was primarily due to an increase in income before provision for income taxes of \$1,002,000, partially offset by an increase in income taxes of \$399,000. Net income as a percentage of sales for the year ended December 31, 2005 and 2004 was 7.9% and 7.4% respectively. Basic and diluted income per share for the year ended December 31, 2005 and 2004 were \$0.10 and \$0.08, respectively.

## LIQUIDITY AND CAPITAL RESOURCES

As of December 31, 2006, we had cash and cash equivalents of \$1,837,000 and working capital of \$19,618,000, an increase in working capital of 37.2% or \$5,320,000 since December 31, 2005. As of December 31, 2006, our current



ratio was 8.32:1 as compared to 6.55:1 as of December 30, 2005. Cash increased by \$674,000 to \$1,837,000 as of December 31, 2006 as compared to \$1,163,000 as of December 31, 2005. The increase in cash is primarily due to cash proceeds of \$734,000 from the exercise of stock options, an income tax benefit from stock options exercised of \$313,000 and cash proceeds of \$500,000 for repayment of the advance from our Harmony joint venture, partially offset by cash used in operating activities of \$427,000, the purchase of property and equipment of \$386,000 and the purchases of intangible assets of \$60,000.

We have a \$3,500,000 credit facility with a bank, consisting of a line of credit with interest at prime plus 0.5%. At December 31, 2006, the prime interest rate was 8.25%. The line of credit was renewed in May 2005 and expires in May 2007. The Company's borrowing capacity on the line of credit was \$3,500,000 at December 31, 2006. The available line of credit is based on a formula of eligible accounts receivable and inventories. As of December 31, 2006, we had no borrowing under this line of credit. As of December 31, 2006, we did not have any debt.

Net cash used in operating activities was \$427,000 for the year ended December 31, 2006 compared to \$2,040,000 net cash used in operating activities for the year ended December 31, 2005. The net cash used in operating activities of \$427,000 for the year ended December 31, 2006 is due to net income of \$3,739,000, \$51,000 of non-cash share-based compensation expense, a decrease in deferred income taxes of \$76,000, increase in accounts payable and accrued liabilities of \$103,000 and depreciation and amortization of \$448,000, adjusted by the following: an increase in inventory of \$2,101,000, an increase in accounts receivable of \$2,203,000, an increase in prepaid expenses of \$480,000, non-cash equity income in unconsolidated affiliates of \$60,000. Net cash used in operating activities was \$2,040,000 for the year ended December 31, 2005 compared to \$1,463,000 of net cash provided for the year ended December 31, 2004. The net cash used in operating activities of \$2,040,000 for the year ended December 31, 2005 is due to an increase in inventory of \$5,810,000, which is net of the elimination of gross profit on inventory from the affiliate of \$113,000, partially offset by net income of \$2,450,000, equity in loss of unconsolidated affiliates of \$16,000, a decrease in prepaid expenses of \$234,000, depreciation and amortization of \$499,000, a decrease in accounts receivable of \$307,000, an increase in accounts payable of \$138,000, an income tax benefit from stock options exercised of \$95,000 and an decrease in deferred income taxes of \$31,000.

Accounts receivable increased by \$2,203,000 or 55.7% to \$6,157,000 as of December 31, 2006 from \$3,954,000 as of December 31, 2005. This increase is primarily due to increased sales of 56.6% for the last two months of 2006 as compared to the last two months of 2005.

Prepaid expenses and other current assets increased by \$480,000 to \$1,195,000 as of December 31, 2006 from \$715,000 as of December 31, 2005. The increase of \$480,000 is primarily due to an increase in prepaid tax payments of \$264,000, prepaid expenses for Engineered Products of \$180,000, an increase of \$46,000 in marketing expenses, partially offset by a decrease in general prepaid expenses of \$10,000.

Accounts payable and accrued liabilities as of December 31, 2006 increased by \$103,000 to \$2,679,000 from \$2,576,000. The net change in 2006 was primarily due a decrease in taxes payable of \$557,000, a decrease in accrued rebates of \$226,000 and a decrease in accrued professional fees of \$7,000, partially offset by a increase in trade payables of \$565,000, an increase in payroll accrual of \$11,000 and an increase in accrued commission/bonus payable of \$317,000.

Net cash provided by investing activities was \$54,000 for the year ended December 31, 2006 compared to net cash used in investing activities of \$2,070,000 for the year ended December 31, 2005. Our investing activity in 2006 consisted primarily of repayment of \$500,000 from our advance to our Harmony joint venture, offset by expenditures for property and equipment of \$386,000 and the purchase of intangible assets of \$60,000. This compared to expenditures for property and equipment of \$594,000, the purchases of intangible assets of \$26,000 and an investment in an India joint venture (Harmony) of \$1,450,000 during the year ended December 31, 2005.

We expect to purchase approximately \$1,000,000 to \$1,500,000 of equipment in 2007. These expenditures will be primarily for equipment for the Engineered Products segment.

For the year ended December 31, 2006, net cash provided by financing activities was \$1,047,000 compared to cash provided by financing activities of \$398,000 for the same period of 2005. Our financing activities in 2006 consisted of cash proceeds of \$734,000 from the exercise of 721,625 stock options and an income tax benefit from stock options exercised of \$313,000. Our financing activities in 2005 consisted primarily of cash proceeds of \$419,000 from the exercise of 341,106 stock options, partially offset by payments of \$21,000 for the repurchase of 10,000 shares of common stock.

In August 2004, our Board of Directors approved the buy-back of up to an additional \$500,000 of the Company's outstanding common stock. This share repurchase program is the sixth \$500,000 buyback authorized by the Board of Directors. In all instances, we are retiring the shares. For the year ended December 31, 2006, we did not buy back any shares of common stock. As of December 31, 2006, we have bought back a total of 2,333,800 shares of common stock at a cost of \$2,518,000 since the end of 1999.

As shown below, at December 31, 2006, our contractual cash obligations totaled approximately \$1,339,000.

#### Contractual Obligations

	Payments Due by Period				
	Total	1 Year	2-3 Years	4-5 Years	After 5 years
Operating leases	\$ 1,339,000	\$ 621,000	\$ 690,000	\$ 28,000	
Total contractual cash obligations	\$ 1,339,000	\$ 621,000	\$ 690,000	\$ 28,000	

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

#### New Accounting Standards

We adopted Statement of Financial Accounting Standards No. 123R, Share-Based Payment (SFAS 123R) effective January 1, 2006, using the modified prospective application method. SFAS 123R requires companies to record compensation expense for the value of all outstanding and unvested share-based payments, including employee stock options and similar awards. As of December 31, 2006, we had 490,000 outstanding and unvested share-based awards. As a result, we recognized a \$51,000 compensation expense related to share-based payments in our consolidated financial statements for the year ended December 31, 2006.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (SAB 108). SAB 108 provides guidance on how prior year misstatements should be taken into consideration when quantifying misstatements in current year financial statements for purposes of determining whether the current year's financial statements are materially misstated. SAB 108 permits registrants to record the cumulative effect of initial adoption by recording the necessary correcting adjustments to the carrying values of assets and liabilities as of the beginning of that year with the offsetting adjustment recorded to the opening balance of retained earnings only if material under the dual method. SAB 108 is effective for fiscal years ending on or after November 15, 2006. The adoption of SAB 108 did not have a material impact on our financial condition or results of operations.

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes and

interpretation of FASB Statement 109 ( FIN 48 ) which clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with FASB Statement No. 109. FIN 48 is effective for fiscal years beginning after December 15, 2006, and prescribes a recognition threshold and measurement attributes for the financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. While we have not completed a comprehensive analysis of FIN 48, the adoption of FIN 48 is not expected to have a material impact on our consolidated financial position, results of operations or cash flows.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements . SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This statement addresses how to calculate fair value measurements required or permitted under other accounting pronouncements. Accordingly, this statement does not require any new fair value measurements. However, for some entities, the application of this statement will change current practice. SFAS No. 157 is effective beginning January 1, 2008. We are currently evaluating the impact of this standard.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 . SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This Statement is expected to expand the use of fair value measurement, which is consistent with the FASB's long-term measurement objectives for accounting for financial instruments. SFAS No. 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company does not expect SFAS No. 159 to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

#### **ITEM 7a. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We subcontract the manufacture of products in China and to a lesser extent in Mexico and have a joint venture in India. In addition, our executive office, which employs 17 people, is located in Canada. Our results of operations could be negatively affected by changes in foreign currency exchange rates due to stronger economic conditions in those countries. We believe we do not have a material foreign currency exposure due to the fact that our purchase agreements with companies in China, India and Mexico are in US dollars. In Canada our foreign currency exposure is not material due to the fact that we do not manufacture in Canada.

We do not expect any significant effect on our results of operations from inflation or interest and currency rate fluctuations. We do not hedge our interest rate or foreign exchange risks.

#### **ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

Consolidated financial statements and the Report of our Independent Registered Public Accounting Firm thereon are set forth under Item 15 (a) (1) of this Form 10-K.



**QUARTERLY FINANCIAL DATA (UNAUDITED)**

Selected quarterly financial data for the years ended December 31, 2006 and 2005 is presented below:

**2006 Quarters**

	1ST	2ND	3RD	4TH
Revenue	\$ 7,971,000	\$ 9,879,000	\$ 8,952,000	\$ 10,536,000
Gross Profit	3,641,000	4,623,000	4,105,000	4,951,000
Net Income	649,000	1,126,000	882,000	1,082,000
Basic and Diluted Income per Share	0.03	0.05	0.04	0.04

**2005 Quarters**

	1ST	2ND	3RD	4TH
Revenue	\$ 6,982,000	\$ 9,040,000	\$ 8,056,000	\$ 7,017,000
Gross Profit	3,161,000	4,227,000	3,649,000	3,110,000
Net Income	444,000	1,003,000	693,000	310,000
Basic and Diluted Income per Share	0.02	0.04	0.03	0.01

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None

**ITEM 9A. CONTROLS AND PROCEDURES****Evaluation of Disclosure Controls and Procedures.**

The Company's chief executive officer and its chief financial officer, after evaluating the effectiveness of the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-14(c) and 15d-14(c)) as of the end of the period for this annual report (the "Evaluation Date"), have concluded that, as of the Evaluation Date, the Company's disclosure controls and procedures were effective to ensure that material information related to the Company and its consolidated subsidiaries would be made known to them by others within those entities. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating and implementing possible controls and procedures.

**Changes in Internal Controls.**

There have been no significant changes in the Company's internal controls or in other factors that could significantly affect the Company's internal controls subsequent to the Evaluation Date.

**ITEM 9B. OTHER INFORMATION**

None

**PART III**

The information pursuant to Items 10, 11, 12 and 13 is omitted from this report (in accordance with General Instruction G for Form 10-K), since the Company is filing with the Commission (by no later than April 30, 2007), a



definitive proxy statement pursuant to Regulation 14A, which involves the election of directors at the annual shareholders meeting of the Company which is expected to be held in June 2007.

**ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES**

Information concerning principal accountant fees and services will appear in the Proxy Statement under the heading Fees Paid to PricewaterhouseCoopers LLP and is incorporated herein by reference.

**PART IV**

**ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K**

(a) 1 and 2 Financial Statements and Financial Statement Schedules

See Index to Financial Statements and Financial Statement Schedules appearing on Page F-1 of this Form 10-K

(b) A Form 8-K was filed during the last quarter covered by this report, reporting the issuance of a release dated November 1, 2006 announcing the registrant's financial results for the third quarter of 2006.

(c) Exhibit Index

23 (a) Consent of Independent Registered Public Accounting Firm (filed herewith)

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

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

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

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

**ITEM 16. Exhibits**

(3)

- (a) Certificate of Incorporation dated February 17, 1983
- (b) Certificate of Change of Name dated July 27, 1988
- (c) Certificate of Change of Name dated July 4, 1989
- (d) Memorandum
- (e) Articles (equivalent to By-Laws)
- (f) Certificate of Incorporation of Alpha Pro Tech, Ltd. dated June 15, 1994\*
- (g) Application for Certificate of Registration and Articles of Continuance- State of Wyoming - Filed June 24, 1994 \*
- (h) Certificate of Registration and Articles of Continuance of Secretary of State, State of Wyoming, dated June 24, 1994 \*
- (i) Certificate of Secretary of State of Wyoming dated June 24, 1995 \*



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- (j) Certificate of Amendment of Certificate of Incorporation of Alpha Pro Tech, Ltd., dated June 24, 1994 \*
  - (k) Article of Merger of BFD Industries, Inc., a Wyoming Corporation and Alpha Pro Tech, Ltd., a Delaware Corporation, effective July 1, 1994 \*
  - (l) Certificate of Ownership and Merger which merges BFD Industries with and into Alpha Pro Tech, Ltd., a Delaware Corporation effective July 1, 1994 \*
- (4) (a) Form of Common Stock Certificate \*\*
- (10) (a) Form of Director s Stock Option Agreement  
(b) Form of Employee s Stock Option Agreement  
(c) Employment Agreement between the Company and Al Millar dated June, 1989  
(c)(i) Employment Agreement between the Company and Donald E. Bennett, Jr. \*\*  
(c)(ii) Employment Agreement between the Company and Michael Scheerer \*\*\*  
(d) Lease Agreement between White Dairy Company, Inc. and the Company for lease of the premises situated at 2724-7th Avenue South, Birmingham, Alabama, 35233, dated March 1990 and amendment thereto dated April, 1990  
(e) BFD Industries Limited Partnership Agreement between 881216 Ontario Inc. and Bernard Charles Sherman dated May 17, 1990  
(f) Asset Purchase Agreement between the Company and the BFD Industries Limited Partnership dated May 17, 1990  
(g) Purchase Agreement between the Company, Bernard Charles Sherman and Apotex, Inc. dated June 21, 1991 and amendment thereto made August 30, 1991  
(h) Professional Services Agreement between the Company and Quanta Corporation dated September, 1991  
(i) Sales and Marketing Agreement between the Company and MDC Corp., dated October 4, 1991  
(j) National Account Marketing Agreement between the Company and National Contracts, Inc. dated October 7, 1991  
(k) Group Purchasing Agreement between the Company and Premier Hospitals Alliance, Inc. dated November 1, 1991.  
(l) Letter of Intent between the Company and the shareholders of Alpha Pro Tech, Inc. dated December 11, 1991 and amendment thereto dated February 19, 1992  
(m) Group Purchasing Agreement between the Company and AmeriNet Incorporated dated January, 1992  
(n) Group Purchasing Agreement between the Company and Magnet, Inc.  
(o) Share Purchase Agreement re Acquisition of Alpha Pro Tech, Inc.  
(p) VWR Scientific Products Corporation Distribution Agreement dated January 1, 2000\*\*\*\*  
(q) Business Relationship/Confidentially Agreement between the Company and McDonald s Corporation dated February 1, 2000 and First Amendment thereto \*\*\*\*\*  
(r) Joint Manufacturing & Marketing Agreement between Alpha ProTech Engineered Products, Inc. and Perma R Products, Inc. for housewrap dated January 28, 2005 \*\*\*\*\*  
(s) Joint Manufacturing & Marketing Agreement between Alpha ProTech Engineered Products, Inc. and Perma R Products, Inc. for synthetic roof underlayment dated February 24, 2005 \*\*\*\*\*
- (23) (a) Consent of Independent Registered Public Accounting Firm \*\*\*\*\*

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Unless otherwise noted, all of the foregoing exhibits are incorporated by reference to Form 10 Registration Statement (File No. 0-1983) filed on February 25, 1992.



\* Incorporated by reference to Annual Report on Form 10-K for the year ended December 31, 1994 (File No. 019893)

\*\* Incorporated by reference to Registration Statement on Form S-1, (File No. 33-93894) which became effective August 10, 1995

\*\*\* Incorporated by reference to Post-Effective Amendment No. 1 filed January 30, 1997 to Registration Statement on Form S-1 (File No., 33-93894)

\*\*\*\* Incorporated by reference to Annual Report on Form 10-K for the year ended December 31, 2000 (File No. 01-9893)

\*\*\*\*\* Incorporated by reference to Annual Report on Form 10-K for the year ended December 31, 2001 (File No. 01-9893)

\*\*\*\*\* Incorporated by reference to Annual Report on Form 10-K for the year ended December 31, 2004 (File No. 01-9893)

\*\*\*\*\*Filed herewith

**SIGNATURES**

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

ALPHA PRO TECH, LTD.

DATE: March 9, 2007 BY: /s/ Sheldon Hoffman  
Sheldon Hoffman  
Chief Executive Officer and Director

DATE: March 9, 2007 BY: /s/ Lloyd Hoffman  
Lloyd Hoffman  
Chief Financial Officer and Senior Vice President

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated on March 9, 2007.

/s/ David B. Anderson  
David B. Anderson, Director

/s/ Donald E. Bennett Jr.  
Donald E. Bennett, Jr. Director

/s/ Sheldon Hoffman  
Sheldon Hoffman, Director

/s/ Robert H. Isaly  
Robert H. Isaly, Director

/s/ Russ Manock  
Russ Manock, Director

/s/ Alexander W. Millar  
Alexander W. Millar, Director

/s/ Dr. John Ritota  
Dr. John Ritota, Director



**Alpha Pro Tech, Ltd.**

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<u>Consolidated Income Statements for the three years in the period ended December 31, 2006</u>	F-4
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All other schedules are omitted because they are not applicable or the required information is shown in the financial statements or notes thereto.

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**Report of Independent Registered Public Accounting Firm**

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To Board of Directors and Shareholders of Alpha Pro Tech, Ltd.

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Alpha Pro Tech, Ltd. and its subsidiaries at December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

**PricewaterhouseCoopers LLP**

Salt Lake City, UT

March 7, 2007

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**Alpha Pro Tech, Ltd****Consolidated Income Balance Sheets**

	December 31, 2006	2005
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 1,837,000	\$ 1,163,000
Accounts receivable, net of allowance for doubtful accounts of \$61,000 and \$76,000 at December 31, 2006 and 2005, respectively	6,157,000	3,954,000
Inventories, net	12,713,000	10,612,000
Prepaid expenses and other current assets	1,195,000	715,000
Deferred income taxes	395,000	430,000
Total current assets	22,297,000	16,874,000
Property and equipment, net	3,355,000	3,389,000
Goodwill, net	55,000	55,000
Intangible assets, net	151,000	119,000
Equity investments in and advances to unconsolidated affiliates	994,000	1,434,000
Total assets	\$ 26,852,000	\$ 21,871,000
<b>Liabilities and Shareholders Equity</b>		
Current liabilities:		
Accounts payable	\$ 1,213,000	\$ 648,000
Accrued liabilities	1,466,000	1,928,000
Total current liabilities	2,679,000	2,576,000
Deferred income taxes	693,000	652,000
Total liabilities	3,372,000	3,228,000
Commitments and contingencies (Note 11)		
Shareholders equity:		
Common stock, \$.01 par value, 50,000,000 shares authorized, 24,509,580 and 23,787,955 issued and outstanding at December 31, 2006 and 2005, respectively	245,000	238,000
Additional paid-in capital	25,774,000	24,683,000
Accumulated deficit	(2,539,000 )	(6,278,000 )
Total shareholders equity	23,480,000	18,643,000
Total liabilities and shareholders equity	\$ 26,852,000	\$ 21,871,000

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

**Alpha Pro Tech, Ltd****Consolidated Income Statements**

	Year ended December 31,		
	2006	2005	2004
Net sales	\$ 37,338,000	\$ 31,095,000	\$ 24,841,000
Cost of goods sold, excluding depreciation and amortization shown below	20,018,000	16,948,000	12,555,000
Gross profit	17,320,000	14,147,000	12,286,000
Expenses:			
Selling, general and administrative	10,939,000	9,796,000	8,925,000
Depreciation and amortization	448,000	499,000	517,000
Income from operations	5,933,000	3,852,000	2,844,000
Other income			
Equity in income (loss) of unconsolidated affiliates	60,000	(16,000)	)
Gain on sale of assets			7,000
Interest, net	36,000	24,000	7,000
Income before provision for income taxes	6,029,000	3,860,000	2,858,000
Provision for income taxes	2,290,000	1,410,000	1,011,000
Net income	\$ 3,739,000	\$ 2,450,000	\$ 1,847,000
Basic income per share	\$ 0.15	\$ 0.10	\$ 0.08
Diluted income per share	\$ 0.15	\$ 0.10	\$ 0.08
Basic weighted average shares outstanding	24,141,535	23,684,229	23,215,809
Diluted weighted average shares outstanding	25,129,198	25,247,236	24,624,613

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

**Alpha Pro Tech, Ltd****Consolidated Statements of Shareholders Equity**

	Shares	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Total
Balance at					
December 31, 2003	22,727,907	\$ 227,000	\$ 23,375,000	(\$10,575,000 )	\$ 13,027,000
Options exercised	824,894	9,000	751,000		760,000
Warrants exercised	119,048	1,000	207,000		208,000
Common stock repurchased	(215,000 )	(2,000 )	(370,000 )		(372,000 )
Income tax benefit from stock options exercised			230,000		230,000
Net income				1,847,000	1,847,000
Balance at					
December 31, 2004	23,456,849	235,000	24,193,000	(8,728,000 )	15,700,000
Options exercised	341,106	3,000	416,000		419,000
Common stock repurchased	(10,000 )		(21,000 )		(21,000 )
Income tax benefit from stock options exercised			95,000		95,000
Net income				2,450,000	2,450,000
December 31, 2005	23,787,955	238,000	24,683,000	(6,278,000 )	18,643,000
Options exercised	721,625	7,000	727,000		734,000
Income tax benefit from stock options exercised			313,000		313,000
Share based compensation expense			51,000		51,000
Net income				3,739,000	3,739,000
Balance at					
December 31, 2006	24,509,580	\$ 245,000	\$ 25,774,000	\$ (2,539,000 )	\$ 23,480,000

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

## Alpha Pro Tech, Ltd

## Consolidated Statements of Cash Flows

	Year ended December 31,		
	2006	2005	2004
Cash flows from operating activities:			
Net income	\$3,739,000	\$2,450,000	\$1,847,000
Adjustments to reconcile net income to net cash (used in) provided by operating activities:			
Share-based compensation expenses	51,000		
Depreciation and amortization	448,000	499,000	517,000
Equity in (income)/loss of unconsolidated affiliates	(60,000 )	16,000	
Gain on sale of assets			(7,000 )
Deferred income taxes	76,000	31,000	(21,000 )
Income tax benefit from stock options exercised		95,000	230,000
Changes in assets and liabilities:			
Accounts receivable, net	(2,203,000 )	307,000	(1,554,000 )
Inventories, net	(2,101,000 )	(5,810,000 )	1,213,000
Prepaid expenses and other current assets	(480,000 )	234,000	(704,000 )
Accounts payable and accrued liabilities	103,000	138,000	(58,000 )
Net cash (used in) provided by operating activities	(427,000 )	(2,040,000 )	1,463,000
Cash flows from investing activities:			
Investments in and advances to Joint Venture		(1,450,000 )	
Repayments of advances to Joint Venture	500,000		
Purchase of property and equipment	(386,000 )	(594,000 )	(586,000 )
Proceeds from sale of assets			16,000
Purchase of intangible assets	(60,000 )	(26,000 )	(41,000 )
Net cash provided by (used in) investing activities	54,000	(2,070,000 )	(611,000 )
Cash flows from financing activities:			
Proceeds from exercise of stock options	734,000	419,000	760,000
Proceeds from exercise of warrants			208,000
Payments for the repurchase of common stock		(21,000 )	(372,000 )
Income tax benefit from stock options exercised	313,000		
Proceeds from revolving credit agreement	2,691,000	356,000	
Payments on revolving credit agreement	(2,691,000 )	(356,000 )	
Net cash provided by financing activities	1,047,000	398,000	596,000
Increase (decrease) in cash and cash equivalents	674,000	(3,712,000 )	1,448,000
Cash and cash equivalents, beginning of period	1,163,000	4,875,000	3,427,000
Cash and cash equivalents, end of period	\$1,837,000	\$1,163,000	\$4,875,000
Supplemental disclosure of cash flow information:			
Cash paid for interest	\$5,000	\$8,700	\$9,800
Cash paid for income taxes	\$2,724,000	\$333,000	\$1,682,000



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

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## Alpha Pro Tech, Ltd

### Notes to Consolidated Financial Statements

#### 1. The Company

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

In 2005, the Company commenced sales from a new business segment, Alpha ProTech Engineered Products, Inc., a wholly-owned subsidiary of Alpha Pro Tech. This segment consists of a line of construction supply weatherization products as well as a line of paint with antimicrobials. The construction supply weatherization products consist of house wrap and synthetic roof underlayment. The line of paint with antimicrobials is designed to inhibit growth of bacteria, fungi and algae on the painted surfaces in hospitals, surgical rooms and cleanrooms and associated controlled environments.

#### 2. Summary of Significant Accounting Policies

##### Principles of consolidation

The consolidated financial statements of the Company include the accounts of the Company and its wholly-owned subsidiary, Alpha Pro Tech, Inc. (APT), as well as APT's wholly-owned subsidiary, Alpha ProTech Engineered Products, Inc. (Engineered Products). All significant intercompany accounts and transactions have been eliminated.

##### Reclassifications

Certain December 31, 2005 balances have been reclassified to conform to the current years presentation.

##### Inventories

Inventories include freight-in, materials, labor and overhead costs and are stated at the lower of cost (computed on a standard cost basis, which approximates average cost) or market. Provision is made for slow-moving, obsolete or unusable inventory. The Company assesses inventory for estimated obsolescence or unmarketable inventory and writes down the difference between the cost of inventory and the estimated market value based upon assumptions about future sales and supply on-hand.

##### Property and equipment

Property and equipment is stated at cost less accumulated depreciation and amortization and is depreciated or amortized using the straight-line method over the shorter of the respective useful lives of the assets or the related lease terms as follows:

Buildings	25 years
Machinery and equipment	5-15 years
Office furniture and equipment	2-7 years
Leasehold improvements	4-5 years

Expenditures for renewals and betterments are capitalized, whereas costs of maintenance and repairs are charged to operations in the period incurred.

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### **Goodwill and Intangible assets**

The excess of purchase price over the fair value of assets acquired and liabilities assumed in acquisition transactions is classified as goodwill. Effective January 1, 2002, the Company adopted SFAS No. 142, Goodwill and Other Intangible Assets. SFAS No. 142 primarily addresses the accounting for goodwill and intangible assets subsequent to their acquisition. As prescribed by SFAS No. 142, goodwill is not amortized, but rather is tested for impairment (Note 5). Patent rights and trademarks are recorded at cost and are amortized using the straight-line method over their estimated useful lives of 5-17 years.

### **Impairment of long-lived assets**

The Company reviews long-lived assets for impairment whenever events or changes in business circumstances indicate that the carrying amounts of the assets may not be fully recoverable. An impairment loss is recognized when the estimated undiscounted future net cash flows expected to result from the use of an asset and its eventual disposition are less than its carrying amount. The Company believes the future net cash flows to be received from its long-lived assets exceed the assets' carrying values, and accordingly, the Company has not recognized any impairment losses during the years ended December 31, 2006, 2005 and 2004.

### **Revenue recognition**

For sales transactions, the Company complies with the provisions of Staff Accounting Bulletin 104 Revenue Recognition, which states that revenue should be recognized when the following revenue recognition criteria are met: (1) persuasive evidence of an arrangement exists; (2) the product has been shipped and the customer takes ownership and assumes the risk of loss; (3) the selling price is fixed or determinable; and (4) collection of the resulting receivable is reasonably assured. These criteria are satisfied upon shipment of product and revenues are recognized accordingly.

Sales are reduced for any anticipated sales returns, rebates and allowances based on historical data.

### **Shipping and Handling Costs**

The costs of shipping product to distributors are classified in cost of goods sold.

### **Stock Based Compensation**

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

The Company adopted Statement of Financial Accounting Standards No. 123R, Share-Based Payment ( SFAS 123R ) effective January 1, 2006, using the modified prospective application method. SFAS 123R requires companies to record compensation expense for the value of all outstanding and unvested share-based payments, including employee stock options and similar awards. As of December 31, 2005, the Company had no outstanding and unvested share-based awards. During the third quarter of 2006, 490,000 stock options were granted under the option plan. As a result, the Company recognized \$51,000 in share-based compensation expense in its consolidated financial statements for the year ended December 31, 2006.

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

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation, as amended by SFAS No. 148, to stock-based employee compensation.

	<b>For the Year Ended December 31,</b>	
	<b>2005</b>	<b>2004</b>
Net income, as reported	\$ 2,450,000	\$ 1,847,000
Deduct: Total stock-based employee compensation expense determined using the fair value method for all awards, net of related tax effects	(317,000 )	(150,000 )
Pro forma net income	\$ 2,133,000	\$ 1,697,000
Net income per share:		
Basic as reported	\$ 0.10	\$ 0.08
Basic pro forma	0.09	0.07
Diluted as reported	0.10	0.08
Diluted pro forma	0.08	0.07

### Income Taxes

The Company accounts for income taxes in accordance with SFAS No.109, Accounting for Income Taxes. This statement requires an asset and liability approach for accounting for income taxes. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets unless it is more likely than not such assets will be realized.

### Net Income Per Share

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

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**Translation of foreign currencies**

Transactions in foreign currencies during the reporting periods are translated into U.S. dollars at the exchange rate prevailing at the transaction date. Monetary assets and liabilities in foreign currencies at each period end are translated at the exchange rate in effect at that date.

Transaction gains or losses on foreign currencies are reflected in net income for the periods presented and were not material for the years ended December 31, 2006, 2005 and 2004.

	<b>For the Year Ended December 31,</b>		
	<b>2006</b>	<b>2005</b>	<b>2004</b>
Net income (Numerator)	\$ 3,739,000	\$ 2,450,000	\$ 1,847,000
<b>Shares (Denominator):</b>			
Basic weighted average shares outstanding	24,141,535	23,684,229	23,215,809
Add: Dilutive effect of stock options and warrants	987,663	1,563,007	1,408,804
Diluted weighted average shares outstanding	25,129,198	25,247,236	24,624,613
<b>Net income per share:</b>			
Basic	\$ 0.15	\$ 0.10	\$ 0.08
Diluted	\$ 0.15	\$ 0.10	\$ 0.08

**Cash Equivalents**

The Company considers all highly liquid instruments with a remaining maturity date of three months or less at the date of purchase to be cash equivalents.

**Research and Development**

Research and development costs are expensed as incurred and are included in selling, general and administrative expenses. Such costs were not material for the years ended December 31, 2006, 2005 and 2004.

**Advertising**

The Company expenses advertising costs as incurred. These costs are included in selling, general and administrative expenses. Such costs were not material for the years ended December 31, 2006, 2005 and 2004.

**Use of estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

**Fair value of financial instruments**

The fair values of financial instruments, including cash and cash equivalents, accounts receivable and accounts payable, approximate their respective book values at December 31, 2006 and 2005.

### **New accounting standards**

The Company adopted Statement of Financial Accounting Standards No. 123R, Share-Based Payment (SFAS 123R) effective January 1, 2006, using the modified prospective application method. SFAS 123R requires companies to record compensation expense for the value of all outstanding and unvested share-based payments, including employee stock options and similar awards. As of December 31, 2006, we had 490,000 outstanding and unvested share-based awards. As a result, the Company recognized a \$51,000 compensation expense related to share-based payments in the Company's consolidated financial statements for the year ended December 31, 2006.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (SAB 108). SAB 108 provides guidance on how prior year misstatements should be taken into consideration when quantifying misstatements in current year financial statements for purposes of determining whether the current year's financial statements are materially misstated. SAB 108 permits registrants to record the cumulative effect of initial adoption by recording the necessary correcting adjustments to the carrying values of assets and liabilities as of the beginning of that year with the offsetting adjustment recorded to the opening balance of retained earnings only if material under the dual method. SAB 108 is effective for fiscal years ending on or after November 15, 2006. The adoption of SAB 108 did not have a material impact on the Company's financial condition or results of operations.

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement 109 (FIN 48) which clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with FASB Statement No. 109. FIN 48 is effective for fiscal years beginning after December 15, 2006, and prescribes a recognition threshold and measurement attributes for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. While the Company has not completed a comprehensive analysis of FIN 48, the adoption of FIN 48 is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This statement addresses how to calculate fair value measurements required or permitted under other accounting pronouncements. Accordingly, this statement does not require any new fair value measurements. However, for some entities, the application of this statement will change current practice. SFAS No. 157 is effective for the Company beginning January 1, 2008. The Company is currently evaluating the impact of this standard.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115. SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This Statement is expected to expand the use

of fair value measurement, which is consistent with the FASB's long-term measurement objectives for accounting for financial instruments. SFAS No. 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company does not expect SFAS No. 159 to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

### 3. Inventories

Inventories consist of the following:

	December 31, 2006	2005
Raw materials	\$ 9,632,000	\$ 7,489,000
Work in process	182,000	325,000
Finished goods	3,217,000	3,124,000
	13,031,000	10,938,000
Less reserve for slow-moving, obsolete or unusable inventory	(318,000 )	(326,000 )
	\$ 12,713,000	\$ 10,612,000

### 4. Property and Equipment

Property and equipment consist of the following:

	December 31, 2006	2005
Buildings	\$ 355,000	\$ 355,000
Machinery and equipment	6,049,000	5,798,000
Office furniture and equipment	641,000	965,000
Leasehold improvements	297,000	251,000
	7,342,000	7,369,000
Less accumulated depreciation	(3,987,000 )	(3,980,000 )
	\$ 3,355,000	\$ 3,389,000

Depreciation of property and equipment was \$420,000, \$462,000 and \$487,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

### 5. Goodwill and Intangible Assets

The Company adopted SFAS 142 effective January 1, 2002. In accordance with the requirements of SFAS 142, goodwill is not amortized, but is subject to an annual impairment test. The annual impairment tests have been completed and did not result in an impairment charge.



Intangible assets, consisting of patents and trademarks, are amortized over their useful lives. Intangible assets consist of the following:

	Weighted Average Amortization Period (Years)	December 31, 2006			December 31, 2005		
		Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Patents and Trademarks	15.1	\$ 347,000	(\$196,000 )	\$ 151,000	\$ 287,000	(\$168,000 )	\$ 119,000

Amortization of intangible assets was \$28,000, \$37,000 and \$30,000 for the years ended December 31, 2006, 2005 and 2004 respectively.

Estimated future amortization expense related to intangible assets subject to amortization is as follows:

Year ending December 31,

2007	\$ 21,000
2008	21,000
2009	20,000
2010	18,000
2011	18,000
After 2011	53,000
	\$ 151,000

## 6. Investment in and Advances to Unconsolidated Affiliates

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

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

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

The Company is subject to the provisions of FIN 46 which defines the criteria by which the Company determines the proper accounting for its investments in related entities. Specifically, FIN

46 requires the Company to assess whether or not related entities are variable interest entities (VIEs), as defined. For those related entities that qualify as variable interest entities, FIN 46 requires the Company to determine whether or not the Company is the primary beneficiary of the VIE, and if so, to consolidate the VIE.

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

The Company records its investment in Harmony as Equity investments in and advances to unconsolidated affiliates on the accompanying Consolidated Balance Sheets. The Company records its equity interest in Harmony's results of operations as equity in income (loss) of unconsolidated affiliates on the accompanying Consolidated Income Statements.

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

Alpha ProTech Engineered Products initially invested \$1,450,000 in the joint venture; \$508,000 for share capital and \$942,000 as a long term advance. Fifty percent of the \$942,000 long term advance for materials is to be repaid over a six year term commencing in July 2006 and the balance is to be paid in the seventh year. During the third and fourth quarter of 2006, Harmony repaid \$39,000 in scheduled payments and \$461,000 in additional payments for a total of \$500,000, leaving a balance of \$442,000. Effective April 2006, interest of 3.5% is to be paid annually in January on this advance.

Harmony commenced operations in August of 2005. For the year ended December 31, 2006 and 2005, Alpha ProTech Engineered Products purchased \$5,718,000 and \$1,592,000, respectively from Harmony. For the year ended December 31, 2006, we recorded equity income in unconsolidated affiliates of \$60,000. For the year ended December 31, 2005, we recorded an equity loss in unconsolidated affiliates of \$16,000. As of December 31, 2006, our investment in Harmony is \$994,000 which comprises our original \$1,450,000 investment and total equity income in unconsolidated affiliates of \$44,000 less \$500,000 in repayments of the advance.

## 7. Accrued Liabilities

Accrued liabilities consist of the following:

	December 31, 2006	2005
Payroll expenses	\$ 199,000	\$ 188,000
Bonuses payable	986,000	669,000
Accrued professional fees	153,000	160,000
Accrued rebates and other	128,000	354,000
Income taxes payable		557,000
	\$ 1,466,000	\$ 1,928,000

## **8. Notes Payable**

In December 1997, the Company entered into a credit facility with an asset-based lender. The facility was renewed in May 2005 and expires in May 2007. Pursuant to the terms of the credit facility, the Company has a line of credit for up to \$3,500,000 based on eligible accounts receivable and inventories. The Company's borrowing capacity on the line of credit was \$3,500,000 at December 31, 2006. The credit facility bears interest at prime plus 0.5%, (8.75% and 7.0% at December 31, 2006 and 2005, respectively) and is collateralized by accounts receivable, inventories, trademarks, patents, property and equipment. Under the terms of the facility, the Company pays a 0.5% loan fee annually.

As of December 31, 2006, we had no outstanding balance on the line of credit and we had no debt.

## **9. Shareholders Equity**

### **Warrant activity**

As of January 1, 2004, the Company had outstanding warrants to purchase 119,048 shares of common stock at an exercise price of \$1.75 per share. These warrants were exercised during 2004 and as of December 31, 2006 the Company has no outstanding warrants.

### **Option activity**

During 1993, the Company adopted stock option plans for employees and directors of the Company. Under those plans, 4.8 million options were reserved for issuance and approximately 4.3 million options were granted. Under the 1993 plans, option grants vested immediately and expired no later than the fifth anniversary of the date of grant. The exercise price of the options was determined based on the fair value of the stock on the date of grant. These plans have expired and in 2004 the Company received shareholder approval for the 2004 Stock Option Plan.

Under the 2004 Stock Option Plan (2004 Plan), 2.5 million options have been reserved for issuance and approximately 1,070,000 options have been granted as of December 31, 2006. Under the 2004 Plan, option grants have a three year vesting period and expire no later than the fifth anniversary of the date of grant. The exercise price of the options is determined based on the fair value of the stock on the date of grant.

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The following table summarizes option activity for the three years ended December 31, 2006:

	Shares	Weighted Average Exercise Price Per Option
Options outstanding, December 31, 2003	3,464,000	\$ 0.93
Granted to employees and directors	520,000	\$ 1.58
Exercised	(825,000 )	\$ 0.92
Canceled/Expired/Forfeited	(15,000 )	\$ 1.06
Options outstanding, December 31, 2004	3,144,000	\$ 1.04
Granted to employees and directors	60,000	\$ 1.98
Exercised	(341,000 )	\$ 1.23
Canceled/Expired/Forfeited	(50,000 )	\$ 1.58
Options outstanding, December 31, 2005	2,813,000	\$ 1.03
Granted to employees and directors	490,000	\$ 1.98
Exercised	(722,000 )	\$ 1.02
Options outstanding, December 31, 2006	2,581,000	\$ 1.21
Options exercisable, December 31, 2006	2,091,000	\$ 1.03

Stock options to purchase 2,581,000 and 2,813,000 shares of common stock were outstanding at December 31, 2006 and 2005, respectively. Of these outstanding stock options, all of the options to purchase common stock at December 31, 2006 and 2005 were included in the computation of diluted earnings per share because the exercise prices of the stock options were less than the average share price of the Company's common stock and, therefore, the effect would have been dilutive. Unrecognized compensation expense as of December 31, 2006 was also included in calculating the diluted weighted average shares. Based on the application of the treasury stock method, the dilutive effect of stock options was 987,663 for the twelve months ended December 31, 2006.

The Company used the Black-Scholes option pricing model to value the options. The table below presents the weighted average expected life in years. The Company used SAB 107's simplified method for estimating the expected life of the options. The risk-free interest rate for periods within the contractual life of the award is based on the US Treasury yield curve in effect at the time of grant. The expected volatility is based on historical volatility of the expected life in years.

The fair value of the share-based payment awards was estimated using the Black-Scholes option pricing method with the following assumptions and weighted average fair values:

	Stock Options (1)		
	For the Year Ended December 31,		
	2006	2005	2004
Exercise price	\$ 1.98	\$ 1.98	\$ 1.58
Risk-free interest rate	4.78 %	4.28 %	3.45 %
Expected volatility	58.95 %	78.20 %	81.00 %
Black-Scholes fair value	\$ 0.93	\$ 1.64	\$ 1.32
Expected life in years	3.50	10.00	10.00

(1) The fair value calculation was based on the stock options granted during the period.

The following table summarizes stock option activity during the twelve months ended December 31, 2006:

	Options	Weighted-Average Exercise Price	Weighted - Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Options outstanding at December 31, 2005	2,813,000	\$ 1.03		
Exercised	(722,000 )	1.02		
Granted	490,000	1.98		
Forfeited or expired				
Options outstanding at December 31, 2006	2,581,000	\$ 1.21	2.77	\$ 4,100,000
Options exercisable at December 31, 2006	2,091,000	\$ 1.03	2.33	\$ 3,698,000

The intrinsic value is the amount by which the market value of the underlying common stock exceeds the exercise price of the respective stock option. The intrinsic value of stock options exercised during the three and twelve months ended December 31, 2006 was \$560,000 and \$962,000, respectively.

As of December 31, 2006 \$405,000 of total unrecognized compensation cost related to stock options is expected to be recognized over a weighted average remaining period of 2.67 years. Cash received from options exercised for the three and twelve months ended December 31, 2006 was \$337,000 and \$734,000, respectively.

## 10. Income Taxes

In 1994, the Company changed its name and commercial domicile from Canada to the United States. As a result of the change in domicile, NOL differences were created for book and tax purposes. With the change in domicile, the majority of the Canadian company's NOLs could not be utilized for tax purposes. As well, during 1995 the Company wrote off \$4.9 million of intangible assets which resulted in a loss for book purposes and not for tax purposes. Although the items mentioned above are

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included in the accumulated deficit they cannot be used for tax purposes. During the year ended December 31, 2000 all available NOL s had been utilized or expired.

The provision for income taxes consists of the following:

	Year ended December 31,		
	2006	2005	2004
Current	\$ 2,214,000	\$ 1,379,000	\$ 1,032,000
Deferred	76,000	31,000	(21,000 )
	\$ 2,290,000	\$ 1,410,000	\$ 1,011,000

Deferred tax assets (liabilities) comprise the following:

	December 31, 2006	2005
<b>Deferred tax assets:</b>		
Alternative minimum tax credits	\$ 72,000	\$ 34,000
<b>Temperary differences:</b>		
Inventory reserve	108,000	111,000
Intangible assets	37,000	33,000
Other	215,000	252,000
Gross deferred tax assets	432,000	430,000
<b>Deferred tax liabilities:</b>		
<b>Temperary differences:</b>		
Property and equipment	(710,000 )	(643,000 )
State income taxes	(20,000 )	(9,000 )
Gross deferred tax liabilities	(730,000 )	(652,000 )
Net deferred tax liability	\$ (298,000 )	\$ (222,000 )

The provision for income taxes differs from the amount that would be obtained by applying the United States statutory rate to income before income taxes as a result of the following:

	Year ended December 31,		
	2006	2005	2004
Income taxes based on US statutory rate 34%	\$ 2,050,000	\$ 1,312,000	\$ 972,000
Non-deductible meals and entertainment	7,000	14,000	17,000
Domestic manufacturer s deduction	(20,000 )	(35,000 )	
State taxes	200,000	135,000	73,000
Other	53,000	(16,000 )	(51,000 )
	\$ 2,290,000	\$ 1,410,000	\$ 1,011,000



## 11. Lease Commitments

The Company leases manufacturing facilities under non-cancelable operating leases expiring through May 30, 2010.

The following summarizes future minimum lease payments required under non-cancelable operating leases:

Year Ending December 31,	Operating Leases
2007	\$ 621,000
2008	497,000
2009	193,000
2010	28,000
Future minimum lease payments	\$ 1,339,000

Total rent expense under operating leases for the years ended December 31, 2006, 2005 and 2004 was \$710,000, \$638,000 and \$554,000, respectively.

## 12. Employee Benefit Plans

401(k) Plan: The Company has a 401(k) defined contribution profit sharing plan. Under the plan, employees may contribute up to 12% of their gross earnings subject to certain limitations. The Company contributes an additional 0.5% of gross earnings for those employees contributing 1% of their gross earnings and contributes an additional 1% of gross earnings for those employees contributing 2% to 12% of their gross earnings. The Company contributions become fully vested after five years. The amounts contributed to the plan by the Company were \$31,000, \$26,000 and \$23,000 for the years ended December 31, 2006, 2005 and 2004, respectively.

The Company does not have any other significant pension, profit sharing or similar plans established for its employees; however, the chief executive officer and president are each entitled to a bonus equal to 5% of the pre-tax profits of the Company. Bonuses of \$670,000, \$429,000 and \$318,000 were accrued for the years ended December 31, 2006, 2005 and 2004, respectively.

## 13. Activity of Business Segments

The Company operates through four segments:

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

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



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

Engineered Products: this new fourth segment commenced business in 2005 with the formation of Alpha ProTech Engineered Products, Inc., a wholly-owned subsidiary. This segment consists of a line of construction supply weatherization products as well as a line of paint with antimicrobials. The construction supply weatherization products consist of house wrap and a synthetic roof underlayment. The line of paint with antimicrobials is designed to inhibit growth of bacteria, fungi and algae on the painted surfaces in hospitals, surgical rooms and cleanrooms and associated controlled environments. The Company has an exclusive licensing agreement for the proprietary antimicrobial formulation to be used in the paint. The agreement requires a royalty payment of 5.0% of the net sales associated with the antimicrobial formulation. This product is designed to reduce operating costs in cleanrooms and hospitals while preserving environmental safety.

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

The following table shows net sales for each segment:

	<b>Year Ended December 31,</b>		
	<b>2006</b>	<b>2005</b>	<b>2004</b>
Disposable Protective Apparel	\$ 21,183,000	\$ 19,444,000	\$ 17,783,000
Infection Control	6,944,000	5,136,000	5,108,000
Extended Care	1,430,000	1,802,000	1,932,000
Engineered Products	7,781,000	4,713,000	18,000
Consolidated total net sales	\$ 37,338,000	\$ 31,095,000	\$ 24,841,000

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The following table shows the reconciliation of total segment income to total consolidated net income.

	Year Ended December 31,		
	2006	2005	2004
Disposable Protective Apparel	\$ 7,942,000	\$ 6,917,000	\$ 6,349,000
Infection Control	3,233,000	2,163,000	1,942,000
Extended Care	85,000	214,000	305,000
Engineered Products	717,000	(54,000 )	(371,000 )
Total segment income	11,977,000	9,240,000	8,225,000
Unallocated corporate overhead expenses	(5,948,000 )	(5,380,000 )	(5,367,000 )
Provision for income taxes	(2,290,000 )	(1,410,000 )	(1,011,000 )
Consolidated net income	\$ 3,739,000	\$ 2,450,000	\$ 1,847,000

The following reflects sales and long-lived asset information by geographic area:

	Year Ended December 31,		
	2006	2005	2004
<b>Net sales by region</b>			
United States	\$ 35,726,000	\$ 29,427,000	\$ 23,684,000
International	1,612,000	1,668,000	1,157,000
Consolidated total net sales	\$ 37,338,000	\$ 31,095,000	\$ 24,841,000
<b>Long-lived assets by region</b>			
United States	\$ 3,293,000	\$ 3,376,000	\$ 3,179,000
International	62,000	13,000	77,000
Consolidated total long-lived assets	\$ 3,355,000	\$ 3,389,000	\$ 3,256,000

Net sales by region are based on the countries in which the customers are located. For the years ended December 31, 2006, 2005 and 2004, the Company did not generate sales from any single foreign country that were significant to the Company's consolidated net sales.

#### 14. Concentration of Risk

The Company maintains its cash and cash equivalents in accounts in several banks, the balances which at times may exceed federally insured limits.

For the year ended December 31, 2006, two distributor's account for 65.5% for total revenues.

The Company sells significant amounts of disposable protective apparel product to a large distributor on credit terms. The Company has had a contractual relationship with this distributor since

1995 and effective January 1, 2006 signed a multiple year contract which provides optional extensions beyond the initial term of the agreement. Previously, this distributor had exclusive rights to sell and distribute Alpha Pro Tech's Critical Cover® trade named products, and exclusive rights to sell and distribute Alpha Pro Tech branded products to domestic and international clean room and industrial customers. Under terms of the new contract, this distributor has the exclusive right to sell and distribute Alpha Pro Tech's Critical Cover® trade named products, but non-exclusive rights to sell and distribute Alpha Pro Tech branded products. Net sales to this distributor were 45.1%, 53.1% and 63.7% of total sales for the years ended December 31, 2006, 2005 and 2004, respectively. Accounts receivable from this distributor represented 59.9% of total accounts receivable at December 31, 2006. The loss of this customer would have a material adverse effect on the Company's business. Management believes that adequate provision has been made for risk of loss on all credit transactions.

In early 2005, we entered into two sales and marketing agreements for our Engineered Products segment. On January 31, 2005, we signed a 3-year mutually exclusive agreement with Perma-R Products, Inc., (Perma-R) a Grenada, Mississippi based company. As part of the agreement, Perma-R is responsible for all marketing of our house wrap products, and has agreed to minimum sales of \$5 million per year. On February 28, 2005 we signed a second 3-year, mutually exclusive agreement with Perma-R. This second agreement stipulates that Perma-R will be responsible for all sales & marketing of our synthetic roof underlayment product and has agreed to minimum sales of \$3 million per year. In 2005 this distributor did not meet the minimums for either house wrap or synthetic roof underlayment. In 2006 they purchased \$5.1 million of house wrap, meeting their contractual minimum requirement of \$5.0 million but did not meet the minimum for synthetic roof underlayment.

The Company currently buys a significant amount of its disposable protective apparel products from one third party subcontractor located in China. Although there are a limited number of manufacturers of the particular product, management believe that other suppliers could provide similar products at comparable terms. A change in suppliers, however, could cause a delay in shipment and a possible loss of sales, which would affect operating results adversely.

The Engineered Products segment buys semi-finished house wrap and synthetic roof underlayment from its joint venture, Harmony Plastics located in India. Although there are a limited number of manufacturers of the particular product, management believe that other suppliers could provide similar products at comparable terms. A change in suppliers however could cause a delay in shipment and a possible loss of sales, which would affect operating results adversely.

## Alpha Pro Tech, Ltd. And Subsidiaries

## Schedule II - Valuation and Qualifying Accounts

Description	Balance at Beginning of Period	Charged to Costs and Expenses	Charged to Other Accounts	Deductions	Balance at End of Period
Year Ended December 31, 2006					
Allowance for doubtful accounts	\$ 76,000	\$	\$	\$ 15,000	\$ 61,000
Reserve for slow moving, obsolete or unusable inventory	\$ 326,000	\$	\$	\$ 8,000	\$ 318,000
Year Ended December 31, 2005					
Allowance for doubtful accounts	\$ 75,000	\$ 1,000	\$		\$ 76,000
Reserve for slow moving, obsolete or unusable inventory	\$ 426,000	\$	\$	\$ 100,000	\$ 326,000
Year Ended December 31, 2004					
Allowance for doubtful accounts	\$ 69,000	\$ 6,000	\$		\$ 75,000
Reserve for slow moving, obsolete or unusable inventory	\$ 386,000	\$ 40,000	\$	\$	\$ 426,000