

ALPHA PRO TECH LTD
Form 10-Q
November 06, 2008
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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the Quarter Ended September 30, 2008

Commission File No. 01-15725

Alpha Pro Tech, Ltd.

(exact name of registrant as specified in its charter)

Delaware, U.S.A.
(State or other jurisdiction of incorporation)

63-1009183
(I.R.S. Employer Identification No.)

**Suite 112, 60 Centurian Drive
Markham, Ontario, Canada**
(Address of principal executive offices)

L3R 9R2
(Zip Code)

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

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

Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller Reporting Company

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

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of November 3, 2008. 24,249,753 shares of common stock, \$.01 par value

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

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

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

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

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Alpha Pro Tech, Ltd.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

You should read the following unaudited interim consolidated financial statements and the accompanying notes together with the Company's current year 10-Q's and 8-K's as well as the Annual Report on Form 10-K for the year ended December 31, 2007. The Company's 2007 Annual Report contains information that may be helpful in analyzing the financial information contained in this report and in comparing its results of operations for the three and nine months ended September 30, 2008 with the same period in 2007.

Table of Contents**Alpha Pro Tech, Ltd.****CONSOLIDATED BALANCE SHEETS (UNAUDITED)**

	September 30, 2008	December 31, 2007 (1)
Assets		
Current assets:		
Cash and cash equivalents	\$ 4,817,000	\$ 4,064,000
Accounts receivable, net of allowance for doubtful accounts of \$64,000 at September 30, 2008 and \$65,000 at December 31, 2007	5,113,000	4,422,000
Inventories, net	12,655,000	14,111,000
Prepaid expenses and other current assets	1,324,000	1,588,000
Deferred income taxes	509,000	419,000
Total current assets	24,418,000	24,604,000
Property and equipment, net	3,083,000	3,439,000
Goodwill, net	55,000	55,000
Intangible assets, net	202,000	180,000
Equity investments in and advances to unconsolidated affiliates	1,331,000	1,208,000
Total assets	\$ 29,089,000	\$ 29,486,000
Liabilities and Shareholders Equity		
Current liabilities:		
Accounts payable	\$ 212,000	\$ 457,000
Accrued liabilities	1,235,000	1,478,000
Total current liabilities	1,447,000	1,935,000
Deferred income taxes	751,000	747,000
Total liabilities	2,198,000	2,682,000
Shareholders equity		
Common stock, \$.01 par value, 50,000,000 shares authorized, 24,557,255 and 25,583,655 issued and outstanding at September 30, 2008 and December 31, 2007, respectively	246,000	256,000
Additional paid-in capital	25,498,000	26,670,000
Retained earnings (accumulated deficit)	1,147,000	(122,000)
Total shareholders equity	26,891,000	26,804,000
Total liabilities and shareholders equity	\$ 29,089,000	\$ 29,486,000

(1) The condensed consolidated balance sheet as of December 31, 2007 has been prepared using information from the audited financial statements at that date.

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

Table of Contents**Alpha Pro Tech, Ltd.****Consolidated Income Statements (Unaudited)**

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
Net sales	\$ 10,217,000	\$ 9,308,000	\$ 26,654,000	\$ 27,501,000
Cost of goods sold, excluding depreciation and amortization	5,862,000	4,913,000	14,931,000	14,671,000
Gross margin	4,355,000	4,395,000	11,723,000	12,830,000
Expenses:				
Selling, general and administrative	3,078,000	2,949,000	9,413,000	9,557,000
Depreciation and amortization	151,000	114,000	433,000	349,000
Income from operations	1,126,000	1,332,000	1,877,000	2,924,000
Other income				
Equity in income of unconsolidated affiliates	85,000	128,000	123,000	194,000
Interest, net	7,000	28,000	59,000	58,000
Income before provision for income taxes	1,218,000	1,488,000	2,059,000	3,176,000
Provision for income taxes	473,000	572,000	790,000	1,216,000
Net income	\$ 745,000	\$ 916,000	\$ 1,269,000	\$ 1,960,000
Basic net income per share	\$ 0.03	\$ 0.04	\$ 0.05	\$ 0.08
Diluted net income per share	\$ 0.03	\$ 0.04	\$ 0.05	\$ 0.08
Basic weighted average shares outstanding	24,720,617	25,626,172	24,979,837	25,240,202
Diluted weighted average shares outstanding	24,720,617	25,636,151	24,979,837	25,630,223

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

Table of Contents**Alpha Pro Tech, Ltd.****Consolidated Statement of Shareholders Equity (Unaudited)**

	Common Stock		Additional		(Accumulated	
	Shares	Amount	Paid-in	Capital	Deficit)	Total
					Retained	
					Earnings	
Balance at December 31, 2007	25,583,655	\$ 256,000	\$	26,670,000	\$ (122,000)	\$ 26,804,000
Share- based compensation expense				153,000		153,000
Common Stock repurchased & retired	(1,026,400)	(10,000)		(1,325,000)		(1,335,000)
Net income					1,269,000	1,269,000
Balance at September 30, 2008	24,557,255	\$ 246,000	\$	25,498,000	\$ 1,147,000	\$ 26,891,000

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

Table of Contents**Alpha Pro Tech, Ltd.****Consolidated Statements of Cash Flows (Unaudited)**

	For the Nine Months Ended September 30,	
	2008	2007
Cash Flows From Operating Activities:		
Net income	\$ 1,269,000	\$ 1,960,000
Adjustments to reconcile net income to net cash used in operating activities:		
Share-based compensation expense	153,000	104,000
Depreciation and amortization	433,000	349,000
Deferred income taxes	(86,000)	(48,000)
Equity in income of unconsolidated affiliates	(123,000)	(194,000)
Changes in assets and liabilities:		
Accounts receivable, net	(691,000)	878,000
Inventories, net	1,456,000	(1,157,000)
Prepaid expenses and other current assets	264,000	132,000
Accounts payable and accrued liabilities	(488,000)	(803,000)
Net cash provided by operating activities:	2,187,000	1,221,000
Cash Flows From Investing Activities:		
Purchase of property and equipment	(56,000)	(341,000)
Purchase of intangible assets	(43,000)	(37,000)
Net cash used in investing activities	(99,000)	(378,000)
Cash Flows From Financing Activities:		
Payments for the repurchase of common stock	(1,335,000)	
Income tax benefit from stock options exercised		189,000
Proceeds from the exercise of stock options		1,318,000
Net cash (used in) provided by financing activities	(1,335,000)	1,507,000
Increase in cash during the period	753,000	2,350,000
Cash and cash equivalents, beginning of period	4,064,000	1,837,000
Cash and cash equivalents, end of period	\$ 4,817,000	\$ 4,187,000

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

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Notes to Consolidated Financial Statements (Unaudited)

1. The Company

Alpha Pro Tech, Ltd. (Alpha Pro Tech , the Company) is in the business of protecting people, products and environments. The Company accomplishes this by developing, manufacturing and marketing a line of disposable protective apparel for the cleanroom, industrial and pharmaceutical markets, a line of infection control products for the medical and dental markets and a line of construction weatherization products. The disposable protective apparel consists of a complete line of shoe covers, bouffant caps, coveralls, gowns, frocks and lab coats. The infection control line of products includes a line of face masks and eye shields. The line of construction supply weatherization products consists of house wrap and synthetic roof underlayment. 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.

2. Basis of Presentation

The interim financial information included herein is unaudited; however, the information reflects all adjustments (consisting of normal recurring adjustments) that are, in the opinion of management, necessary for the fair presentation of the consolidated financial position, results of operations and cash flows for the interim periods. The consolidated financial statements should be read in conjunction with the current year 10-Q's and 8-K's, as well as the consolidated financial statements for the year ended December 31, 2007, which are included in the Company's Annual Report on Form 10-K (2007 10-K). The results of operations for the three and nine months ended September 30, 2008 are not necessarily indicative of the results to be expected for the full year. The consolidated balance sheet at December 31, 2007 was extracted from the audited consolidated financial statements contained in the 2007 10-K and does not include all disclosures required by accounting principles generally accepted in the United States of America for annual consolidated financial statements.

3. Stock Based Compensation

The Company maintains a stock option plan 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 (SFAS) 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. During the first nine months 2008 and 2007 there were 550,000 and 435,000 stock options granted, respectively, under the option plan. The Company recognized \$153,000 and

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\$104,000 in share-based compensation expense in its consolidated financial statements for the nine months ended September 30, 2008 and 2007, respectively related to previously issued options.

Stock options to purchase 1,870,000 and 1,460,000 shares of common stock were outstanding at September 30, 2008 and 2007, respectively. As of September 30, 2008 none of the outstanding stock options were included in the computation of diluted earnings per share because the exercise prices of all stock options were greater than the average share price of the Company's common stock and, therefore, there was no dilutive effect. Of the September 30, 2007 outstanding stock options totaling 1,460,000, all of the options to purchase common stock 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,

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Alpha Pro Tech, Ltd.

Notes to Consolidated Financial Statements (Unaudited)

the effect was dilutive.

The Company used the Black-Scholes-Merton option pricing model to value the options. Prior to 2008, The Company used the simplified method as discussed in Staff Accounting Bulletin (SAB) No.107, Share- Based Payment (SAB 107) for estimating the expected life of the options. For options granted during the quarter ended September 30, 2008 the Company used historical data to estimate 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 Company uses an estimated dividend payout ratio of zero as the Company has not paid dividends in the past and does not expect to in the future.

As of September 30, 2008, \$487,000 of total unrecognized compensation cost related to stock options is expected to be recognized over a weighted average period of 2.8 years.

4. New Accounting Standards

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157), which 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 157 was adopted by the Company on January 1, 2008. In February 2008, the FASB deferred for one year the effective date of SFAS 157 only with respect to nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis, and removed certain leasing transactions from the scope of SFAS 157. The adoption of SFAS 157 did not have a material impact on the Company's consolidated financial statements.

Financial Liabilities (SFAS 159). Under SFAS 159, companies may elect to measure certain financial instruments and certain other items at fair value. The standard requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007. SFAS 159 was adopted for fiscal 2008; however, the Company did not elect to apply the fair value option to any financial instruments or other items upon adoption of SFAS 159 or during the three months ended September 30, 2008. Therefore, the adoption of SFAS 159 did not impact the Company's consolidated financial position, results of operations or cash flows.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations, (SFAS 141R), which changes how business combinations are accounted for and will impact financial statements both on the acquisition date and in subsequent periods. SFAS 141R is effective January 1, 2009, and will be applied prospectively. The impact of adopting SFAS 141R will depend on the nature and terms of future

acquisitions.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements (SFAS 160), which changes the accounting and reporting standards for the noncontrolling interests in a subsidiary in consolidated financial statements. SFAS 160 recharacterizes minority interests as noncontrolling interests and requires noncontrolling interests to be classified as a component of shareholders equity. SFAS 160 is effective January 1, 2009 and requires retroactive adoption of the presentation and disclosure requirements for existing minority interests. The Company is currently evaluating the impact of SFAS 160 on the consolidated financial statements.

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In May 2008, the FASB issued SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles (SFAS 162). This Standard identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles. SFAS 162 directs the hierarchy to the entity, rather than the independent auditors, as the entity is responsible for selecting accounting principles for financial statements that are presented in conformity with generally accepted accounting principles. The Standard is effective 60 days following SEC approval of the Public Company Accounting Oversight Board amendments to remove the hierarchy of generally accepted accounting principles from the auditing standards. SFAS 162 is not expected to have an impact on the Company's financial condition, results of operations or cash flows

5. Inventories

Inventories consist of the following:

	September 30, 2008	December 31, 2007
Raw materials	\$ 9,049,000	\$ 10,175,000
Work in process	254,000	535,000
Finished goods	3,714,000	3,728,000
	13,017,000	14,438,000
Less reserve for slow-moving, obsolete or unusable inventory	(362,000)	(327,000)
	\$ 12,655,000	\$ 14,111,000

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.

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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 60,000 square-foot facility for the manufacturing of house wrap and other building products.

The Company is subject to the provisions of FASB Interpretation (FIN) No. 46R, Consolidation of Variable Interest Entities an Interpretation of ARB No. 51 (FIN 46R), which defines the criteria by which the Company determines the proper accounting for its investments in related entities. Specifically, FIN 46R 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 46R requires the Company to determine whether or not the Company is the primary beneficiary of the VIE, and if so, to consolidate the VIE.

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Notes to Consolidated Financial Statements (Unaudited)

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 (unaudited). The Company records its equity interest in Harmony's results of operations as Equity in income of unconsolidated affiliates on the accompanying Consolidated Income Statements (unaudited).

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 18). APB 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. The Company has concluded that no impairment was identified.

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 was to be repaid over a six year term commencing in July 2006 and the balance is to be paid in the seventh year. During 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. Harmony has not made any further payments to date. Effective April 2006, interest of 3.5% is to be paid annually on this advance. The Company has an interest receivable of \$27,000 as of September 30, 2008 related to this agreement.

Harmony commenced operations in August of 2005. For the nine months ended September 30, 2008 and 2007, the Engineered Products segment purchased \$1,484,000 and \$2,331,000, respectively from Harmony. For the nine months ended September 30, 2008 and 2007, the Disposable Protective Apparel segment purchased \$321,000 and \$0, respectively from Harmony. For the nine months ended September 30, 2008 and 2007, the Company recorded equity income in unconsolidated affiliates of \$123,000 and \$194,000, respectively. As of September 30, 2008, the Company's investment in Harmony is \$1,331,000 which comprises its original \$1,450,000 investment and cumulative equity in income of unconsolidated affiliates of \$381,000 less \$500,000 in repayments of the advance.

7. Accrued Liabilities

Accrued liabilities consist of the following:

	September 30, 2008		December 31, 2007	
Payroll	\$	165,000	\$	229,000
Commission and bonus accrual		409,000		706,000
Accrued professional fees		161,000		200,000
Accrued rebates and other		182,000		343,000
Income tax payable		318,000		
	\$	1,235,000	\$	1,478,000

8. Basic and Diluted Net Income Per Share

The following table provides a reconciliation of both net income and the number of shares used in the computation of basic earnings per share (EPS), which utilizes the weighted average number

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of shares outstanding without regard to potential shares, and diluted EPS, which includes all such dilutive shares:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
Net income (Numerator)	\$ 745,000	\$ 916,000	\$ 1,269,000	\$ 1,960,000
Shares (Denominator):				
Basic weighted average shares outstanding	24,720,617	25,626,172	24,979,837	25,240,202
Add: Dilutive effect of stock options		9,979		390,021
Diluted weighted average shares outstanding	24,720,617	25,636,151	24,979,837	25,630,223
Net income per share:				
Basic	\$ 0.03	\$ 0.04	\$ 0.05	\$ 0.08
Diluted	\$ 0.03	\$ 0.04	\$ 0.05	\$ 0.08

9. Activity of Business Segments

The Company operates through four segments:

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

Engineered Products: consisting of a line of construction supply weatherization. The construction supply weatherization products consist of house wrap and synthetic roof underlayment. The Company's equity in income (loss) of unconsolidated affiliates (Harmony) is included in the total segment income for Engineered Products in the table below.

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 with this material.

The accounting policies of the segments excludes charges allocated to corporate office expenses, professional fees, public company expenses, executive and management bonuses and income taxes. The Company evaluates the performance of its segments and allocates resources to them based primarily on net sales.

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The following table shows net sales for each segment for the three and nine months ended September 30, 2008 and 2007:

	For the Three Months Ended September 30,		For the Nine Month Ended September 30,	
	2008	2007	2008	2007
Disposable Protective Apparel	\$ 5,439,000	\$ 6,163,000	\$ 15,226,000	\$ 17,377,000
Engineered Products	3,155,000	1,407,000	6,439,000	4,253,000
Infection Control	1,456,000	1,514,000	4,384,000	5,078,000
Extended Care	167,000	224,000	605,000	793,000
Consolidated total net sales	\$ 10,217,000	\$ 9,308,000	\$ 26,654,000	\$ 27,501,000

The following table shows the reconciliation of total segment income to total consolidated net income for the three and nine months ended September 30, 2008 and 2007:

	For the Three Months Ended September 30,		For the Nine Month Ended September 30,	
	2008	2007	2008	2007
Disposable Protective Apparel	\$ 1,378,000	\$ 1,853,000	\$ 3,691,000	\$ 4,916,000
Engineered Products	535,000	(57,000)	343,000	(490,000)
Infection Control	583,000	674,000	1,670,000	2,185,000
Extended Care	(51,000)	(15,000)	(99,000)	(17,000)
Total segment income	2,445,000	2,455,000	5,605,000	6,594,000
Unallocated corporate expenses	(1,227,000)	(967,000)	(3,546,000)	(3,418,000)
Provision for income taxes	(473,000)	(572,000)	(790,000)	(1,216,000)
Consolidated net income	\$ 745,000	\$ 916,000	\$ 1,269,000	\$ 1,960,000

10. Subsequent Events

During the period of October 1, 2008 through October 31, 2008, the Company purchased 307,500 shares of its own common stock at a cost of \$ 369,000. These shares will be retired.

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ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion and analysis together with our consolidated financial statements (unaudited) and the notes to our consolidated financial statements (unaudited), which appear elsewhere in this report.

CAUTIONARY STATEMENTS REGARDING FORWARD-LOOKING INFORMATION

This report on Form 10-Q 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 include statements concerning plans, objectives, goals, strategies, future events, future revenues or performance, capital expenditures and other information that is not historical information. When used in this report, the words estimates, expects, anticipates, forecasts, plans, intends, believes and variations of such words or similar expressions are intended to identify forward-looking statements. Additional forward-looking statements may be made by us from time to time. All such subsequent forward-looking statements, whether written or oral and whether made by or on behalf of us, are also expressly qualified by these cautionary statements.

Our forward-looking statements are based upon our current expectations and various assumptions. Our expectations, beliefs and projections are expressed in good faith and we believe there is a reasonable basis for them, including without limitation, management's examination of historical operating trends, data contained in our records and other data available from third parties. However, we cannot assure you that management's expectations; beliefs and projections will result or be achieved or accomplished. Our forward-looking statements apply only as of the date made. Except as required by law, we undertake no obligation to publicly update or revise forward-looking statements which may be made to reflect events or circumstances after the date made or to reflect the occurrence of unanticipated events.

Where to find more information about us. 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 furnished or 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. In addition, we provide electronic or paper copies of our filings free of charge upon request.

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, if necessary, write down the difference between the cost of inventory and the estimated market value less cost to sell based upon assumptions about future sales and supply on-hand. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

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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: We adopted Statement of Financial Accounting Standards (SFAS) 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. For the nine months ended September 30, 2008 and September 30, 2007, 550,000 and 435,000 options were granted respectively. We recognized \$55,000 and \$153,000 in share-based compensation expense in our consolidated financial statements for the three and nine months ended September 30, 2008 related to options issued in prior periods. We recognized \$42,000 and \$104,000 in share-based compensation expense in our consolidated financial statements for the three and nine months ended September 30, 2007 related to options issued in prior periods.

The Company uses the Black-Scholes-Merton option pricing model, which was developed for use in estimating the fair value of traded options that have no vesting restrictions and that are fully transferable. 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. Prior to 2008, we used the simplified method as discussed in Staff Accounting Bulletin (SAB) No. 107, Share-Based Payment (SAB 107) for estimating the expected life of options. For options granted during the quarter ended September 30, 2008 the Company used historical data to estimate 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. We use an estimated dividend payout ratio of zero as we have not paid dividends in the past and do not expect to in the future.

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 clean room, industrial, pharmaceutical, medical and dental markets. We also manufacture a line of construction weatherization products and 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.

Our products 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.

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Our target markets are pharmaceutical manufacturing, bio-pharmaceutical manufacturing and medical device manufacturing, lab animal research, high technology electronics manufacturing which includes

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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 clean rooms, 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.

RESULTS OF OPERATIONS

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

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2008	2007	2008	2007
Sales	100.0%	100.0%	100.0%	100.0%
Gross profit	42.6%	47.2%	44.0%	46.7%
Selling, general and administrative	30.1%	31.7%	35.3%	34.8%
Income from operations	11.0%	14.3%	7.0%	10.6%
Income before provision for income taxes	11.9%	16.0%	7.7%	11.5%
Net income	7.3%	9.8%	4.8%	7.1%

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Three and nine months ended September 30, 2008, compared to the three and nine months ended September 30, 2007

Sales Consolidated sales for the three months ended September 30, 2008 increased to \$10,217,000 from \$9,308,000 for the three months ended September 30, 2007, representing an increase of \$909,000 or 9.8%. This increase consists of increased sales of Engineered Products segment of \$1,748,000, partially offset by decreased Disposable Protective Apparel products of \$724,000, decreased Infection Control segment sales of \$58,000 and decreased sales from our Extended Care products segment of \$57,000. Quarter over quarter sales this year has increased from \$7,524,000 in the first quarter to \$8,913,000 in the second quarter to \$10,217,000 in the third quarter of 2008.

Sales for the Disposable Protective Apparel segment for the three months ended September 30, 2008 decreased by \$724,000 or 11.7% to \$5,439,000 compared to \$6,163,000 for the same period of 2007. The decrease is primarily related to decreased sales to our largest distributor as well as lower sales to other clean room and industrial distributors, partially offset by increased sales to a major national distributor in which we received preferred vendor status during the first quarter of 2008. Although sales for this segment were down for the quarter, sales have increased quarter over quarter in the second and third quarters of this year.

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Engineered Products segment sales for the three months ended September 30, 2008 increased by \$1,748,000 or 124.2% to \$3,155,000 as compared to \$1,407,000 for the same period of 2007. The increase for the quarter is primarily due to a 258.9% or \$1,640,000 increase in sales of REX Synfelt synthetic roof underlayment and a 14.7% or \$108,000 increase in sales of REX Wrap house wrap. The sales for the first, second and third quarters of 2008 were \$1,360,000, \$1,924,000 and \$3,155,000 respectively. This segment had growth of 64.0% in the third quarter 2008 when compared to the second quarter of 2008 and growth of 41.5% in the second quarter of 2008 when compared to the first quarter of 2008.

REX Synfelt synthetic roof underlayment sales of \$2,308,000 was by far the highest quarterly sales since the inception of the product line, up from the previous record of \$996,000 in second quarter of 2008. As well, this was the second highest revenue quarter for REX Wrap house wrap since the first quarter of 2007, following only the second quarter of 2008. The sales mix of the Engineered Products sales for second quarter 2008 was: 72% synthetic roof underlayment and 28% house wrap, compared to 45% synthetic roof underlayment and 55% house wrap for third quarter 2007.

Our change in distribution channel strategy is starting to gain momentum as evidenced above. Our REX synthetic roof underlayment is being positively received as a cost effective and superior alternative to felt paper. Our ICC-ES approval for our REX Wrap house wrap significantly expands our market opportunities as many construction supply companies, builders and architects require this certification to sell the product. Although our house wrap sales are growing and we expect will continue to grow, the downturn in the housing market continues to affect our house wrap sales as fewer houses are being built and distributors continue to keep inventories low.

We continue to be optimistic that the new distribution channel strategy will broaden our ability to take advantage of market opportunities for house wrap and synthetic roof underlayment throughout the remainder of 2008 and in the future. We are currently working on opportunities with existing and new distributors and we are optimistic about the future of this segment.

Infection Control segment sales for the three months ended September 30, 2008 decreased by \$58,000 or 3.8% to \$1,456,000 compared to \$1,514,000 for the same period of 2007. Mask sales were down 2.6% and shield sales were down 7.5% when compared to last year's third quarter. Medical mask sales were down but were partially offset by higher dental and industrial mask sales. Mask sales in this segment for the balance of 2008 are expected to be similar to that of 2007. Shield sales are expected to increase considerably over the next three quarters as subsequent to quarter end, we received a \$1.7 million shield order from the same customer from which we received the non-recurring order from in the first quarter of 2007.

Sales from our Extended Care segment decreased by \$57,000 or 25.4% to \$167,000 for the three months ended September 30, 2008 from \$224,000 for the three months ended September 30, 2007. The decrease in sales is primarily the result of lower pet bed sales. This line of products is not expected to be a growth segment for the Company.

Consolidated sales for the nine months ended September 30, 2008 decr