MINE SAFETY APPLIANCES CO
Form S-3/A
June 22, 2004
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As filed with the Securities and Exchange Commission on June 22, 2004

Registration No. 333-114533

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

AMENDMENT NO. 3

TO

FORM S-3

REGISTRATION STATEMENT

UNDER THE SECURITIES ACT OF 1933

MINE SAFETY APPLIANCES COMPANY

(Exact name of Registrant as specified in its charter)

PENNSYLVANIA

(State or other jurisdiction of incorporation or organization)

25-0668780

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

121 Gamma Drive

RIDC Industrial Park

O Hara Township

Pittsburgh, PA 15238

(412) 967-3000

(Address, Including Zip Code, and Telephone Number, Including Area Code, of each Registrant s Principal Executive Offices)

John T. Ryan III

Chairman and Chief Executive Officer

121 Gamma Drive

RIDC Industrial Park

O Hara Township

Pittsburgh, PA 15238

(412) 967-3000

(Name, Address, Including Zip Code, and Telephone Number, Including Area Code, of Agent for Service)

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Approximate date of commencement of proposed sale to the public: As soon as practicable after this registration statement becomes effective.

If the only securities being registered on this Form are being offered pursuant to dividend or interest reinvestment plans, check the following box. ¨

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box. ¨

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box: ¨

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Amount to be Registered(1)	Proposed Maximum Offering Price Per Share(2)	Proposed Maximum Aggregate Offering Price(2)	Amount of Registration Fee(4)
Common Stock, no par value(3)	3,027,000 shares	$ 28.59	$ 86,541,930	$ 10,964.86

(1) Includes shares of common stock that the underwriters will have the right to purchase to cover over-allotments, if any.
(2) Estimated solely for the purpose of computing the amount of the registration fee pursuant to Rule 457(c) of the Securities Act of 1933, as amended, based on the average of the high and low prices per share of the registrant s common stock as reported on the American Stock Exchange on April 14, 2004.
(3) Includes preferred stock purchase rights, which prior to the occurrence of certain events, will not be exercisable or evidenced separately from the common stock.
(4) Previously paid in connection with the filing of the initial Registration Statement.

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until this registration statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.

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The information in this preliminary prospectus is not complete and may be changed. The selling shareholders may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This preliminary prospectus is not an offer to sell these securities and the selling shareholders are not soliciting an offer to buy these securities in any jurisdiction where the offer or sale is not permitted.

PRELIMINARY PROSPECTUS SUBJECT TO COMPLETION June 22, 2004

2,632,174 Shares

MINE SAFETY APPLIANCES COMPANY

Common Stock

The selling shareholders are offering 2,632,174 shares of our common stock. We will not receive any proceeds from the sale of the shares of our common stock sold by the selling shareholders.

Our common stock is listed on the American Stock Exchange, and we have applied to list our common stock on the New York Stock Exchange, under the symbol MSA. On June 10, 2004, the reported last sale price of our common stock on the American Stock Exchange was $34.00 per share.

Investing in our common stock involves a high degree of risk. Before buying any shares, you should carefully consider the risk factors described in Risk factors beginning on page 8.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

	Per Share	Total
Public offering price	$	$
Underwriting discounts and commissions	$	$
Proceeds, before expenses, to the selling shareholders	$	$

The underwriters may also purchase up to an additional 394,826 shares of common stock from one of the selling shareholders, the MSA Non-Contributory Pension Plan for Employees, at the public offering price, less underwriting discounts and commissions, within 30 days from the date of this prospectus. The underwriters may exercise this option only to cover over-allotments, if any. If the underwriters exercise the option in full, the total underwriting discounts and commissions will be $, and the total proceeds, before expenses, to the selling shareholders will be $.

The underwriters are offering the common stock as set forth under Underwriting. Delivery of the shares of common stock will be made in New York, New York on or about , 2004.

UBS Investment Bank

Robert W. Baird & Co. **KeyBanc Capital Markets**

The date of this prospectus is , 2004.

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You should only rely on the information contained or incorporated by reference in this prospectus. We have not and the underwriters have not authorized anyone to provide you with information different from that contained or incorporated by reference in this prospectus. The selling shareholders are offering to sell, and seeking offers to buy, shares of common stock only in jurisdictions where offers and sales are permitted. The information contained in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or of any sale of common stock.

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Forward-looking statements

This prospectus, including the sections entitled Prospectus summary, Risk factors, Management s discussion and analysis of financial condition and results of operations and Business, and the documents incorporated by reference in this prospectus contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements relate to future events or our future financial performance and involve known and unknown risks, uncertainties and other factors that may cause our or our industry s actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements. These risks and other factors include, among other things, those listed under Risk factors, and elsewhere in this prospectus and in the documents incorporated by reference in this prospectus. In some cases, you can identify forward-looking statements by words such as may, will, should, expects, intends, plans, anticipates, believes, estimates, predicts, potential, continue or the negative of these terms or other comparable words. These sta are only predictions and are not guarantees of future performance. Therefore, actual events or results may differ materially from those expressed or forecast in these forward-looking statements. In evaluating these statements, you should specifically consider various factors, including the risks outlined under Risk factors in this prospectus.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. We are under no duty to update publicly any of the forward-looking statements after the date of this prospectus whether as a result of new information, future events or otherwise.

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Prospectus summary

The following summary highlights selected information in this prospectus, but it may not contain all of the information that you should consider before deciding to invest in our common stock. You should read this prospectus carefully, including the Risk factors section and the consolidated financial statements, including the notes thereto, included elsewhere in this prospectus, as well as the documents incorporated by reference herein. In this prospectus, all references to we, us, our and MSA refer to Mine Safety Appliances Company and its subsidiaries, unless the context otherwise requires or it is otherwise indicated.

OVERVIEW

We are a global leader in the development, manufacture and supply of sophisticated products that protect people s health and safety. Sophisticated safety products typically integrate any combination of electronics, mechanical systems and advanced materials to protect users against hazardous or life threatening situations. Our comprehensive line of safety products are used by workers around the world in the fire service, homeland security, construction and other industries, as well as the military. This broad product offering includes self-contained breathing apparatus, or SCBAs, gas masks, gas detection instruments, head protection, respirators and thermal imaging devices. Additionally, we also provide a broad offering of consumer and contractor safety products through retail channels. Our net sales from continuing operations have increased from approximately $509.7 million in 2001 to approximately $696.5 million in 2003, a compound annual growth rate of 16.9%. Excluding the favorable currency exchange effects of approximately $36.6 million, our net sales from continuing operations have increased from approximately $509.7 million in 2001 to approximately $659.9 million in 2003, a compound annual growth rate of 13.8%. We achieved these results through growth in the markets we serve and increased penetration of those markets at a rate that we believe is greater than that of our peers.

We dedicate significant resources to research and development, which allows us to produce innovative, sophisticated safety products that are often first to market and exceed industry standards. Our global product development teams include cross-geographic and cross-functional members from various areas throughout the company, including research and development, marketing, sales, operations and quality management. Our engineers and technical associates work closely with the safety industry s leading standards-setting groups and trade associations, such as the National Institute for Occupational Safety and Health, or NIOSH, and the National Fire Protection Association, or NFPA, to develop industry product requirements and standards and anticipate their impact on our product lines. Evidencing our commitment to innovation, in 2003, we generated nearly one-third of our net sales from new products introduced over the prior three years.

We tailor our product offerings and distribution strategy to satisfy distinct customer preferences that vary across geographic regions. We believe that we best serve these customer preferences by organizing our business into the following three geographic segments: North America; Europe; and International. Our net sales from continuing operations for the quarter ended March 31, 2004 were approximately $129.6 million, $39.4 million and $25.5 million, and for the year ended December 31, 2003 were approximately $452.6 million, $146.2 million and $97.7 million, for the North America, Europe and International segments, respectively.

INDUSTRY BACKGROUND

We believe the worldwide personal protection equipment market, including the sophisticated safety products market in which we compete, generated net sales in excess of $5.0 billion in 2003. The industry supplying this market is broad and highly fragmented with few participants able to offer a comprehensive line of safety products. Generally, global demand for safety products has been stable

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because purchases of these products are non-discretionary since they protect workers in hazardous and life-threatening work environments and because their use is often mandated by government and industry regulations.

Several trends are reshaping the worldwide personal protection equipment market, including the following:

- *Heightened global awareness of and commitment to worker safety.*
- *Integration of electronics into safety products.*
- *Focus on domestic preparedness and homeland security.*

We believe that those developers, manufacturers and suppliers of safety products that can best meet the challenges and opportunities created by these industry trends will be best positioned to capture greater market share.

COMPETITIVE STRENGTHS

We believe the following strengths are critical to our success and continue to provide us with competitive advantages:

Strong, trusted and well-recognized brand representing a long-standing dedication to safety. Since 1914, we have been dedicated to protecting the health and safety of workers throughout the world. While our original customers were workers in the mining industry, we have evolved to supply the fire service, homeland security, construction and other industries and the military, as well as retail consumers and contractors, with high-quality, sophisticated safety products. The MSA brand, associated with durability and reliability, has helped us cultivate a loyal customer base. End-users have a strong preference for safety equipment from recognized manufacturers with a proven track record of producing quality products because they depend upon this equipment to protect them in hazardous or life-threatening situations.

Innovative product offering with expertise in safety and electronics integration. Over the course of our 90-year history of protecting people s health and safety, we have developed an expertise in creating both electronic instruments and safety products. We believe that the skills we have developed and our ability to create integrated products across these two areas of expertise provide us with a competitive advantage. We also benefit from the fact that we have the in-house engineering, technological and operational capabilities to integrate gas detection, communication and thermal imaging technologies with advanced respiratory and head protection products.

Diverse portfolio of safety products, sold to a wide range of end-users, across diverse geographic markets. We have a comprehensive line of personal safety products. MSA s broad range of products protect the health and safety of end-users in more than 120 countries in industries as diverse as manufacturing, chemical, steel, construction, hazardous materials, oil and gas, power plant, utility, shipbuilding, agricultural and paper, as well as sectors including first responders and the military. We believe that this end-market diversity helps mitigate the effects of an economic downturn in any particular industry or geographic region. We also have a diverse customer base, with no single non-military customer accounting for more than 2.0% of our 2003 net sales, and no single military customer accounting for more than 4.3% of our 2003 net sales. Our U.S. military customers, which are comprised of multiple U.S. government entities, including the U.S. Department of Defense, represented the largest group of military customers based on our 2003 net sales and accounted for approximately 12% of such sales.

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Strong relationships with leading safety equipment distributors in North America. We conduct a significant portion of our global sales through distributors, with virtually all non-military sales in North America being made through various industry distribution channels. We have developed strong strategic relationships with key safety products distributors in North America as a result of our dedicated sales force, our strong brand name and our broad product offering. To generate demand, our sales force works jointly with select distributors to call on end-users of our products to educate them about hazards, exposure limits, safety requirements and product applications, as well as specific performance requirements of our products. We believe this strategy allows us to deliver a customer value proposition that differentiates our products and services from those of our competitors resulting in increased customer loyalty and demand.

Ability to anticipate and adapt quickly to market requirements. The safety products market is constantly evolving as a result of regulatory bodies and standard-setting entities updating their requirements at five-year intervals, new hazard assessments and the integration of new technologies into personal protective equipment. This gives us an opportunity to develop, manufacture and often be the first to introduce new products to meet changes in standards and performance requirements. Because of our technological sophistication, our participation on global standard-setting bodies, our commitment to research and development and our knowledgeable sales organization, we believe we are well positioned to anticipate and adapt to the needs of changing product standards and gain the approvals and certifications necessary to meet new government and multi-national product regulations.

Experienced management team. We have an experienced senior management team. Our chairman and chief executive officer, John T. Ryan III, vice president and president of MSA North America, William M. Lambert, and vice president, chief financial officer and treasurer, Dennis L. Zeitler, have worked at MSA for approximately 35, 23 and 27 years, respectively. Under the leadership of these key members of management, we have successfully improved operations, integrated acquisitions and increased market share. Additionally, the top 80 members of our global management team have worked at MSA for an average of 18 years.

GROWTH STRATEGY

We are executing a targeted growth strategy designed to capitalize on our strong customer relationships, leverage our expertise in developing innovative products and improve our operational efficiency. Our growth strategy includes the following:

Identify and develop promising new markets. Our safety products have wide-ranging applications across many markets. We continue to identify, develop and produce safety products that meet the needs of attractive new markets where there are growing demands for MSA s safety solutions. We identify these new markets using criteria such as market size, growth potential, opportunities created by regulation and our ability to transfer existing technologies to new applications. We believe that we will be successful in developing new market opportunities as a result of our brand reputation, electronics expertise, adaptability, strong distributor relationships and the reliability and innovation of our designs.

Focus on innovation and new product introductions. Our focus on innovation and new product introductions allows us to provide unique safety solutions to customers with fast-to-market product development. We plan to continue to dedicate significant financial and human resources to research and development and to work closely with customers and potential customers to develop these solutions. Internally, we monitor our success in this area by measuring the percentage of annual net sales from new products introduced over the prior three years. In 2003, we generated nearly one-third of our net sales

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from new products, an achievement which represents an increasing trend for us over the past five years. Consistent with our prior performance, we expect to continue to focus our resources on a high-quality new product development pipeline with staged introductions over the coming three-to-five year period.

Further strengthen relationships with major distributors. We continue to invest in our sales organization and information technology systems in order to support and strengthen our distributor relationships. To better serve our customers, we are hiring market specialists and training them to have more specialized knowledge of our growing product lines. We are also organizing our sales force into teams in order to provide broader coverage of our distributors. In terms of information technology, we are further investing in our online ePartner Network and our SAP System, which we installed six years ago, so that we may continue to be recognized by our distributors as their most integrated vendor. We intend to further enhance our growth prospects by continuing to work closely with our distributors, understand their business needs and integrate our systems to improve the efficiency and effectiveness of the distribution supply chain management process.

Optimize factory performance and drive operational excellence. We have a successful track record of significantly improving operating margins. Our *DRIVE for Excellence* initiative focuses on process excellence, resulting in reduced costs, increased inventory turns, improved operations and more efficient and effective supply chain management processes. In addition, initiatives in Lean Sigma, a combination of Lean Manufacturing and Six Sigma programs, have continued to benefit our business. An immediate benefit from Lean Sigma is improved asset utilization and factory efficiency. We plan to further drive operational excellence through our efforts to capture and implement best practices at our facilities around the world. We intend to effect further process improvements and cost reductions through these shared best practices and by optimizing the use of our global manufacturing capacity.

Position international business to capture growth. Our international operations represent a key opportunity for our overall growth. The core international growth markets in which we currently have a presence are China, Australia, South Africa and Brazil. To accelerate our penetration of the Asia-Pacific region, our largest international market, we are focusing our international expansion efforts on new opportunities in countries such as Malaysia, Korea and Taiwan. The growth in our International segment is driven by a number of factors, including heightened awareness of worker safety needs, increased promulgation and enforcement of safety regulations and increased overseas manufacturing. We believe we will continue to benefit from these trends by expanding our already significant manufacturing, sales and customer service presence overseas.

Pursue strategic acquisitions. The safety products industry offers a broad range of products, is highly fragmented and is characterized by many product manufacturers that offer only single product lines. We have successfully acquired and integrated several complementary personal protection equipment companies. We maintain a strong balance sheet with sufficient liquidity to provide capital resources both to invest in the growth of our existing businesses and to allow us to move rapidly and with certainty when acquisition opportunities of interest arise in our industry. We intend to continue to selectively pursue acquisitions that will add complementary product offerings, provide access to new geographic markets and distribution channels and expand our technological capabilities.

PRINCIPAL EXECUTIVE OFFICES

MSA is a Pennsylvania corporation formed in 1914. Our principal executive offices are located at 121 Gamma Drive, RIDC Industrial Park, O Hara Township, Pittsburgh, Pennsylvania 15238, and our telephone number is (412) 967-3000. We maintain a website at www.msanet.com where general information about our business is available. The information contained in our website is not a part of this prospectus.

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The offering

Common stock being offered by the selling shareholders	2,632,174 shares
Common stock to be outstanding after this offering	40,610,059 shares
Use of proceeds	We will not receive any proceeds from the sale of shares offered by the selling shareholders. The selling shareholders will receive all net proceeds from the sale of shares of our common stock in this offering. See Use of proceeds.
American Stock Exchange symbol; proposed New York Stock Exchange symbol	MSA
Dividend policy	We currently pay a regular quarterly cash dividend. In 2003, we paid cash dividends totaling $0.26 per share of common stock. See Dividend policy for a discussion of the factors that will affect the determination by our board of directors to declare dividends, as well as other matters concerning our dividend distribution.

Unless otherwise indicated, common stock to be outstanding after this offering is based on 40,610,059 shares outstanding as of June 9, 2004, including 3,549,719 shares of common stock held by our Stock Compensation Trust. Earnings per share data presented in this prospectus excludes shares of common stock held by our Stock Compensation Trust. The shares held by our Stock Compensation Trust are available to satisfy our obligations under our stock incentive plans, which include 2,196,201 options granted to our officers and directors, 1,899,136 of which are currently exercisable or will become exercisable within 60 days. Except as otherwise indicated, the information in this prospectus assumes the underwriters over-allotment option is not exercised.

The selling shareholders in this offering include the MSA Non-Contributory Pension Plan for Employees, the Pittsburgh Oratory, John T. Ryan III, our chairman and chief executive officer, and certain members of the Ryan family. The 2,068,674 shares being offered by the MSA Pension Plan reflect approximately 79% of the common stock being offered hereby. As a result of the recent performance of our common stock, the trading price of which has increased approximately 200% in the last 12 months, the selling stockholders are offering their shares at this time for the purpose of diversifying their respective portfolios.

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Summary of selected financial data

The summary of our selected financial data set forth below for the years ended December 31, 1999, 2000, 2001, 2002 and 2003 and for the three months ended March 31, 2003 and 2004 and as of December 31, 2003 and March 31, 2004 should be read in conjunction with Selected historical financial data, Management s discussion and analysis of financial condition and results of operations, and our historical consolidated financial statements, including the respective notes thereto, appearing elsewhere or incorporated by reference in this prospectus. In the opinion of management, the interim financial information presented below includes all adjustments (consisting of normal recurring accruals) necessary for a fair presentation of our results of operations and financial position for such periods. Interim results are not necessarily indicative of full year results. All share and per share information in this prospectus has been adjusted to reflect the 3-for-1 stock splits of our common stock effected on May 24, 2000 and January 28, 2004.

Statement of operations data:	Years ended December 31,					For the three months ended March 31,	
	1999	2000	2001	2002	2003	2003	2004
	(dollars in thousands, except per share data)						
Net sales	$ 462,166	$ 468,307	$ 509,736	$ 564,426	$ 696,473	$ 160,391	$ 194,490
Other income	3,619	2,444	2,776	2,271	1,724	96	786
Cost of products sold(a)	282,687	277,972	292,940	331,215	408,219	93,853	109,331
Selling, general and administrative(a)	131,281	124,840	130,092	140,924	170,081	39,096	47,730
Research and development	15,235	15,988	16,740	20,372	21,722	5,042	5,215
Depreciation and amortization	20,550	20,936	22,590	21,525	23,208	5,393	5,820
Interest expense	3,916	4,040	5,349	4,769	4,564	1,119	514
Currency exchange (gains) losses	(694)	(444)	1,197	(191)	(3,356)	(1,150)	667
Provision for income taxes	3,098	8,531	17,753	16,870	24,835	6,635	9,861
Net income from continuing operations	9,712	18,888	25,851	31,213	48,924	10,499	16,138
Net income from discontinued operations(b)	6,614	4,351	5,780	3,864	2,685	1,514	
Gain on sale of discontinued operations after tax(b)					13,658		
Change in reporting period, net of tax(c)	(1,192)						
Net income	$ 15,134	$ 23,239	$ 31,631	$ 35,077	$ 65,267	$ 12,013	$ 16,138
Earnings per share data:							
Basic per common share continuing operations	$ .22	$ .51	$ .72	$ .85	$ 1.33	$ .29	$ .44
Diluted per common share continuing operations	.22	.51	.71	.85	1.31	.29	.43
Dividends paid per common share	.15	.16	.18	.22	.26	.06	.07
Weighted average number of common shares outstanding basic	38,917	36,904	35,729	36,512	36,730	36,631	36,964

(footnotes on following page)

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Balance sheet data:	As of December 31, 2003	As of March 31, 2004
	(dollars in thousands, except per share data)	
Working capital(d)	$ 206,216	$ 221,521
Working capital ratio(d)	2.8	2.9
Net property	120,560	120,069
Total assets(e)	643,885	663,428
Long-term debt	59,915	59,717
Common shareholders equity	306,867	320,887
Equity per common share	8.31	8.67

(a) Noncash pension income, pre-tax, was approximately $10.2 million, $14.9 million, $15.0 million, $13.1 million and $8.8 million for the years ended December 31, 1999, 2000, 2001, 2002 and 2003, respectively. These represent the aggregate amounts included in costs of products sold and selling, general and administrative expenses.

(b) On September 12, 2003, we sold certain assets of the Callery Chemical Division to BASF Corporation for approximately $64.6 million. The operating results of the Callery Chemical Division and the gain on the sale of such division have been classified as discontinued operations for all periods presented, except for the three months ended March 31, 2004. Net income from discontinued operations for 2002 includes approximately $42,000 of expenses directly related to the sale of the division.

(c) In 1999, the fiscal year end for certain international affiliates was changed from November 30th to December 31st. The after-tax effect of the change in reporting period is included in the 1999 income statement as a change in accounting principle.

(d) Working capital at December 31, 2003 excludes assets held for sale.

(e) Total assets include approximately $2.3 million of assets held for sale at December 31, 2003.

Risk factors

You should carefully consider the risks described below together with all of the other information contained or incorporated by reference in this prospectus before you decide to invest in our common stock. If any of the following risks actually occur, our business, financial condition or results of operations could suffer. In that event, the trading price of our common stock could decline, and you may lose all or part of your investment.

RISKS RELATED TO OUR BUSINESS

A reduction in the spending patterns of government agencies could materially and adversely affect our net sales, earnings and cash flow.

The demand for our products sold to the fire services industry, the homeland security market and to U.S. government agencies, including the Department of Defense, is, in large part, driven by available government funding. The level of government funding in these areas has increased significantly since the tragedies of September 11, 2001 and has fueled the demand for many of our products such as SCBAs and gas masks. Approximately 12%, or $83.7 million, of our net sales for the year ended December 31, 2003 were made directly to U.S. government entities, including the Department of Defense. As of April 15, 2004, we had three firm fixed-price contracts with an aggregate value exceeding $78.0 million with the U.S. Army to produce Advanced Combat Helmets. Government budgets are set annually and we cannot assure you that government funding will be sustained at the same level in the future. A significant reduction in available government funding in the future could materially and adversely affect our net sales, earnings and cash flow.

The markets in which we compete are highly competitive, and some of our competitors have greater financial and other resources than we do. The competitive pressures faced by us could materially and adversely affect our business, results of operations and financial condition.

The safety products market is highly competitive, with participants ranging in size from small companies focusing on single types of safety products, to large multinational corporations that manufacture and supply many types of safety products. Our main competitors vary by region and product. We believe that participants in this industry compete primarily on the basis of product characteristics (such as functional performance, agency approvals, design and style), price, brand name trust and recognition, and customer service. Some of our competitors have greater financial and other resources than we do and our cash flows from operations could be adversely affected by competitors new product innovations, technological advances made to competing products and pricing changes made by us in response to competition from existing or new competitors. We may not be able to compete successfully against current and future competitors and the competitive pressures faced by us could materially and adversely affect our business, results of operations and financial condition.

If we fail to introduce successful new products or extend our existing product lines, we may lose our market position and our financial performance may be materially and adversely affected.

In the safety products market, there are frequent introductions of new products and product line extensions. If we are unable to identify emerging consumer and technological trends, maintain and improve the competitiveness of our products and introduce new products, we may lose our market position, which could have a material adverse effect on our business, financial condition and results of operations. In 2003, approximately 30% of our net sales came from products that we introduced in the prior three years. Although we continue to invest significant resources in research and development and market research, continued product development and marketing efforts are subject to the risks inherent in the development of new products and product line extensions, including development delays, the failure of new products and product line extensions to achieve anticipated levels of market acceptance and the cost of failed product introductions.

Product liability claims could have a material adverse effect on our business, operating results and financial condition.

We face an inherent business risk of exposure to product liability claims arising from the alleged failure of our products to prevent the types of personal injury or death against which they are designed to protect. Although we have not experienced any material uninsured losses due to product liability claims, it is possible that we could experience material losses in the future.

We are presently named as a defendant in approximately 1,850 lawsuits primarily involving respiratory protection products allegedly manufactured and sold by us. Collectively, these lawsuits represent a total of approximately 30,000 plaintiffs. Approximately 85% of these lawsuits involve plaintiffs alleging they suffer from silicosis, with the remainder alleging they suffer from other or combined injuries, including asbestosis. These lawsuits typically allege that these conditions resulted in part from respirators that were negligently designed or manufactured by us. Consistent with the experience of other companies involved in silica and asbestos-related litigation, there has been an increase in the number of asserted claims that could potentially involve us. We cannot determine our potential liability, if any, for such claims, in part because the defendants in these lawsuits are often numerous, the claims generally do not specify the amount of damages sought and our product s involvement is speculative. With some limited exceptions, we maintain insurance against product liability claims and reserves for uninsured product liability claims, but it is possible that our insurance coverage will not continue to be available on terms acceptable to us or that such coverage or our reserves, as the case may be, will not be adequate for liabilities actually incurred.

In the event any of our products prove to be defective, we could be required to recall or redesign such products. In addition, we may voluntarily recall or redesign certain products that could potentially be harmful to end users. A successful claim brought against us in excess of available insurance coverage, or any claim or product recall that results in significant expense or adverse publicity against us, could have a material adverse effect on our business, operating results and financial condition.

Our ability to market and sell our products is subject to existing regulations and standards. Changes in such regulations and standards or our failure to comply with them could materially and adversely affect our results of operations.

Most of our products are required to meet performance and test standards designed to protect the health and safety of people around the world. Our inability to comply with these standards may materially and adversely affect our results of operations. Changes in regulations could reduce the demand for our products or require us to reengineer our products, thereby creating opportunities for our competitors. Regulatory approvals for our products may be delayed or denied for a variety of reasons that are outside of our control.

We have significant international operations, and we are subject to the risks of doing business in foreign countries.

We have significant business operations in approximately 27 foreign countries. In 2003, approximately 35% of our net sales were made by operations located outside the United States. Our international

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operations are subject to various political, economic and other risks and uncertainties, which could adversely affect our business. These risks include the following:

Ø unexpected changes in regulatory requirements;

Ø currency exchange rate fluctuations;

Ø changes in trade policy or tariff regulations;

Ø changes in tax laws and regulations;

Ø intellectual property protection difficulties;

Ø difficulty in collecting accounts receivable;

Ø complications in complying with a variety of foreign laws and regulations, some of which conflict with U.S. laws;

Ø increased international instability or potential instability of foreign governments;

Ø the need to take extra security precautions for our international operations; and

Ø costs and difficulties in managing culturally and geographically diverse international operations.

Any one or more of these risks could have a negative impact on the success of our international operations and thereby materially and adversely affect our business as a whole.

Our future results are subject to availability of, and fluctuations in the costs of, purchased components and materials due to market demand, currency exchange risks, material shortages and other factors.

We depend on various components and materials to manufacture our products. Although we have not experienced any difficulty in obtaining components and materials, it is possible that any of our supplier relationships could be terminated. Any sustained interruption in our receipt of adequate supplies could have a material adverse effect on our business, results of operations and financial condition. While we attempt to minimize volatility in component and material pricing primarily by negotiating longer-term supply agreements with fixed prices or fixed price ranges and maintaining multiple sources of key materials, we cannot assure you that we will be able to successfully manage price fluctuations due to market demand, currency risks or material shortages, or that future price fluctuations will not have a material adverse effect on our business, results of operations and financial condition.

If we lose any of our key personnel or are unable to attract, train and retain qualified personnel, our ability to manage our business and continue our growth would be negatively impacted.

Our success depends in large part on the continued contributions of our key management, engineering and sales and marketing personnel, many of whom are highly skilled and would be difficult to replace. Our success also depends on the abilities of new personnel to function effectively, both individually and as a group. If we are unable to attract, effectively integrate and retain management, engineering or sales and marketing personnel, then the execution of our growth strategy and our ability to react to changing market requirements may be impeded, and our business could suffer as a result. Competition for personnel is intense, and we cannot assure you that we will be successful in attracting and retaining qualified personnel. In addition, we do not currently maintain key person life insurance.

We are subject to various environmental laws and any violation of these laws could adversely affect our results of operations.

We are subject to federal, state and local laws, regulations and ordinances relating to the protection of the environment, including those governing discharges to air and water, handling and disposal practices

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Risk factors

for solid and hazardous wastes, and the maintenance of a safe workplace. These laws impose penalties for noncompliance and liability for response costs and certain damages resulting from past and current spills, disposals or other releases of hazardous materials. We could incur substantial costs as a result of noncompliance with or liability for cleanup pursuant to these environmental laws. We have identified several known and potential environmental liabilities, which we do not believe are material. Environmental laws have changed rapidly in recent years, and we may be subject to more stringent environmental laws in the future. If more stringent environmental laws are enacted, these future laws could have a material adverse effect on our results of operations.

Our inability to successfully identify, consummate and integrate future acquisitions or to realize anticipated cost savings and other benefits could adversely affect our business.

One of our key operating strategies is to selectively pursue acquisitions. Any future acquisitions will depend on our ability to identify suitable acquisition candidates and successfully consummate such acquisitions. Acquisitions involve a number of risks including:

Ø failure of the acquired businesses to achieve the results we expect;

Ø diversion of our management s attention from operational matters;

Ø our inability to retain key personnel of the acquired businesses;

Ø risks associated with unanticipated events or liabilities;

Ø potential disruption of our existing business; and

Ø customer dissatisfaction or performance problems at the acquired businesses.

If we are unable to integrate or successfully manage businesses that we may acquire in the future, we may not realize anticipated cost savings, improved manufacturing efficiencies and increased revenue, which may result in material adverse short- and long-term effects on our operating results, financial condition and liquidity. Even if we are able to integrate the operations of our acquired businesses into our operations, we may not realize the full benefits of the cost savings, revenue enhancements or other benefits that we may have expected at the time of acquisition. In addition, even if we achieve the expected benefits, we may not be able to achieve them within the anticipated time frame, and such benefits may be offset by costs incurred in integrating the companies and increases in other expenses.

Because we derive a significant portion of our sales from the operations of our foreign subsidiaries, future exchange rate fluctuations may adversely affect our results of operations and financial condition and may affect the comparability of our results between financial periods.

For the year ended December 31, 2003, our operations in our Europe and International segments accounted for 21% and 14% of our net sales, respectively. The results of our foreign operations are reported in the local currency and then translated into U.S. dollars at the applicable exchange rates for inclusion in our consolidated financial statements. The exchange rates between some of these currencies and the U.S. dollar have fluctuated significantly in recent years and may continue to do so in the future. In addition, because our financial statements are stated in U.S. dollars, such fluctuations may affect our results of operations and financial position and may affect the comparability of our results between financial periods. For example, net sales generated by our Europe segment were $146.2 million in 2003, an increase of $23.8 million, or 19%, from $122.4 million in 2002. When stated in U.S. dollars,

Risk factors

approximately half of the sales increase in Europe was due to the favorable currency translation effects of the stronger Euro. We cannot assure you that we will be able to effectively manage our exchange rate risks or that any volatility in currency exchange rates will not have a material adverse effect on our results of operations and financial condition.

Our continued success depends on our ability to protect our intellectual property. If we are unable to protect our intellectual property, our net sales could be materially and adversely affected.

Our success depends, in part, on our ability to obtain and enforce patents, maintain trade secret protection and operate without infringing on the proprietary rights of third parties. We have been issued patents and have registered trademarks with respect to many of our products, but our competitors could independently develop similar or superior products or technologies, duplicate any of our designs, trademarks, processes or other intellectual property or design around any processes or designs on which we have or may obtain patents or trademark protection. In addition, it is possible that third parties may have, or will acquire, licenses for patents or trademarks that we may use or desire to use, so that we may need to acquire licenses to, or to contest the validity of, such patents or trademarks of third parties. Such licenses may not be made available to us on acceptable terms, if at all, and we may not prevail in contesting the validity of third party rights.

In addition to patent and trademark protection, we also protect trade secrets, know-how and other confidential information against unauthorized use by others or disclosure by persons who have access to them, such as our employees, through contractual arrangements. These agreements may not provide meaningful protection for our trade secrets, know-how or other proprietary information in the event of any unauthorized use, misappropriation or disclosure of such trade secrets, know-how or other proprietary information. If we are unable to maintain the proprietary nature of our technologies, our results of operations and financial condition could be materially and adversely affected.

RISKS RELATED TO OUR COMMON STOCK

The market price of our common stock may fluctuate substantially, which could cause the value of your investment to decline.

Securities markets experience significant price and volume fluctuations. This market volatility, as well as general economic or political conditions, could reduce the market price of our common stock. In addition, if our financial results are below the expectations of securities analysts and investors, the market price of our common stock could decrease significantly. Broad market and industry factors may also negatively affect the price of our common stock, regardless of our operating performance. As a result, you may be unable to resell your shares of our common stock at or above the public offering price.

Future sales of our common stock may depress the market price of our common stock.

We cannot predict what effect, if any, future sales of our common stock, or the availability of our common stock for future sale, will have on its market price. Sales of substantial amounts of our common stock in the public market following this offering, or the perception that such sales could occur, could adversely affect its market price and may make it more difficult for you to sell your common stock at a time and price which you deem appropriate. As of June 9, 2004, 37,060,340 shares of common stock were outstanding, excluding 3,549,719 shares of common stock held by our Stock Compensation Trust. The shares held by our Stock Compensation Trust are available to satisfy our obligations under our stock incentive plans, which include 2,196,201 options granted to our officers and directors, 1,899,136 of which are currently exercisable or will become exercisable within 60 days. In addition, the number of shares of common stock outstanding includes 171,385 shares of common stock which are not currently freely tradable but which may be eligible for resale from time to time subject to the volume, manner of sale and other conditions of Rule 144 under the Securities Act of 1933.

We, our directors and executive officers and each selling shareholder have agreed with the underwriters, subject to limited exceptions, not to sell, offer to sell, contract or agree to sell, hedge or otherwise dispose of, directly or indirectly, any shares of our common stock or securities convertible into or exercisable or exchangeable for shares of common stock, or warrants or other rights to purchase shares of common stock from the date of the initial filing of the registration statement of which this prospectus forms a part and until after the date that is 90 days after the date of this prospectus without the prior written consent of UBS Securities LLC. See Underwriting.

The interests of our executive officers and directors who own a significant percentage of our common stock may conflict with our interests or your interests as our public shareholders.

Following this offering, our executive officers, directors, and their family members and direct affiliates will beneficially own approximately 45.1% (or 43.1% if the underwriters exercise their over-allotment option in full) of our outstanding common stock. As a result, these shareholders, if they act together, will exert significant influence over all matters requiring shareholder approval, including the election and removal of our directors, any merger, consolidation or sale of all or substantially all of our assets, as well as any charter amendment and other matters requiring shareholder approval. In addition, there could be potential conflicts of interest when our directors and officers are faced with decisions that could have different implications for our company than for themselves in their capacity as shareholders. There are no specific policies in place with respect to any conflicts that may arise, except those adopted by our audit committee pursuant to the Sarbanes-Oxley Act of 2002 and the rules of New York Stock Exchange, on which our common stock will be listed. We expect conflicts to be resolved on a case-by-case basis, and in a manner consistent with applicable law. We cannot assure you that conflicts will not be resolved in a manner adverse to us, which could harm our business.

Certain provisions in our articles of incorporation and bylaws, as well as Pennsylvania corporate law and our shareholders rights plan may discourage a takeover attempt.

Certain provisions in our restated articles of incorporation and amended by-laws, as well as Pennsylvania corporate law and our shareholders rights plan may delay or prevent a change in control, discourage bids at a premium over the market price of our common stock and adversely affect the market price of our common stock and the voting and other rights of the holders of our common stock. These provisions include:

Ø dividing our board of directors into three classes serving staggered three-year terms;

Ø prohibiting our shareholders from calling a special meeting of shareholders;

Ø requiring advance notice for raising matters of business or making nominations at shareholders meetings;

- prohibiting the removal of directors without cause; and
- prohibiting shareholders action by written consent.

We have also implemented a shareholder rights plan which could make an unsolicited takeover more difficult. As a result, all of these provisions may deprive you of the opportunity to sell your shares to potential acquirers at a premium over prevailing market prices. This potential inability to obtain a control premium could reduce the market price of our common stock.

Use of proceeds

We will not receive any proceeds from the sale of shares of our common stock offered by the selling shareholders. The selling shareholders will receive all net proceeds from the sale of shares of our common stock in this offering.

Price range of common stock and dividend payments

Our common stock is listed on the American Stock Exchange under the symbol MSA. The following table sets forth, for the periods indicated, the high and low sales prices per share as reported on the American Stock Exchange and the dividends paid or declared by us on our common stock.

	Price Range of Our Common Stock		Dividend
	High	Low	/Share
Fiscal year ended December 31, 2001			
First Quarter	$ 8.55	$ 7.33	$ .04
Second Quarter	11.42	8.48	.04
Third Quarter	15.97	10.12	.05
Fourth Quarter	17.30	10.70	.05
Fiscal year ended December 31, 2002			
First Quarter	14.40	11.78	.04
Second Quarter	16.83	11.67	.06
Third Quarter	13.58	10.63	.06
Fourth Quarter	13.08	9.13	.06
Fiscal year ended December 31, 2003			
First Quarter	12.44	10.17	.06
Second Quarter	14.99	11.76	.06
Third Quarter	19.58	14.21	.07
Fourth Quarter	28.83	17.71	.07
Fiscal year ended December 31, 2004			
First Quarter	31.92	21.37	.07

The last reported sale price of our common stock on the American Stock Exchange on June 10, 2004 was $34.00 per share. As of such date, there were 360 registered holders of our shares of common stock.

Dividend policy

We currently pay a regular quarterly cash dividend on our common stock. For the first quarter of 2004, we paid a cash dividend at a rate of $0.07 per share of common stock. While we have declared a dividend in each of the prior 86 years, the declaration and payment of future dividends to holders of our common stock will be at the discretion of our board of directors and will depend upon many factors, including our results of operations, cash requirements, financial condition, legal requirements and other factors that our board of directors may deem relevant.

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Selected historical consolidated financial data

The following selected financial data should be read in conjunction with our consolidated financial statements, including the respective notes thereto, as well as the section entitled Management s discussion and analysis of financial condition and results of operations, included elsewhere in this prospectus. The statement of operations data for the fiscal years ended December 31, 2001, 2002 and 2003 and the balance sheet data as of December 31, 2002 and 2003 are derived from our consolidated financial statements that have been audited by PricewaterhouseCoopers LLP, independent registered public accounting firm, and which are included elsewhere or incorporated by reference in this prospectus. The statement of operations data for the three months ended March 31, 2003 and 2004 and the balance sheet data as of March 31, 2004 are derived from our unaudited consolidated condensed financial statements included elsewhere in the prospectus. In the opinion of management, the interim financial information presented below includes all adjustments (consisting of normal returning accruals) necessary for a fair presentation of our results of operations and financial position for such periods. Interim results are not necessarily indicative of full year results. The statement of operations data for the fiscal years ended December 31, 1999 and 2000 and the balance sheet data as of December 31, 1999, 2000 and 2001 are derived from our consolidated financial statements that have been audited by PricewaterhouseCoopers LLP, independent registered public accounting firm, which are not included in this prospectus.

Statement of operations data:	**Years ended December 31,**					**For the three months ended March 31,**	
	1999	**2000**	**2001**	**2002**	**2003**	**2003**	**2004**
			(dollars in thousands, except per share data)				
Net sales	$ 462,166	$ 468,307	$ 509,736	$ 564,426	$ 696,473	$ 160,391	$ 194,490
Other income	3,619	2,444	2,776	2,271	1,724	96	786
Cost of products sold(a)	282,687	277,972	292,940	331,215	408,219	93,853	109,331
Selling, general and administrative(a)	131,281	124,840	130,092	140,924	170,081	39,096	47,730
Research and development	15,235	15,988	16,740	20,372	21,722	5,042	5,215
Depreciation and amortization	20,550	20,936	22,590	21,525	23,208	5,393	5,820
Interest expense	3,916	4,040	5,349	4,769	4,564	1,119	514
Currency exchange (gains) losses	(694)	(444)	1,197	(191)	(3,356)	(1,150)	667
Provision for income taxes	3,098	8,531	17,753	16,870	24,835	6,635	9,861
Net income from continuing operations	9,712	18,888	25,851	31,213	48,924	10,499	16,138
Net income from discontinued operations(b)	6,614	4,351	5,780	3,864	2,685	1,514	
Gain on sale of discontinued operations after tax(b)					13,658		
Change in reporting period, net of tax(c)	(1,192)						
Net income	$ 15,134	$ 23,239	$ 31,631	$ 35,077	$ 65,267	$ 12,013	$ 16,138

(footnotes on following page)

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Selected historical consolidated financial data

	Years ended December 31,					For the three months ended March 31,	
	1999	2000	2001	2002	2003	2003	2004
	(dollars in thousands, except per share data)						
Earnings per share data:							
Basic per common share continuing operations	$ .22	$ .51	$ .72	$ .85	$ 1.33	$ .29	$ .44
Diluted per common share continuing operations	.22	.51	.71	.85	1.31	.29	.43
Dividends paid per common share	.15	.16	.18	.22	.26	.06	.07
Weighted average number of common shares outstanding basic	38,917	36,904	35,729	36,512	36,730	36,631	36,964

	As of December 31,					As of March 31,
Balance sheet data:	1999	2000	2001	2002	2003	2004
	(dollars in thousands, except per share data)					
Working capital(d)	$ 123,085	$ 114,175	$ 135,186	$ 138,182	$ 206,216	$ 221,521
Working capital ratio(d)	2.5	2.3	2.6	2.4	2.8	2.9
Net property	163,509	159,586	156,413	130,407	120,560	120,069
Total assets(e)	451,741	489,683	520,698	579,765	643,885	663,428
Long-term debt	36,550	71,806	67,381	64,350	59,915	59,717
Common shareholders equity	241,374	225,382	252,451	288,009	306,867	320,887
Equity per common share	6.25	6.35	6.95	7.86	8.31	8.67

(a) Noncash pension income, pre-tax, was approximately $10.2 million, $14.9 million, $15.0 million, $13.1 million and $8.8 million for the years ended December 31, 1999, 2000, 2001, 2002 and 2003, respectively. These represent the aggregate amounts included in costs of products sold and sales, general and administrative expenses.

(b) On September 12, 2003, we sold certain assets of the Callery Chemical Division to BASF Corporation for approximately $64.6 million. The operating results of the Callery Chemical Division and the gain on the sale of such division have been classified as discontinued operations for all periods presented, except for the three months ended March 31, 2004. Net income from discontinued operations for 2002 includes approximately $42,000 of expenses directly related to the sale of the division.

(c) In 1999, the fiscal year end for certain international affiliates was changed from November 30th to December 31st. The after-tax effect of the change in reporting period is included in the 1999 income statement as a change in accounting principle.

(d) Working capital at December 31, 2003 excludes assets held for sale.

(e) Total assets include approximately $2.3 million of assets held for sale at December 31, 2003.

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Management s discussion and analysis of financial condition and results of operations

The following discussion and analysis should be read in conjunction with the historical financial statements and other financial information included elsewhere or incorporated by reference in this prospectus, including Selected historical consolidated financial data. This discussion contains forward-looking statements that involve risks and uncertainties. The forward-looking statements are not historical facts, but rather are based on current expectations, estimates, assumptions and projections about our industry, business and future financial results. Our actual results could differ materially from the results contemplated by these forward-looking statements due to a number of factors, including those discussed in the sections of this prospectus entitled Risk factors, Forward-looking statements and other sections in this prospectus.

BUSINESS OVERVIEW

We are a global leader in the development, manufacture and supply of sophisticated products that protect people s health and safety. In recent years, we have concentrated on specific initiatives intended to help improve our competitive position and profitability, including:

Ø identify and develop promising new markets;

Ø focus on innovation and new product introductions;

Ø further strengthen relationships with major distributors;

Ø optimize factory performance and drive operational excellence;

Ø position international business to capture growth; and

Ø pursue strategic acquisitions.

We tailor our product offerings and distribution strategy to satisfy distinct customer preferences that vary across geographic regions. We believe that we best serve these customer preferences by organizing our business into three geographic segments: North America, Europe, and International. Each segment includes a number of operating companies. In 2003, approximately 65%, 21% and 14% of our net sales from continuing operations were made by our North America, Europe and International Segments, respectively.

North America. Our largest manufacturing and research and development facilities are located in the United States. We serve our North American markets with sales and distribution functions in the U.S., Canada, and Mexico.

Europe. Our Europe segment, comprising 11 operating entities, includes well-established companies in most Western European countries, and more recently established operations in a number of Eastern European locations. Our largest European companies, based in Germany and France, develop, manufacture, and sell a wide variety of products. Operations in other European countries focus primarily on sales and distribution in their respective home country markets. While some of these companies may perform limited production, most of their sales are of products that are manufactured in our plants in Germany, France, and the U.S., or purchased from third party vendors.

International. Our International segment comprises 13 operating entities located in Abu Dhabi, Argentina, Australia, Brazil, Chile, China, India, Japan, Malaysia, Peru, Singapore, South Africa and Zimbabwe, some of which are in developing regions of the world. Principal manufacturing operations are located in Australia, Brazil, South Africa, and China. These companies develop and manufacture products that are sold primarily in each company s home country and regional markets. The other companies in the International segment focus primarily on sales and distribution in their respective home country markets. While some of these companies may perform limited production, most of their sales are of products that are manufactured in our plants in the U.S., Germany and France, or purchased from third party vendors.

Because some of the countries that comprise our International segment are located in developing regions of the world, several factors have the potential to adversely affect our international operations and our financial results, including:

- significant changes in economic, social, political, monetary or trade policies of the governments of countries that comprise our International segment, as well as political or social unrest in those countries;
- trade protection measures and price controls;
- trade sanctions and embargos; and
- nationalization and expropriation.

These events are infrequent and unpredictable. However, it is highly unlikely that such events will occur simultaneously in several or all of the countries that comprise our International segment. We believe that our exposure is not material since, with the exception of Australia, which represents approximately 5% of our net sales, no individual international affiliate represents more than 3% of our total assets, net sales or gross profits.

Because our financial statements are stated in U.S. dollars, currency fluctuations may affect our results of operations and financial position and may affect the comparability of our results between financial periods. We manage our exchange rate risks primarily by sourcing our products in the same currency as our customer pays us. In the few instances where product cost and product payment are not in the same currency and such mismatch creates a material exchange rate risk, we use foreign currency forward contracts. On a global basis, we have a broad based balance sheet exposure to numerous currencies that serves to minimize the impact of fluctuations in any one currency.

In 2003, we achieved record sales and net income from continuing operations for the third consecutive year. We believe that this performance and our improving financial performance in recent years are the result of initiatives that have allowed us to anticipate and respond quickly to market requirements, particularly in the fire service, homeland security, construction and general industries, as well as the military. We believe that sales growth in the fire service market reflects our ability to quickly bring to market products that comply with changing industry standards and to create new market demand with innovative products. For example, we have successfully responded to increased homeland security and military market demand for products such as the Millennium Chemical-Biological Mask and the MCU-2/P gas masks and the Advanced Combat Helmet that has occurred since the September 11th attacks and during the ongoing war on terrorism. Additionally, in 2003, we developed our Solaris handheld multi-gas detector and brought it from concept-to-customer in only 10 months in response to the gas detection needs of our industrial and petrochemical customers. Demand in the homeland security and military markets has more than offset continuing sluggishness in North American industrial markets.

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Management s discussion and analysis of financial condition and results of operations

The level of demand for our products in the fire service, homeland security and military markets is strongly influenced by the levels of government funding available to address the needs of first responders and to meet the requirements of military operations. A reduction in available government funding in the future could adversely affect the demand for our products in these markets.

Our results in Europe improved modestly in 2003, but continue to suffer from the effects of the poor economic climate in Western Europe. Our acquisition of CGF Gallet in 2002, now MSA Gallet, added the leading line of European firefighter head protection to our product line and has helped improve our overall performance in Europe. In other international markets, 2003 results were generally higher in most markets, particularly in Australia and Latin America. These improvements reflect focused efforts to effectively reach customers and, particularly in Latin America, improvements in general economic conditions.

To sharpen our focus on our core safety products business, in November 2002, we announced our decision to explore the potential sale of Callery Chemical, our only non-safety products business unit. As discussed further below under Discontinued Operations, this division was sold in September 2003.

ACQUISITIONS

On April 30, 2002, we acquired CGF Gallet of Lyon, France, the leading European manufacturer of protective helmets for the fire service, as well as head protection for the police and military. The acquisition of Gallet complements our strong existing line of fire service products and provides the opportunity to capitalize on opportunities in other areas where Gallet is strong such as the law enforcement, military, and aviation markets. Gallet s results of operations have been included in our consolidated financial statements from the acquisition date. The aggregate purchase price was $16.6 million of cash and includes amounts paid to the previous owners and other direct external costs associated with the acquisition.

On February 1, 2001, we acquired Surety Manufacturing and Testing, Ltd., or Surety, a leading provider of fall protection equipment and rescue systems. The acquisition was recorded using the purchase method of accounting. The purchase price of $7.1 million was allocated to assets acquired and liabilities assumed based on estimated fair values and included $5.6 million in goodwill, which was included in the North American operating segment.

DISCONTINUED OPERATIONS

On September 12, 2003, we sold our Callery Chemical Division to BASF Corporation. In accordance with accounting principles generally accepted in the United States of America, the operating results of the Callery Chemical Division for the three months ended March 31, 2003 and for the year ended December 31, 2003 and the gain on the sale to BASF Corporation for the year ended December 31, 2003 have been reported as discontinued operations in the consolidated statements of income. The net assets of the division have been classified as assets held for sale in the consolidated balance sheet as of December 31, 2003.

Discontinued operations reported sales of $8.2 million, $21.3 million, $29.5 million and $33.1 million and net income of $1.5 million, $2.7 million, $3.9 million and $5.8 million for the three months ended March 31, 2003 and the years ended December 31, 2003, 2002, and 2001, respectively. Discontinued operations for the three months ended March 31, 2003 and the year ended December 31, 2003, represent operating results of Callery Chemical Division through the date of sale. The sale of the Callery Chemical Division to BASF Corporation resulted in an after-tax gain of $13.7 million.

Management s discussion and analysis of financial condition and results of operations

At December 31, 2003, approximately $2.3 million of trade receivables related to the Callery Chemical Division operation were reported as assets held for sale. These assets were liquidated during the first quarter of 2004.

The after-tax proceeds of $53.8 million received from the sale of the Callery Chemical Division and the subsequent liquidation of net assets retained by us were distributed to shareholders on November 24, 2003 and charged to retained earnings as a capital distribution.

RESULTS OF CONTINUING OPERATIONS

Three Months Ended March 31, 2004 Compared to Three Months Ended March 31, 2003

Net Sales. Net sales for the first quarter of 2004 were $194.5 million, compared with $160.4 million in the first quarter of 2003, an increase of $34.1 million, or 21%.

	Three Months Ended March 31,		Dollar	Percent
(In millions)	2004	2003	Increase	Increase
North America	$ 129.6	$ 106.8	$ 22.8	21%
Europe	39.4	34.6	4.8	14%
International	25.5	19.0	6.5	34%

First quarter 2004 net sales of the North America segment were $129.6 million, an increase of $22.8 million, or 21%, compared to first quarter 2003, led by a $13.5 million increase in sales of SCBA and a $4.7 million increase in sales of thermal imaging cameras, or TICs, to the fire service market. Demand has been particularly strong for our latest generation SCBA which, in 2003, was the first SCBA to be approved under the 2002 NFPA performance standard and the NIOSH Chemical, Biological, Radiological and Nuclear, or CBRN, standard to protect first responders against possible terrorist attacks. Increased thermal imaging camera sales reflect strong demand for our Evolution® 5000 TIC, which combines the functionality and durability required by the fire service with features and performance not found on other small format cameras. Sales of our Advanced Combat Helmet for the military and related communication systems were also significantly higher in the current quarter.

In Europe, first quarter 2004 net sales were $39.4 million, an increase of $4.8 million, or 14%, compared to the same quarter in 2003. The improvement was related to the favorable effect of the stronger Euro on net sales when stated in U.S. dollars. Local currency sales in Europe were flat quarter-to-quarter.

Net sales for International operations of $25.5 million in the first quarter of 2004 were $6.5 million, or 34%, higher than in first quarter 2003. Local currency sales increased approximately $2.4 million, primarily in the Africa/Mideast and Latin America regions. The remainder of the sales improvement, when stated in U.S. dollars, was related to favorable currency exchange effects associated with the stronger Australian dollar and South African rand.

Cost of Products Sold. Cost of products sold was $109.3 million in the first quarter of 2004, an increase of $15.5 million, or 16%, compared to the same quarter last year. The increase relates to higher sales.

Gross Profit. Gross profit for the first quarter of 2004 was $85.2 million, which is $18.6 million, or 28%, higher than the same quarter in the prior year. The ratio of gross profit to net sales was 43.8% in

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Management s discussion and analysis of financial condition and results of operations

the first quarter of 2004 compared to 41.5% in the same quarter last year. The improved gross profit ratio was primarily due to production efficiencies associated with higher North American sales of Advanced Combat Helmets to the military and SCBA and TICs to the fire service market. Our European operations also reported improved gross profits primarily related to higher production volumes and strong sales of higher margin fire helmets.

Selling, General and Administrative Expenses. Selling, general and administrative expenses were $47.7 million during the first quarter of 2004, an increase of $8.6 million, or 22%, compared to first quarter 2003. Selling, general and administrative expenses were 24.5% of sales in the first quarter of

2004 and 24.4% of sales in the first quarter of last year. The increase in selling, general and administrative expenses includes an increase of approximately $3.0 million in selling expenses in North America associated with increased sales volumes and a $3.3 million exchange effect related to the strengthening of international currencies, particularly the Euro. Local currency expenses in Europe during the first quarter of 2004 increased by approximately $1.2 million compared to the same period in 2003, primarily due to rent expense in Germany on the lease-back of property that was sold in September 2003 and increased sales commission expense in Germany and the Netherlands. During the first quarter of 2004, our local currency International expenses increased approximately $600,000 compared to the first quarter of 2003, primarily due to higher selling expenses associated with increased sales volumes.

Research and Development Expense. Research and development expense for the first quarter of 2004 was $5.2 million, an increase of $173,000, or 3%, compared to $5.0 million for the first quarter of 2004. The increase occurred in the United States and relates to ongoing instrument research efforts.

Depreciation and Amortization Expense. Depreciation and amortization expense for the first quarter of 2004 was $5.8 million, an increase of $427,000, or 8%, compared to the first quarter of 2003. The increase was related to new asset additions in ordinary course.

Interest Expense. Interest expense for the first quarter of 2004 was $514,000 compared to $1.1 million in the same quarter last year. First quarter 2004 interest expense was favorably affected by a gain of $678,000 related to an interest rate swap transaction that we terminated during the quarter.

Currency Exchange Adjustments. Currency exchange adjustments resulted in a loss of $667,000 in the first quarter of 2004 compared to a gain of $1.2 million in the same quarter last year. The current quarter loss was primarily due to the weakening of the Euro during March. The gain during the first quarter of 2003 related to the strengthening of the Euro and the Canadian dollar.

Income Taxes. The effective tax rate for the quarter ended March 31, 2004 was 37.9% compared to 38.7% for the same quarter last year.

Net Income from Continuing Operations. Net income from continuing operations in the first quarter of 2004 was $16.1 million, or $0.44 per basic share, compared to $10.5 million, or $0.29 per basic share, in the same quarter last year.

North American net income from continuing operations was $13.8 million, an increase of $5.8 million, or 72%, compared to the first quarter of 2003. The improvement in North American net income was due to the previously-discussed sales growth.

European net income in the first quarter of 2004 was $1.8 million, an improvement over first quarter 2003 of $736,000, or 67%, primarily due to improved gross margins related to higher production volumes in Germany and France and strong sales of higher margin fire helmets.

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International net income in the first quarter of 2004 was $1.1 million, compared to $1.2 million in the same quarter of last year.

Year Ended December 31, 2003 Compared to Year Ended December 31, 2002

Net sales. Net sales for the year ended December 31, 2003 were $696.5 million, an increase of $132.1 million, or 23%, from $564.4 million for the year ended December 31, 2002. Our net sales increased in all segments as follows:

(In millions)	2003	2002	Dollar Increase	Percent Increase
North America	$ 452.6	$ 369.7	$ 82.9	22%
Europe	146.2	122.4	23.8	19%
International	97.7	72.2	25.5	35%

Sales by North American operations were $452.6 million for the year ended December 31, 2003, an increase of $82.9 million, or 22%, from $369.7 million for the year ended December 31, 2002. Approximately half of the sales growth was driven by increased sales of SCBA and thermal imaging cameras to the fire service market. These improvements reflect a combination of continued strong government funding and increased demand for our new CBRN-compliant SCBA and Evolution 5000 thermal imaging cameras. The remainder of the sales growth in North America was due to increased sales of gas masks and ballistic helmets to military and homeland security markets, which reflects increased government spending on military and homeland security needs. Sales of instruments and fall protection equipment were flat year-to-year, reflecting continued sluggishness in industrial markets.

During 2003, we changed our standard shipping terms to U.S. distributors from FOB Shipping Point to FOB Destination. We made this change to improve customer service by obtaining greater control and flexibility over carrier selection and delivery schedules and by reducing customer exposure to in-transit loss and damage. The effect of this change, which delays revenue recognition on affected shipments until the goods reach their destination, reduced sales and gross margins in 2003 by approximately $4.7 million and $2.7 million, respectively.

Sales by European operations were $146.2 million for the year ended December 31, 2003, an increase of $23.8 million, or 19%, from $122.4 million for the year ended December 31, 2002. The sales increase was primarily due to favorable translation effects of approximately $18.9 million due to a stronger Euro and the inclusion of a full year of sales by MSA Gallet, which was acquired during the second quarter of 2002. Local currency sales at our other European affiliates were somewhat lower year-to-year, reflecting the general sluggishness in the Western European industrial sector.

Sales by International operations were $97.7 million for the year ended December 31, 2003 compared to $72.2 million for the year ended December 31, 2002, an increase of $25.5 million, or 35%. The sales improvement occurred primarily in Australia where sales grew by approximately $7.1 million, including sales of approximately $4.3 million of breathing apparatuses to the Australian Navy and as a result of higher sales of $3.6 million of various products in various locations in Latin America. Approximately one-third of the increase in International sales, when stated in U.S. dollars, was due to the favorable currency translation effects of a stronger Australian dollar and South African Rand.

Cost of products sold. Cost of products sold was $408.2 million for the year ended December 31, 2003, an increase of $77.0 million, or 23%, from $331.2 million for the year ended December 31, 2002. The increase relates primarily to higher sales.

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Cost of products sold and selling, general and administrative expenses in 2003 were favorably affected by a change in the vacation vesting policy for U.S. employees. Under the vacation vesting policy adopted in 2003, employees earn their vacation entitlement during the current year. Previously, vacation was vested on the last day of the prior year. The policy resulted in favorable adjustments to cost of products sold and selling, general and administrative expenses during 2003 of $3.6 million and $1.8 million, respectively. The vacation policy was changed to align the year the benefit is earned with the year it is received.

Cost of products sold and selling, general and administrative expenses include net periodic pension benefit costs (credits). Pension credits, combined with pension costs, resulted in net pension credits of $10.8 million in 2003, of which $5.7 million was included in the cost of products sold and $3.1 million was included in the selling, general and administrative expenses. The remaining $2.0 million relating to a curtailment gain from the sale of the Callery Chemical Division was included in net income from discontinued operations. The recognition of pension income in the years ended December 31, 2003 and 2002 is primarily the result of the exceptional investment performance of the MSA Non-Contributory Pension Plan for the Employees, or the MSA Pension Plan, over the past ten years. During that period, the investment performance of the MSA Pension Plan has ranked among the top 1% of all U.S. pension funds. Future net pension credits can be volatile depending on the future performance of plan assets, changes in actuarial assumptions regarding such factors as the selection of discount rates and rates of return on plan assets, changes in the amortization levels of actuarial gains and losses, plan amendments affecting benefit pay-out levels, and profile changes in the participant populations being valued. Changes in any of these factors could cause net pension credits to change. To the extent net pension credits decline in the future, our net income would be adversely affected.

Gross profit. Gross profit for the year ended December 31, 2003 was $288.3 million, an increase of $55.1 million, or 24%, from $233.2 million for the year ended December 31, 2002. The ratio of gross profit to sales was steady at 41.4% in 2003 compared to 41.3% in 2002.

Selling, general and administrative expenses. Selling, general and administrative expenses for the year ended December 31, 2003 were $170.1 million, an increase of $29.2 million, or 21%, from $140.9 million for the year ended December 31, 2002. Approximately half of the increase was related to higher marketing and selling expenses required to support the significant sales growth in North America. The remainder of the increase occurred in Europe, and reflects an increase due to inclusion of a full year s expenses of $4.8 million for MSA Gallet, which was acquired in the second quarter of 2002, and the currency exchange effect of $7.3 million due to a stronger Euro. Selling, general and administrative expenses were 24.4% of sales in 2003 compared to 25.0% of sales in 2002.

Research and development expenses. Research and development expenses were $21.7 million for the year ended December 31, 2003, an increase of $1.3 million, or 6%, from $20.4 million for the year ended December 31, 2002. Research and development activities are performed primarily in the United States and Europe.

Depreciation and amortization expense. Depreciation and amortization expense was $23.2 million for the year ended December 31, 2003, an increase of $1.7 million, or 8%, from $21.5 million for the year ended December 31, 2002. The increase was primarily due to new asset additions in the United States to support higher production volumes.

Interest expense. Interest expense for the year ended December 31, 2003 was $4.6 million compared to $4.8 million for the year ended December 31, 2002. The decrease relates to reductions in long term debt and short term borrowings.

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Currency exchange. Currency exchange gains of $3.4 million were recorded in the year ended December 31, 2003 compared to gains of $191,000 for the year ended December 31, 2002. Currency exchange gains in 2003 were primarily related to Euro and Canadian dollar denominated assets held by us, and reflect a significant strengthening of those currencies during the year.

Income tax provision. The effective income tax rate was 33.7% for the year ended December 31, 2003 and 35.1% for the year ended December 31, 2002. The effective tax rate in 2003 was lower than the U.S. statutory income tax rate due in part to favorable effect of research and development credits and the one-time effect of releasing $1.2 million of previously-established valuation allowances on foreign tax credit carry forwards. These valuation allowances were released in 2003 as a result of tax planning strategies that were implemented during the year and an improved outlook for foreign source income. The company has maintained tax reserves established in prior years on research and development credits that were claimed in tax years that are currently being examined by the Internal Revenue Service. We believe that our established reserves are adequate for income taxes and interest that may become payable for years that are not settled.

Net income. Net income from continuing operations for the year ended December 31, 2003 was $48.9 million, an increase of $17.7 million, or 57%, over net income from continuing operations for the year ended December 31, 2002 of $31.2 million. Continuing operations basic earnings per share of common stock improved to $1.33 in 2003 compared to $0.85 in 2002.

North American net income from continuing operations for the year ended December 31, 2003 was $38.7 million, an increase of $12.8 million, or 49%, from $25.9 million for the year ended December 31, 2002. The improvement in North American net income was primarily due to the previously-discussed sales growth.

European net income from continuing operations for the year ended December 31, 2003 was $2.8 million, an increase of $276,000, or 11%, from $2.5 million for the year ended December 31, 2002. The improvement reflects a full year of income for MSA Gallet, partially offset by lower income in our German operation.

International net income from continuing operations for the year ended December 31, 2003 was $6.3 million, an increase of $3.9 million, or 167%, from $2.4 million for the year ended December 31, 2002. Approximately two-thirds of the improvement occurred in Australia and Latin America on higher sales. The remainder of the improvement occurred in our operations in Peru, Chile and China, which all experienced losses in 2002, primarily as a result of one-time charges. The most significant one-time charges in 2002, approximately $800,000, were related to employee severance costs and inventory write-offs incurred in Peru as a result of our decision to terminate an arrangement under which we serviced mining equipment for a customer. During 2002, our operation in China incurred charges of approximately $280,000 related to the impairment of respirator production equipment. Charges of approximately $200,000 in Chile during 2002 included employee severance costs and receivable write-offs related to a customer bankruptcy.

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Year Ended December 31, 2002 Compared to Year Ended December 31, 2001

Net sales. Net sales for the year ended December 31, 2002 were $564.4 million, an increase of $54.7 million, or 11%, from $509.7 million for the year ended December 31, 2001. Our sales increased in the North America and Europe segments and were stable in International segment as follows.

(In millions)	2002	2001	Dollar Increase	Percent Increase
North America	$ 369.7	$ 343.6	$ 26.1	8%
Europe	122.4	94.2	28.2	30%
International	72.2	71.7	0.5	1%

Sales by North American operations were $369.7 million for the year ended December 31, 2002, an increase of $26.1 million, or 8%, from $343.6 million for the year ended December 31, 2001. The sales improvement was primarily driven by increased sales of $21.0 million of gas masks to the military and homeland security markets, which reflects increased government spending on military and homeland security needs and the inclusion of sales of $9.4 million by the Gallet North American companies following their acquisition in the second quarter of 2002. This sales improvement was partially offset by a decrease of $4.5 million in sales of instruments and fall protection equipment, reflecting sluggishness in industrial markets. Sales to the fire service market were relatively flat year-to-year with increased sales of SCBA being offset by lower sales of thermal imaging cameras. Thermal imaging camera sales are dependent on the level of federal government funding provided to local fire departments. During 2002 much of this funding was diverted to meeting homeland security requirements.

Sales by European operations were $122.4 million for the year ended December 31, 2002, an increase of $28.2 million, or 30%, from $94.2 million for the year ended December 31, 2001. The sales increase was primarily due to the acquisition of Gallet Helmets during the second quarter, which had sales of approximately $16.0 million. European sales for the year ended December 31, 2002 also benefited from strong sales of escape breathing devices in the Netherlands for use in the merchant marine fleet. When stated in U.S. dollars, European sales also benefited from the currency translation effects of a stronger Euro.

Sales by International operations were $72.2 million for the year ended December 31, 2002 compared to $71.7 million for the year ended December 31, 2001, an increase of $471,000, or 1%. Local currency sales growth of approximately 7%, achieved primarily in Africa, Brazil, and Australia, was largely offset by unfavorable currency translation effects when stated in U.S. dollars.

Cost of products sold. Cost of products sold was $331.2 million for the year ended December 31, 2002, and increase of $38.3 million, or 13%, from $292.9 million in 2001. The increase reflects higher sales.

Cost of products sold and selling, general and administrative expenses include net periodic pension benefit costs (credits). Pension credits, combined with pension costs, resulted in net pension credits of $13.1 million in 2002, of which $8.5 million was included in costs of products sold and $4.6 million was included in selling, general and administrative expenses, and $15.0 million in 2001, of which $9.8 million was included in costs of products sold and $5.2 million was included in selling, general and administrative expenses.

Gross profit. Gross profit for the year ended December 31, 2002 was $233.2 million, an increase of $16.4 million, or 8%, from $216.8 million for the year ended December 31, 2001. The ratio of gross profit to sales was 41.3% in 2002 compared to 42.5% in 2001.

Selling, general and administrative expenses. Selling, general and administrative expenses for the year ended December 31, 2002 were $140.9 million, an increase of $10.8 million, or 8%, from $130.1 million for the year ended December 31, 2001. Selling, general and administrative expenses decreased as a percent of sales to 25.0% in 2002 compared to 25.5% in 2001. The increase in selling, general and administrative expenses occurred primarily in the United States and Europe and reflects costs associated with higher sales volumes, higher insurance costs of $2.8 million, and expenses of $2.9 million due to the acquisition of MSA Gallet.

Research and development expenses. Research and development expenses were $20.4 million for the year ended December 31, 2002, an increase of $3.7 million, or 22%, from $16.7 million for the year ended December 31, 2001. Research and development activities are performed primarily in the United States and Europe. The increase reflects higher research and development costs due to the acquisition of MSA Gallet.

Depreciation and amortization expense. Depreciation and amortization expense was $21.5 million for the year ended December 31, 2002, a decrease of $1.1 million, or 5%, from $22.6 million for the year ended December 31, 2001. As required by Financial Accounting Standard, or FAS No. 142, goodwill amortization was discontinued at the beginning of 2002. Goodwill amortization expense was $2.2 million for the year ended December 31, 2001. The decrease associated with the absence of goodwill amortization in 2002 was partially offset by the inclusion of approximately $850,000 of MSA Gallet depreciation and increased depreciation related to new asset additions in the ordinary course of business.

Interest expense. Interest expense for the year ended December 31, 2002 was $4.8 million compared to $5.3 million for the year ended December 31, 2001. The decrease relates to reductions in long term debt and short term borrowings.

Currency exchange. Currency exchange gains of $191,000 were recorded for the year ended December 31, 2002 compared to a loss of $1.2 million for the year ended December 31, 2001. The favorable swing was primarily due to the strengthening of Euro during 2002. The most significant losses from currency valuation changes in 2001 related to the strengthening of the U.S. dollar against the Canadian dollar.

Income tax provision. The effective income tax rate was 35.1% for the year ended December 31, 2002 and 40.7% for the year ended December 31, 2001. The effective tax rate in 2002 was lower than in 2001 due to favorable tax effects associated with the charitable donation of property and adjustments to prior year tax provisions, net of valuation allowances taken on deferred tax assets. The 2001 effective tax rate included the recognition of a valuation allowance on deferred tax assets related to foreign tax credit carry-forwards in the United States and improved earnings in high tax rate countries.

Net income. Net income from continuing operations was $31.2 million for the year ended December 31, 2002, an increase of $5.4 million, or 21%, over net income from continuing operations for the year ended December 31, 2001 of $25.9 million. Continuing operations basic earnings per share of common stock improved to $0.85 in 2002 compared to $0.72 in 2001.

North American net income from continuing operations for the year ended December 31, 2002 was $25.9 million, an increase of $3.3 million, or 15%, from $22.6 million for the year ended December 31, 2001. The improvement in North American net income was due to the previously-discussed sales growth.

European net income from continuing operations for the year ended December 31, 2002 was $2.5 million, an increase of $2.4 million, from $130,000 for the year ended December 31, 2001. The improvement was primarily related to the acquisition of MSA Gallet.

International net income from continuing operations for the year ended December 31, 2002 was $2.4 million, a decrease of $1.2 million, or 34%, from $3.6 million for the year ended December 31, 2001. The decrease was primarily related to one-time charges associated with restructuring activities and asset write-offs at our operations in Peru, Chile and China, partially offset by somewhat higher earnings in our other International operations.

The most significant one-time charges in 2002 of approximately $800,000 were related to employee severance costs and inventory write-offs incurred in Peru as a result of our decision to terminate an arrangement under which we serviced mining equipment for a customer. During 2002, our operation in China incurred charges of approximately $280,000 related to the impairment of respirator production equipment. Charges of approximately $200,000 in Chile during 2002 included employee severance costs and receivable write-offs related to a customer bankruptcy.

LIQUIDITY AND CAPITAL RESOURCES

The main sources of our liquidity are cash generated from operations and borrowing capacity. Our principal liquidity requirements are for working capital, capital expenditures, and principal and interest payments on outstanding indebtedness.

Cash and cash equivalents increased $673,000 during the first quarter of 2004 compared to a decrease of $8.6 million in the same quarter last year and increased $36.8 million during 2003, compared to an increase of $9.8 million in 2002.

During the first quarter of 2004, continuing operations provided $8.3 million in cash, compared to using $3.2 million in the first quarter of 2003. The improvement reflects higher income from continuing operations in the current period and improved collections on accounts receivables related to increased sales, partially offset by increases in inventories. Accounts receivable increased approximately $6.6 million during the first quarter of 2004 compared to an increase of $23.8 million in the first quarter of 2003. This improvement was partially offset by the use of approximately $8.1 million in first quarter 2004 to fund higher inventory levels.

Continuing operations provided cash of $32.5 million in 2003 compared to providing $43.0 million in 2002. Higher net income from continuing operations in 2003 was more than offset by increases in net operating assets. In 2003, increases in receivables used cash of $27.0 million compared to using $3.0 million in 2002. Approximately $18.0 million of the increase was due to changes in the level of net proceeds borrowed under the receivable securitization arrangement. In 2003, the net proceeds decreased from $29.0 million to $15.0 million. In 2002, the net proceeds increased from $25.0 million to $29.0 million. The remainder of the difference was primarily related to increased sales in 2003. Increases in inventories during 2003 used $3.2 million compared to inventory reductions in 2002, which provided $5.5 million in cash. Trade receivables related to continuing operations were $89.9 million at December 31, 2003. Trade receivables for continuing operations expressed in number of days sales outstanding were 47 days at December 31, 2003, compared to 38 days at December 31, 2002. The increase in trade receivables and days sales outstanding reflect lower net proceeds received under our accounts receivable securitization arrangement and increased government and international receivables. Other receivables were $39.0 million at December 31, 2003 and $35.5 million at December 31, 2002, representing a retained interest in securitized receivables. Inventories of continuing operations were $90.1 million at December 31, 2003 and $76.7 million at December 31, 2002. Inventory measured against sales turned 7.7 times in 2003 and 7.4 times in 2002. Cash flow from continuing operations in 2002 was $22.9 million higher than in 2001. Improved cash flow from continuing operations in 2002 reflects higher operating income and relatively small changes in receivables and inventories.

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Discontinued operations provided $2.1 million of cash in the first quarter of 2004, primarily through collection of trade receivables included in assets held for sale. In the first quarter of 2003, discontinued operations provided $4.2 million of cash, primarily through collection of trade receivables and inventory reductions.

Cash provided by discontinued operations in 2003 was $1.6 million higher than in 2002. The increase is primarily related to the liquidation of trade receivables. Cash provided by discontinued operations in 2002 was $1.2 million lower than in 2001, mainly due to lower income.

Investing activities used cash of $7.1 million during the first quarter 2004, compared to using $4.3 million in the same period last year. The increased use of cash in the current quarter related to higher property additions, primarily production equipment, and an installment payment on a technology transfer agreement.

Investing activities provided cash of $66.7 million in 2003 compared to using $34.1 million in 2002. In 2003, the sale of the Callery Chemical Division and property in Germany provided cash of approximately $63.0 million and $22.9 million, respectively. In 2002, net cash of approximately $14.5 million was used for the acquisition of MSA Gallet. In 2001, cash was used for the acquisition of Surety Manufacturing and Testing, Ltd. Capital expenditures of $19.6 million, $20.1 million, and $20.0 million in 2003, 2002 and 2001, respectively, were primarily related to purchases of new or replacement tooling and production equipment.

Financing activities used $2.4 million of cash in the first quarter of 2004, compared to using $5.7 million in the same period last year. The higher use of cash for financing activities in 2003 was related to reductions in short-term debt.

Financing activities used cash of $76.3 million in 2003 compared to using $7.1 million in 2002. The higher use of cash in 2003 includes a special distribution to common shareholders of $53.8 million, representing the after-tax proceeds from the sale of the Callery Chemical Division and the subsequent liquidation of net assets retained by us. Dividends paid on our common stock during 2003 (the 86th consecutive year of dividend payment) were $0.26 per share. Dividends paid on our common stock in 2002 and 2001 were $0.22 and $0.18, per share, respectively.

Long-term debt, including the current portion at March 31, 2004 was $64.6 million, or 16.7% of total capital. For purposes of this calculation, total capital is defined as long-term debt plus the current portion of long-term debt and shareholders equity.

The following table sets forth our long-term debt obligations:

	2003	2002
	(In thousands)	
U.S.		
Industrial development debt issues payable through 2022, 1.3%	$ 10,750	$ 10,750

Series B Senior Notes payable through 2006, 7.69%	12,000	16,000
Senior Notes payable through 2012, 8.39%	40,000	40,000
Other	150	200
International		
Various notes payable through 2010, 5.06% to 19.0%	1,853	2,364
Total	64,753	69,314
Amounts due within one year	4,838	4,964
Long-term debt	59,915	64,350

Approximate maturities of these obligations over the next five years are $4.8 million in 2004, $4.6 million in 2005, $8.2 million in 2006, $105,000 in 2007, and $8.1 million in 2008. Some debt agreements require us to maintain certain financial ratios and minimum net worth and contain restrictions on the total amount of debt. We were in compliance with our debt covenants as of March 31, 2004.

Short-term bank lines of credit amounted to $20.4 million of which $19.4 million was unused at March 31, 2004. Generally, these short-term lines of credit are renewable annually, and there are no significant commitment fees or compensating balance requirements. Short-term borrowings with banks, which exclude the current portion of long-term debt, were $977,000, $828,000 and $9.1 million at March 31, 2004 and December 31, 2003 and 2002, respectively. The average month-end balance of total short-term borrowings during the three months ended March 31, 2004 and during 2003 were $903,000 and $560,000, respectively, while the maximum month-end balance of $1.9 million occurred at March 31, 2003. The average interest rate during 2003 was approximately 9% based upon total short-term interest expense divided by the average month-end balance outstanding, and 3% at year-end.

We believe our sources of liquidity currently available from our cash reserves on hand, cash flow from operations and borrowing capacity are sufficient to meet our principal liquidity requirements for at least the next 12 months.

ACCOUNTS RECEIVABLE SECURITIZATION

We have an arrangement with a financial institution under which it securitizes, on a continuous basis, our undivided interest in eligible trade accounts receivable. Pursuant to this arrangement, we sell eligible trade accounts receivable to Mine Safety Funding Corporation, or MSF, a wholly-owned bankruptcy-remote subsidiary. MSF was formed in November 1999 to purchase these accounts receivable and sell participating interests in such receivables to a special purpose entity in exchange for proceeds from interest-bearing securities that are issued by the special purpose entity and secured by future collections on the sold receivables. Consistent with the requirements of FAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, receivables that are sold to the special purpose entity are no longer assets of the company and no longer appear on our balance sheet. As collections reduce the amount of accounts receivable included in the pool, we sell new accounts receivable to MSF, which, in turn, securitizes these new accounts receivable with the commercial paper conduit. Securitization transactions permit us to borrow at advantageous interest rates and represent a cost-effective and reliable source of funding.

We are permitted to securitize up to $30.0 million of accounts receivable under this arrangement. The actual amount of accounts receivable securitized each month is a function of the net change (new billings, less collections) of eligible accounts receivable, the impact of detailed eligibility requirements in the agreement, such as the aging, terms of payment, quality criteria and customer concentrations, and the application of various reserves, which are typical in securitization transactions. A decrease in the amount of eligible accounts receivable could result in its inability to continue to securitize all or a portion of its accounts receivable. It is not unusual, however, for the amount of its eligible accounts receivable to vary by up to $5.0 to $10.0 million per month. The commercial paper conduit charges us fees based on the level of accounts receivable securitized under this arrangement and the commercial paper market rates plus the financial institution s cost to administer the program. Securitization transactions are used to achieve isolation of the sold receivables for the benefit of the securitization investors and represent cost-effective source of funding.

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At March 31, 2004, $15.0 million of securitized accounts receivable had been removed from our balance sheet under this program. Our retained interest in accounts receivable available for securitization was $56.4 million at March 31, 2004.

At December 31, 2003 and 2002, $15.0 million and $29.0 million, respectively, of securitized accounts receivable had been removed from our balance sheet under this program. Our retained interests in accounts receivable available for securitization and recorded as other receivables were $40.0 million and $36.5 million at December 31, 2003 and 2002, respectively. The costs incurred under this program of $1.0 million, $1.5 million and $1.8 million in 2003, 2002 and 2001, respectively, have been accounted for as a component of other income, net.

CUMULATIVE TRANSLATION ADJUSTMENTS

The March 31, 2004 and December 31, 2003 positions of the U.S. dollar relative to international currencies resulted in translation gains of $159,000 and $14.7 million being credited to the cumulative translation adjustments shareholders equity account in the first quarter of 2004 and the year 2003, compared to gains of $5.8 million in 2002 and losses of $4.9 million in 2001. The transition gain in the first quarter of 2004 was primarily due to a stronger Australian dollar, partially offset by a weaker Euro. Translation gains in 2003 reflect the strengthening of most currencies against the U.S. dollar. The most significant gains related to MSA s operations in Europe and Australia. Translation gains in 2002 occurred primarily in Europe, partially offset by losses in South America. Translation losses in 2001 occurred primarily in South Africa, Brazil, Chile and most European countries.

COMMITMENTS AND CONTINGENCIES

We are obligated to make future payments under various contracts, including debt and lease agreements. Our significant cash obligations as of December 31, 2003 were as follows:

	Total	2004	2005	2006 (In thousands)	2007	2008	Thereafter
Long-term debt	$ 64,753	$ 4,838	$ 4,561	$ 8,231	$ 105	$ 8,105	$ 38,913
Operating leases	27,613	5,262	4,259	3,621	2,739	2,657	9,075
Technology transfer agreement	2,250	1,500	750				
Take or pay supply contract	7,000	1,500	1,500	1,500	1,500	1,000	
Totals	101,616	13,100	11,070	13,352	4,344	11,762	47,988

We expect to make net contributions of $1.3 million to our pension plans in 2004.

We have purchase commitments for materials, supplies, services, and property, plant and equipment as part of our ordinary conduct of business.

During the third quarter of 2003, we sold our real property in Berlin, Germany for approximately $25.7 million, resulting in a gain of approximately $13.6 million. At the same time, we entered into an eight year agreement to lease back the portion of the property that we occupy. Under sale-leaseback accounting, $12.1 million of gain was deferred and is being amortized over the term of the lease.

On September 12, 2003, we entered into a lease agreement with BASF Corporation pertaining to that portion of the Callery Chemical site that is occupied by our Evans City, Pennsylvania manufacturing operations. The initial term of the lease is one year and we have the option to renew for five successive one year periods.

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Various lawsuits and claims arising in the normal course of business are pending against us. These lawsuits are primarily product liability claims. We are presently named as a defendant in approximately 1,850 lawsuits involving primarily respiratory protection products allegedly manufactured and sold by us. Collectively, these lawsuits represent a total of approximately 30,000 plaintiffs. Approximately 85% of these lawsuits involve plaintiffs alleging they suffer from silicosis, with the remainder alleging they suffer from other or combined injuries, including asbestosis. These lawsuits typically allege that these conditions resulted in part from respirators that were negligently designed or manufactured by us. Consistent with the experience of other companies involved in silica and asbestos-related litigation, there has been an increase in the number of asserted claims that could potentially involve us. We cannot determine our potential maximum liability for such claims, in part because the defendants in these lawsuits are often numerous and the claims generally do not specify the amount of damages sought.

With some limited exceptions, we maintain insurance against product liability claims. We also maintain a reserve for uninsured product liability based on expected settlement charges for pending claims and an estimate of unreported claims derived from experience, sales volumes and other relevant information. We reevaluate our exposures on an ongoing basis and make adjustments to reserves as appropriate. Based on information currently available, we believe that the disposition of matters that are pending will not have a materially adverse effect on our financial position.

In connection with our sale of Callery Chemical facility in Evans City, Pennsylvania, we have retained responsibility for certain environmental costs at this site, where relatively low levels of contamination are known to exist. Under the terms of the asset purchase agreement with BASF, our maximum li

Increase in premises and equipment

(679

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(911

)

Purchase of bank owned life insurance

(10,000

)

Purchase of FHLB stock

(649

)

(4,789

)

Net cash used in investing activities

(3,210

)

(108,008

)

CASH FLOWS FROM FINANCING ACTIVITIES

Net (decrease) increase in deposit accounts

(6,434

)

35,751

(Repayment of) proceeds from FHLB advances

(7,835

)

93,500

Proceeds from (repayment of) other borrowings

12,000

(17,400

)

Proceeds from exercise of stock options

57

3

Proceeds from issuance of restricted stock

363

Net cash (used in) provided by financing activities

(1,849

)

111,854

NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS

(675

)

10,286

CASH AND CASH EQUIVALENTS, beginning of period

34,055

16,003

CASH AND CASH EQUIVALENTS, end of period

$

33,380

$

26,289

SUPPLEMENTAL CASH FLOW DISCLOSURES:

Interest paid	$ 19,524	$ 11,233
Income taxes paid	$ 1,345	$ 2,049

NONCASH INVESTING ACTIVITIES DURING THE PERIOD:

Transfers from loans to foreclosed real estate

$

433

$

287

Transfer loans from held for investment

$

1,223

$

Transfer loans from held for sale

$

279

$

Accompanying notes are an integral part of these consolidated financial statements.

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PACIFIC PREMIER BANCORP, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2006
(UNAUDITED)

Note 1 Basis of Presentation

The consolidated financial statements include the accounts of Pacific Premier Bancorp, Inc. (the Corporation) and its wholly owned subsidiary, Pacific Premier Bank, F.S.B. (the Bank) (collectively, the Company). All significant intercompany accounts and transactions have been eliminated in consolidation.

In the opinion of management, the unaudited consolidated financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly the Company s financial position as of September 30, 2006, the results of its operations for the three and nine months ended September 30, 2006 and 2005, changes in stockholders equity, comprehensive income and cash flows for the nine months ended September 30, 2006 and 2005. Operating results for the three and nine months ended September 30, 2006 are not necessarily indicative of the results that may be expected for any other interim period or the full year ending December 31, 2006.

Certain information and note 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 the rules and regulations of the Securities and Exchange Commission (SEC). The unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2005.

The Company accounts for its investments in its wholly owned special purpose entity, PPBI Trust I, using the equity method under which the subsidiary s net earnings are recognized in the Company s statement of income.

The pro forma effects of applying SFAS No. 123 are disclosed for the periods shown below:

	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005
	(dollars in thousands, except per share data)	
Net income to common stockholders:		
As reported	$ 1,833	$ 5,520
Stock-based compensation that would have been reported using the fair value method of SFAS 123		
Pro forma	$ 1,833	$ 5,520
Basic earnings per share:		
As reported	$ 0.35	$ 1.05
Pro forma	$ 0.35	$ 1.05
Diluted earnings per share:		
As reported	$ 0.27	$ 0.83
Pro forma	$ 0.27	$ 0.83

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Note 2 Recently Issued Accounting Pronouncements

In February 2006, the Financial Accounting Standards Board, (FASB), issued Statement of Financial Accounting Standards No. 155, Accounting for Certain Hybrid Financial Instruments (SFAS 155), which provides the following: 1) permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, 2) clarifies which interest-only strips and principal-only strips are not subject to the requirements of Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities, 3) establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, 4) clarifies that concentrations of credit in the form of subordination are not embedded derivatives, and 5) amends Statement of Financial Accounting Standards No. 140 Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities a replacement of FASB Statement 125 to eliminate the prohibition of a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS 155 for accounting for certain hybrid financial instruments is effective for us beginning January 1, 2007. Adoption of SFAS 155 is not expected to have a material impact on the Company.

In March 2006, the FASB issued Statement of Financial Accounting Standards No. 156, Accounting for Servicing of Financial Assets (SFAS 156), which provides the following: 1) revised guidance on when a servicing asset and servicing liability should be recognized, 2) requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable, 3) permits an entity to elect to measure servicing assets and servicing liabilities at fair value each reporting date and report changes in fair value in earnings in the period in which the changes occur, 4) upon initial adoption, permits a one-time reclassification of available-for-sale securities to trading securities for securities which are identified as offsetting the entity s exposure to changes in the fair value of servicing assets or liabilities that a servicer elects to subsequently measure at fair value, and 5) requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional footnote disclosures. SFAS 156 is effective for us beginning January 1, 2007 with the effects of initial adoption being reported as a cumulative-effect adjustment to retained earnings. The impact to retained earnings of the Company as a result of the initial adoption of SFAS 156 is expected to be immaterial.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements, (SFAS 157). SFAS 157 establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), clarifies the definition of fair value within that framework, and expands disclosures about the use of fair value measurements. SFAS 157 is effective for us beginning January 1, 2007 and is not expected to have a material impact on the Company.

Note 3 Regulatory Matters

The Bank s capital amounts and ratios are presented in the following table:

	Actual Amount (dollars in thousands)	Ratio		To be adequately capitalized Amount	Ratio		To be well capitalized Amount	Ratio	
At September 30, 2006 (Unaudited)									
Total Capital (to risk-weighted assets)	$ 62,229	11.89	%	$ 41,854	8.00	%	$ 52,318	10.00	%
Tier 1 Capital (to adjusted tangible assets)	59,312	8.40	%	28,235	4.00	%	35,294	5.00	%
Tier 1 Risk-Based Capital (to risk-weighted assets)	59,312	11.34	%	20,927	4.00	%	31,391	6.00	%
At December 31, 2005									
Total Capital (to risk-weighted assets)	$ 57,135	11.78	%	$ 38,793	8.00	%	$ 48,492	10.00	%
Tier 1 Capital (to adjusted tangible assets)	54,376	7.79	%	27,935	4.00	%	34,919	5.00	%
Tier 1 Risk-Based Capital (to risk-weighted assets)	54,376	11.21	%	19,397	4.00	%	29,095	6.00	%

Note 4 Borrowings

At September 30, 2006, the Bank had $7.0 million on its $100 million credit facility with Salomon Brothers. At September 30, 2006, the Bank had one advance in the amount of $1.0 million at a rate of 6.00% per annum against its $18.7 million credit facility, secured by mutual funds pledged to Pershing LLC. The Bank also had Fed Funds purchased in the amount of $5.0 million at a rate of 5.40% per annum. Additionally, the Company had $299.0 million in Federal Home Loan Bank (FHLB) advances with a weighted average interest rate of 5.24% and a weighted average maturity of 0.26 years as of September 30, 2006. As of such date, advances from the FHLB are collateralized by pledges of certain real estate loans with an aggregate principal balance of $460.3 million. As of September 30, 2006, the Bank was able to borrow up to 45% of its total assets as of June 30, 2006 under the line, which amounted to $319.3 million, an increase of $12.9 million from the quarter ended June 30, 2006. FHLB advances consisted of the following as of September 30, 2006:

FHLB Advances Maturing in:	Amount (dollars in thousands)	Percent of Total		Weighted Average Annual Interest Rate	
One month or less	$ 74,000	24.75	%	5.59	%
Over one month to three months	140,000	46.82	%	4.86	%
Over three months to six months	25,000	8.36	%	5.63	%
Over six months to one year	60,000	20.07	%	5.53	%
Over one year	0	0.00	%	0.00	%
Total FHLB advances	$ 299,000	100.00	%	5.24	%

Note 5 Subordinated Debentures

In March 2004, the Corporation issued $10.3 million of Floating Rate Junior Subordinated Deferrable Interest Debentures (the Subordinated Debentures) to PPBI Trust I, which funded the payment of $10.0 million of Floating Rate Trust Preferred Securities issued by PPBI Trust I in March 2004. The net proceeds from the offering of Trust Preferred Securities were contributed as capital to the Bank to support further growth. Interest is payable quarterly on the Subordinated Debentures at three-month LIBOR plus 2.75% per annum, for an effective rate of 8.26% per annum as of September 30, 2006.

Under FIN 46R, Consolidation of Variable Interest Entities, an interpretation of ARB No. 51, the Corporation is not allowed to consolidate PPBI Trust I into the Company s financial statements. The resulting effect on the Company s consolidated financial statements is to report the Subordinated Debentures as a component of liabilities. Prior to the issuance of FIN 46R, bank holding companies typically consolidated these entities and reported the Trust Preferred Securities as a component of liabilities.

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Note 6 Earnings Per Share

Basic earnings per share is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share is computed by dividing income available to common stockholders including common stock equivalents, such as outstanding stock options and warrants by the weighted average number of common shares and common stock equivalents outstanding for the period. Stock options totaling 85,897 and 109,247 shares for September 30, 2006 and September 30, 2005, respectively, were excluded from the computation of diluted earnings per share due to their exercise price exceeding the average market price.

The table below set forth the Company s unaudited earnings per share calculations for the three and nine months ended September 30, 2006 and 2005.

	For the Three Months Ended September 30,					
	2006			2005		
	Net Earnings (dollars in thousands)	Shares	Per Share Amount	Net Earnings	Shares	Per Share Amount
Net Earnings	$ 1,504			$ 1,833		
Basic EPS Earnings available to common stockholders	$ 1,504	5,263,988	$ 0.29	$ 1,833	5,259,241	$ 0.35
Effect of Warrants and dilutive stock options		1,420,661			1,432,424	
Diluted EPS Earnings Available to common stockholders plus assumed conversions	$ 1,504	6,684,649	$ 0.23	$ 1,833	6,691,665	$ 0.27

	For the Nine Months Ended September 30,					
	2006			2005		
	Net Earnings (dollars in thousands)	Shares	Per Share Amount	Net Earnings	Shares	Per Share Amount
Net Earnings	$ 6,151			$ 5,520		
Basic EPS Earnings available to common stockholders	$ 6,151	5,261,195	$ 1.17	$ 5,520	5,258,907	$ 1.05
Effect of Warrants and dilutive stock options		1,424,068			1,391,257	
Diluted EPS Earnings Available to common stockholders plus assumed conversions	$ 6,151	6,685,263	$ 0.92	$ 5,520	6,650,164	$ 0.83

Note 7 Valuation Allowance for Deferred Income Taxes

During the second quarter of 2006, the Company reversed the remaining valuation allowance of $1.9 million, as the deferred tax assets were determined, more likely than not, to be realized based on the Company s quarterly analysis of its valuation allowance for deferred taxes. The Company benefited from the reduction in its valuation allowance for deferred taxes for the nine months ended September 30, 2006 and for the three and nine months ended September 30, 2005 of $2.4 million, $500,000, and $1.5 million, respectively. The Company s valuation allowance for deferred taxes was zero at September 30, 2006.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

FORWARD-LOOKING STATEMENTS

The statements contained herein that are not historical facts are forward-looking statements based on management s current expectations and beliefs concerning future developments and their potential effects on the Company. There can be no assurance that future developments affecting the Company will be the same as those anticipated by management. Actual results may differ from those projected in the forward-looking statements. These forward-looking statements involve risks and uncertainties. These include, but are not limited to, the following risks: (1) changes in the performance of the financial markets, (2) changes in the demand for and market acceptance of the Company s products and services, (3) changes in general economic conditions including interest rates, presence of competitors with greater financial resources, and the impact of competitive projects and pricing, (4) the effect of the Company s policies, (5) the continued availability of adequate funding sources, and (6) various legal, regulatory and litigation risks.

GENERAL

The following presents management s discussion and analysis of the consolidated financial condition and operating results of the Company for the three and nine months ended September 30, 2006 and 2005. The discussion should be read in conjunction with the Company s Management Discussion and Analysis included in the 2005 Annual Report on Form 10-K, plus the unaudited consolidated financial statements and the notes thereto appearing elsewhere in this report. The results for the three and nine months ended September 30, 2006 are not necessarily indicative of the results expected for the year ending December 31, 2006.

The Corporation, a Delaware corporation organized in 1997, is a unitary savings and loan holding company that owns 100% of the capital stock of the Bank, the Corporation s principal operating subsidiary. The primary business of the Company is community banking.

The Bank was founded in 1983 as a state chartered savings and loan and became a federally chartered stock savings bank in 1991. The Bank is a member of the FHLB of San Francisco, which is a member bank of the Federal Home Loan Bank System. The Bank s deposit accounts are insured up to the $100,000 maximum amount, except for retirement accounts which are insured up to the $250,000 maximum currently allowable under federal laws by the Deposit Insurance Fund, which is an insurance fund administered by the Federal Deposit Insurance Corporation (FDIC). The Bank is subject to examination and regulation by the Office of Thrift Supervision (OTS), its primary federal regulator, and by the FDIC.

The Company is a financial services organization committed to serving consumers and small businesses in Southern California. The Bank operates five depository branches in Southern California located in the cities of San Bernardino, Seal Beach, Huntington Beach, Los Alamitos, and Costa Mesa, and a Small Business Administration (SBA) loan production office in Pasadena, California. The Company s corporate headquarters are located in Costa Mesa, California. In the first quarter of 2007, the Bank will be opening its sixth depository branch in the city of Newport Beach, California. The Bank, through its branches and web site at www.PPBI.net on the Internet, offers a broad array of deposit products and services for both commercial and consumer customers including checking, money market and savings accounts, cash management services, electronic banking, and on-line bill payment. Additionally, the Bank offers a wide array of loan products, such as commercial business loans, lines of credit, commercial real estate loans, SBA loans, residential home loans, and home equity loans. The Bank funds its lending and investment activities with retail deposits obtained through its branches, advances from the FHLB of San Francisco, lines of credit, and wholesale and brokered certificates of deposits.

The Company s principal sources of income are the net spread between interest earned on loans and investments and the interest costs associated with deposits and other borrowings used to finance its loan and investment portfolio. Additionally, the Bank generates fee income from various products and services offered to both depository and loan customers.

CRITICAL ACCOUNTING POLICIES

Management has established various accounting policies which govern the application of accounting principles generally accepted in the United States of America in the preparation of the Company s financial statements. The

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Company s significant accounting policies are described in the Notes to the Consolidated Financial Statements in our 2005 Annual Report on Form 10-K. Certain accounting policies require management to make estimates and assumptions which have a material impact on the carrying value of certain assets and liabilities; management considers these to be critical accounting policies. The estimates and assumptions management uses are based on historical experience and other factors, which management believes to be reasonable under the circumstances. Actual results could differ significantly from these estimates and assumptions, which could have a material impact on the carrying value of assets and liabilities at balance sheet dates and the Company s results of operations for future reporting periods.

Management believes that the allowance for loan losses is the critical accounting policy that requires estimates and assumptions in the preparation of the Company s financial statements that are most susceptible to significant change. For further information, see Allowances for Loan Losses discussed later in this document and in our 2005 Annual Report on Form 10-K.

FINANCIAL CONDITION

Total assets of the Company were $712.3 million as of September 30, 2006, compared to $702.7 million as of December 31, 2005. The $9.6 million, or 1.3%, increase in total assets is primarily due to the purchase of $10.0 million of Bank Owned Life Insurance (BOLI) at the end of March 2006, which is classified in other assets, and an increase in investments of $3.3 million, which was partially offset by a decrease in net loans of $8.4 million.

Investment Securities

A summary of the Company s securities as of September 30, 2006 and December 31, 2005 is as follows:

	September 30, 2006 Amortized Cost (in thousands)	Unrealized Gain	Unrealized Loss	Estimated Market Value
Securities Available for Sale:				
Mortgage-Backed Securities(1)	$ 11,337	$	$ (108)	$ 11,229
Mutual Funds(2)	27,719		(950)	26,769
Total securities available for sale	$ 39,056	$	$ (1,058)	$ 37,998
Securities Held to Maturity:				
FHLB Stock	$ 15,117	$	$	$ 15,117
Total securities held to maturity	$ 15,117	$	$	$ 15,117
Total securities	$ 54,173	$	$ (1,058)	$ 53,115

	December 31, 2005 Amortized Cost (in thousands)	Unrealized Gain	Unrealized Loss	Estimated Market Value
Securities Available for Sale:				
Mortgage-Backed Securities	$ 9,171	$	$ (112)	$ 9,059
Mutual Funds	27,719		(928)	26,791
Total securities available for sale	$ 36,890	$	$ (1,040)	$ 35,850
Securities Held to Maturity:				
FHLB Stock	$ 13,945	$	$	$ 13,945
Total securities held to maturity	$ 13,945	$	$	$ 13,945
Total securities	$ 50,835	$	$ (1,040)	$ 49,795

(1) At September 30, 2006, mortgage-backed securities consisted of two collateralized mortgage obligations (CMO) with a carrying value of $11.3 million. One CMO with a carrying value of $9.0 million is secured by the Federal Home Loan Mortgage Corporation, the other CMO with a carrying value of $2.3 million is a AAA rated private label issue.

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(2) The Company s mutual fund investments are with Shay Assets Management Inc, within their AMF Ultra Short Mortgage fund and their AMF Intermediate Mortgage fund. Both of these funds qualified for inclusion in the 20% risk-weighting capital category for the quarter ended September 30, 2006. An aggregate of $1.4 million of the mutual funds have been pledged to Pershing, LLC to secure an advance of $1.0 million under the Bank s $18.7 million line of credit.

Investment Securities by Contractual Maturity

As of September 30, 2006

(dollars in thousands)

	One Year or Less Carrying Value	Yield		More than One to Five Years Carrying Value	Yield		More than Five to Ten Years Carrying Value	Yield		More than Ten Years Carrying Value	Yield		Total Carrying Value	Yield	
Mortgage-Backed Securities	$	0.00	%	$	0.00	%	$	0.00	%	$ 11,229	4.76	%	$ 11,229	4.76	%
Mutual Fund	26,769	4.60	%		0.00	%		0.00	%		0.00	%	26,769	4.60	%
Total securities available for sale	26,769	4.60	%		0.00	%		0.00	%	11,229	4.76	%	37,998	4.65	%
FHLB Stock	15,117	5.16	%		0.00	%		0.00	%		0.00	%	15,117	5.16	%
Total securities held to maturity	15,117	5.16	%		0.00	%		0.00	%		0.00	%	15,117	5.16	%
Total securities	$ 41,886	4.80	%	$	0.00	%	$	0.00	%	$ 11,229	4.76	%	$ 53,115	4.79	%

The Company reviewed individual securities classified as available for sale to determine whether a decline in fair value below the amortized cost basis is other-than-temporary. If it is probable that the Company will be unable to collect all amounts due according to contractual terms of the debt security not impaired at acquisition, an other-than-temporary impairment shall be considered to have occurred. If an other-than-temporary impairment occurs, the cost basis of the security would have been written down to its fair value as the new cost basis and the write down accounted for as a realized loss. Management has determined that the unrealized losses on these securities are temporary in nature.

Loans

Gross loans outstanding totaled $597.1 million at September 30, 2006 compared to $605.0 million at December 31, 2005. The $7.9 million decrease is primarily due to the Bank selling $142.5 million of multi-family loans, which generated net gains of $2.3 million, and the prepayment of loans totaling $87.8 million, which generated loan servicing fee income of $852,000. Partially offsetting the loan sales and loan prepayments was the origination of $239.5 million of new loans, consisting of $131.4 million of multi-family, $56.4 million of commercial and land, one single-family residential loan of $500,000, and business loans comprised of $26.2 million of commercial owner-occupied loans, $18.2 million of commercial and industrial loans, and $6.7 million of SBA loans. Management has utilized loan sales to manage its liquidity, interest rate risk, loan to deposit ratio, diversification of its loan portfolio, and net balance sheet growth, and expects to continue to do so for the foreseeable future. The Bank s pipeline of new loans at September 30, 2006 was $98.2 million.

The Company s commercial real estate secured loans grew during the nine months ended September 30, 2006 by $51.4 million, an annualized rate of 54.6%.

For the three months ended September 30, 2006, the Bank originated $43.8 million and $30.6 million of multi-family and commercial real estate loans, respectively, as well as $8.3 million, $8.5 million, and $5.4 million of commercial owner-occupied loans, commercial and industrial loans, and SBA loans, respectively. For the nine months

ended September 30, 2006, multi-family and commercial real estate originations totaled $131.4 million and $56.4 million, respectively, while the commercial owner-occupied loans, commercial and industrial loans, and SBA loan originations totaled $26.2 million, $18.2 million, and $6.7 million, respectively. Principal repayments and loan sales for the three months ended September 30, 2006 totaled $40.0 million and $65.2 million, respectively, and principal repayments and loan sales for the nine months ended September 30, 2006 totaled $94.6 million and $144.0 million, respectively.

A summary of the Company s loan originations, loan sales and principal repayments for the nine months ended September 30, 2006 and 2005 are as follows:

	For the Nine Months Ended September 30, 2006 (in thousands)	**September 30, 2005**
Beginning balance, gross	$ 604,976	$ 471,609
Loans originated:		
Real Estate:		
Multi-family	131,440	128,194
Commercial and land	56,409	56,242
One to four family(1)	500	1,944
Business Loans:		
Commercial Owner Occupied(1)	26,187	
Commercial and Industrial(1)	18,248	5,267
SBA(1)	6,712	
Other		1
Total loans originated	239,496	191,648
Total	844,472	663,257
Less:		
Principal repayments	94,631	55,670
Change in undisbursed loan funds	8,275	1,350
Net Charge-offs	71	18
Loan Sales	144,012	31,823
Transfers to Real Estate Owned	433	287
Total Gross loans	597,050	574,109
Less ending balance loans held for sale (gross)	1,223	370
Ending balance loans held for investment (gross)	$ 595,827	$ 573,739

(1) Includes lines of credit

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The following table sets forth the composition of the Company s loan portfolio in dollar amounts and as a percentage of the portfolio at the dates indicated:

	September 30, 2006					December 31, 2005				
	Amount (dollars in thousands)	Percent of Total		Weighted Average Interest Rate		Amount	Percent of Total		Weighted Average Interest Rate	
Real Estate Loans:										
Multi-family	$ 386,865	64.81	%	6.76	%	$ 459,714	75.99	%	6.07	%
Commercial and land	144,922	24.27	%	7.25	%	123,364	20.39	%	6.73	%
One-to-four family(1)	13,067	2.19	%	9.70	%	16,561	2.74	%	9.63	%
Business Loans:										
Commercial Owner Occupied	31,890	5.34	%	7.17	%	2,062	0.34	%	7.32	%
Commercial and Industrial	16,077	2.69	%	8.93	%	3,248	0.54	%	7.95	%
SBA	4,203	0.70	%	10.14	%		0.00	%	0.00	%
Other Loans	26	0.00	%	12.01	%	27	0.00	%	11.90	%
Total Gross loans	$ 597,050	100.00	%	7.04	%	$ 604,976	100.00	%	6.30	%

(1) Includes second trust deeds.

The following table sets forth the repricing characteristics of the Company s multi-family and commercial real estate (excluding land) and commercial owner occupied loan portfolio in dollar amounts as of September 30, 2006:

	Number of Loans (dollars in thousands)	Amount	Weighted Average Interest Rate		Months to Reprice
ARM *	366	$ 278,173	7.360	%	1.82
3 Year	142	143,714	6.200	%	23.74
5 Year	91	95,202	6.575	%	47.01
7 Year	13	8,059	6.966	%	78.83
10 Year	11	10,370	6.805	%	117.74
Fixed	24	24,875	6.917	%	
	647	$ 560,393	6.894	%	19.14

* Includes three and five year hybrid loans that have reached their initial repricing date.

<u>Allowance for Loan Losses</u>

The allowance for loan losses totaled $3.1 million as of September 30, 2006 and $3.1 million as of December 31, 2005. The allowance for loan losses as a percent of nonperforming loans was 539.9% and 180.8% as of September 30, 2006 and December 31, 2005, respectively. The increase in allowance for loan losses as a percent of nonperforming loans of 359.14% is primarily due to a decrease in total net nonperforming loans of $1.0 million from December 31, 2005 to September 30, 2006.

The Company s determination of the level of the allowance for loan losses and, correspondingly, the provision for loan losses, rests upon various judgments and assumptions. The allowance for the one-to-four family residential loan portfolio is primarily based upon the Bank s historical loss experience from charge-offs and real estate owned for the last 37 quarters, and a historical delinquency migration analysis. For the multi-family and commercial real estate loan portfolio, the Bank analyzes and uses the 14.5 year historical loan loss experience for California s multi-family and commercial real estate secured loans compiled by the FDIC to determine its loss factors, since the Bank has not experienced any losses or delinquency on its own loans within this loan portfolio. For the commercial and industrial loan

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portfolio, along with the non-guarantee portion of the SBA portfolio, the Bank bases the level of allowance on the type of collateral and 14.5 year historical loan loss experience for commercial business loans compiled by the FDIC. Given the composition of the Company s loan portfolio, the $3.1 million allowance for loan losses was considered adequate to cover losses inherent in the Company s loan portfolio at September 30, 2006. However, no assurance can be given that the Company will not, in any particular period, sustain loan losses that exceed the amount reserved, or that subsequent evaluation of the loan portfolio, in light of the prevailing factors, including economic conditions which may adversely affect the Company s market area or other circumstances, will not require significant increases in the loan loss allowance. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Bank s allowance for loan losses. Such agencies may require the Bank to recognize additional provisions to increase the allowance or take charge-offs in anticipation of future losses.

The table below summarizes the activity of the Company s allowance for loan losses for the three and nine months ended September 30, 2006 and 2005:

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
	2006	**2005**	**2006**	**2005**
	(in thousands)			
Balance, beginning of period	$ 2,967	$ 2,779	$ 3,050	$ 2,626
Provision for loan losses		56	104	292
Charge-offs				
Real estate:				
Multi-family				
Commercial and land				
Construction				
One-to-four family	(30)	(38)	(266)	(206)
Business Loans:				
Commercial Owner Occupied				
Commercial and Industrial				
SBA loans				
Other loans				(6)
Total charge-offs	(30)	(38)	(266)	(212)
Recoveries				
Real estate:				
Multi-family				
Commercial and land				
Construction		74		74
One-to-four family	146	25	193	97
Business Loans:				
Commercial Owner Occupied				
Commercial and Industrial				
SBA loans				
Other loans		4	2	23
Total recoveries	146	103	195	194
Net (charge-offs) recoveries	116	65	(71)	(18)
Balance, end of period	$ 3,083	$ 2,900	$ 3,083	$ 2,900

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Composition of Nonperforming Assets

The table below summarizes the Company s composition of nonperforming assets as of the dates indicated. Net nonperforming assets totaled $752,000 at September 30, 2006 and $1.7 million as of December 31, 2005, or 0.11% and 0.24% of total assets, respectively. The decrease in the total nonperforming assets is primarily due to decreases in net nonperforming one-to-four family loans of $1.0 million. All nonperforming assets are concentrated in the Bank s single family residential loans and are associated with its prior origination of sub-prime mortgages, which were discontinued in the year 2000.

	At September 30, 2006 (dollars in thousands)		At December 31, 2005	
Nonperforming assets:				
Real Estate:				
Multi-family				
Commercial and land				
One-to-four family	$ 571		$ 1,687	
Business Loans:				
Commercial Owner Occupied				
Commercial and Industrial				
SBA				
Other loans				
Total nonaccrual loans	571		1,687	
Foreclosures in process				
Specific allowance	(83	)	(185	)
Total nonperforming loans, net	488		1,502	
Foreclosed real estate owned	264		211	
Total nonperforming assets, net(1)	$ 752		$ 1,713	
Restructured Loans	$		$	
Allowance for loan losses as a percent of gross loans receivable(2)	0.52	%	0.50	%
Allowance for loan losses as a percent of total nonperforming loans, gross	539.93	%	180.79	%
Nonperforming loans, net of specific allowances, as a percent of gross loans receivable	0.08	%	0.25	%
Nonperforming assets, net of specific allowances, as a percent of total assets	0.11	%	0.24	%

(1) Nonperforming assets consist of nonperforming loans and REO. Nonperforming loans consisted of all loans 90 days or more past due and foreclosures in process less than 90 days and still accruing interest.

(2) Gross loans include loans receivable that are held for investment and are held for sale.

Liabilities and Stockholders Equity

Total liabilities of the Company increased from $652.2 million at December 31, 2005 to $655.1 million at September 30, 2006. The increase is primarily due to increases in other liabilities and other borrowings of $5.2 million and $4.2 million, respectively, which were partially offset by a decrease in deposits of $6.4 million.

The Company had $312.0 million in FHLB advances and other borrowings as of September 30, 2006, compared to $307.8 million in such borrowings at December 31, 2005. Advances from the FHLB are collateralized by pledges of certain real estate loans with an aggregate principal balance of $460.3 million at September 30, 2006. The Bank may borrow up to 45% of its assets under the line. As of September 30, 2006, the maximum the Bank may borrow was $319.3 million, based on the Bank s assets as of June 30, 2006. The total cost of the Company s borrowings at September 30, 2006 was 5.34%, an increase of 182 basis points compared to the same period in 2005.

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Deposits decreased by $6.4 million to $321.5 million at September 30, 2006, compared to $327.9 million of deposits at December 31, 2005. The decrease in deposits is due to a decrease of $22.5 million in brokered certificate of deposits, which was partially offset by increases of $11.4 million in transaction accounts and noninterest deposits and $4.6 million in retail certificates of deposits, respectively. The cost of deposits as of September 30, 2006 was 3.91%, an increase of 75 basis points since December 31, 2005.

During the three months ended September 30, 2006, the cost of funds increased 148 basis points to 4.56% compared to the same period in 2005.

Total stockholder s equity increased $6.6 million to $57.1 million at September 30, 2006, compared to $50.6 million at December 31, 2005, primarily due to net income during this period.

RESULTS OF OPERATIONS

Highlights for the three and nine months ended September 30, 2006 and 2005:

The Company recorded third quarter net income of $1.5 million, or $0.23 per diluted share, compared to net income of $1.8 million, or $0.27 per diluted share, for the third quarter of 2005, a decrease of 17.9% in net income. The net income for the nine months ended September 30, 2006 was $6.2 million, or $0.92 per diluted share, compared to net income of $5.5 million, or $0.83 per diluted share, for the nine months ended September 30, 2005, an increase of 11.4% in net income. All diluted earnings per share amounts have been adjusted to reflect the dilutive effect of all warrants and stock options, except for options whose exercise price exceeds the closing market price as of September 30, 2006, outstanding. See Note 6 Earnings Per Share.

Return on average assets (ROAA) for the three and nine months ended September 30, 2006 was 0.86% and 1.19% compared to 1.16% and 1.24% for the same periods in 2005. The Company s return on average equity (ROAE) for the three and nine months ended September 30, 2006 was 10.38% and 15.16%, respectively, compared to 14.95% and 15.74%, respectively, for the three and nine months ended September 30, 2005. The Company s basic and diluted book value per share increased to $10.85 and $9.02, respectively, at September 30, 2006, reflecting annualized increases of 16.27% and 15.33%, respectively, from December 31, 2005. Options whose exercise price exceeds the closing market price as of September 30, 2006 are excluded from the diluted book value calculation.

Net Interest Income

The Company s earnings are derived predominately from net interest income, which is the difference between the interest income earned on interest-earning assets, primarily loans and securities, and the interest expense incurred on interest-bearing liabilities, primarily deposits and borrowings. The net interest margin is the net interest income divided by the average interest-earning assets.

For the three and nine months ended September 30, 2006, net interest income was $4.1 million and $12.9 million, respectively, compared to $4.3 million and $12.7 million for the same periods a year earlier. The increase for the nine month period is predominately attributable to a 35.1% growth in interest income, from $24.0 million to $32.4 million. Growth in interest income was predominately attributable to a 14.8% increase in average loans outstanding of $78.6 million and a 17.6% increase in the average loan yield to 6.68% from 5.68%, over the prior year period. The increase in loan yield is, in part, a direct reflection of the Bank s focus on originating higher yielding loans to businesses within the Bank s market area plus the selling of lower yielding multifamily loans. Partially offsetting the increase in interest income was an increase in interest expense for the nine months ended September 30, 2006 of 72.3%, or $8.2 million. The increase in interest expense was attributable to increases in average deposits outstanding of $24.5 million and average borrowings of $63.0 million, as well as the increase in the average cost of deposits and borrowings of 95 and 173 basis points, respectively, over the prior year period. For the three month period, the $222,000 decrease in net interest income is primarily due to the $1.9 million increase in interest expense on borrowings and the $865,000 increase in deposit interest expense that was partially offset by the $2.4 million increase in loan interest income. The three month average loan yield increased to 6.97% for the period ended September 30, 2006 from 5.84% for the same period last year.

The Company s net interest margin for the quarter ended September 30, 2006 was 2.46% compared to 2.81% for the same period a year ago. The decrease was primarily attributable to increases in the average cost of deposits and borrowings of 96 and 196 basis points, respectively, which was partially offset by an increase in the average rate earned on loans of 112 basis points. The increase in the cost of funds is attributable to the overall rising interest rate environment, which has lead to higher borrowing cost associated with the Bank s FHLB advances. Additionally, strong competitor deposit pricing within the Bank s primary markets have impacted the cost of deposits. The Company s net interest margin for the nine months ended September 30, 2006 was 2.61% compared to 2.93% for the same period a year ago. The increase in earning assets yields are primarily due to the repricing of the Bank s adjustable rate loans together with the change in the loan portfolio mix to higher yielding commercial real estate and business loans. At September 30, 2006, the Bank s loan portfolio was comprised of $565.7 million of adjustable-rate loans, representing 94.8 of its total loan portfolio at such date. These loans, which include fixed rate hybrid loans with initial terms of 3, 5, 7 and 10 years that become adjustable-rate loans after the initial fixed rate period, have an overall average time to reprice of 18.3 months. The adjustable-rate loan portfolio contains $193.9 million of loans that are scheduled to reprice in October 2006, of which $129.2 million is indexed to the 12 Month Treasury Average rate (12-MTA), a lagging index, and $25.1 million that is indexed to the six-month LIBOR rate.

The following table sets forth the Company s average balance sheets and the related weighted average yields and costs on average interest-earning assets and interest-bearing liabilities, for the three and nine months ended September 30, 2006 and 2005. The yields and costs are derived by dividing income or expense by the average balance of assets or liabilities, respectively, for the periods shown. Average balances are measured on a daily basis. The yields and costs include fees that are considered adjustments to yields.

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	Three Months Ended September 30, 2006			Three Months Ended September 30, 2005		
	Average Balance (dollars in thousands)	Interest	Average Annualized Yield/Cost	Average Balance	Interest	Average Annualized Yield/Cost
Assets						
Interest-earning assets:						
Cash and cash equivalents	$ 377	$ 22	23.34 %	$ 864	$ 16	7.41 %
Federal funds sold	1,376	18	5.13 %	403	4	3.70 %
Investment securities	50,790	638	5.02 %	48,025	491	4.09 %
Loans receivable	611,760	10,658	6.97 %	563,260	8,230	5.84 %
Total interest-earning assets	664,303	11,336	6.83 %	612,552	8,741	5.71 %
Non-interest-earning assets	36,357			17,201		
Total assets	$ 700,660			$ 629,753		
Liabilities and Equity						
Interest-bearing liabilities:						
Transaction accounts	$ 93,522	$ 430	1.84 %	$ 80,739	$ 308	1.53 %
Retail certificates of deposit	192,945	2,215	4.59 %	173,742	1,432	3.30 %
Wholesale/brokered certificates of deposit	29,408	366	4.98 %	46,821	406	3.47 %
Total interest-bearing deposits	315,875	3,011	3.81 %	301,302	2,146	2.85 %
Borrowings	309,355	4,028	5.21 %	263,674	2,125	3.22 %
Subordinated debentures	10,310	211	8.19 %	10,310	162	6.29 %
Total borrowings	319,665	4,239	5.30 %	273,984	2,287	3.34 %
Total interest-bearing liabilities	635,540	7,250	4.56 %	575,286	4,433	3.08 %
Non-interest-bearing liabilities	7,174			5,420		
Total liabilities	642,714			580,706		
Equity	57,946			49,047		
Total liabilities and equity	$ 700,660			$ 629,753		
Net interest income		$ 4,086			$ 4,308	
Net interest rate spread			2.26 %			2.63 %
Net interest margin			2.46 %			2.81 %
Ratio of interest-earning assets to interest-bearing liabilities			104.53 %			106.48 %

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	Nine Months Ended September 30, 2006			Nine Months Ended September 30, 2005		
	Average Balance (dollars in thousands)	Interest	Average Annualized Yield/Cost	Average Balance	Interest	Average Annualized Yield/Cost
Assets						
Interest-earning assets:						
Cash and cash equivalents	$ 620	$ 101	21.72 %	$ 541	$ 36	8.87 %
Federal funds sold	1,108	39	4.68 %	328	7	2.91 %
Investment securities	50,283	1,801	4.78 %	46,961	1,378	3.91 %
Loans receivable	608,574	30,504	6.68 %	529,947	22,585	5.68 %
Total interest-earning assets	660,585	32,445	6.55 %	577,777	24,006	5.54 %
Non-interest-earning assets	30,001			15,765		
Total assets	$ 690,586			$ 593,542		
Liabilities and Equity						
Interest-bearing liabilities:						
Transaction accounts	$ 90,301	$ 1,191	1.76 %	$ 78,937	$ 844	1.43 %
Retail certificates of deposit	191,620	6,001	4.18 %	171,223	3,859	3.01 %
Wholesale/brokered certificates of deposit	39,002	1,296	4.43 %	46,270	1,033	2.98 %
Total interest-bearing deposits	320,923	8,488	3.53 %	296,430	5,736	2.58 %
Borrowings	298,556	10,429	4.66 %	235,532	5,138	2.91 %
Subordinated debentures	10,310	592	7.66 %	10,310	446	5.77 %
Total borrowings	308,866	11,021	4.76 %	245,842	5,584	3.03 %
Total interest-bearing liabilities	629,789	19,509	4.13 %	542,272	11,320	2.78 %
Non-interest-bearing liabilities	6,691			4,522		
Total liabilities	636,480			546,794		
Equity	54,106			46,748		
Total liabilities and equity	$ 690,586			$ 593,542		
Net interest income		$ 12,936			$ 12,686	
Net interest rate spread			2.42 %			2.76 %
Net interest margin			2.61 %			2.93 %
Ratio of interest-earning assets to interest-bearing liabilities			104.89 %			106.55 %

The following table sets forth the effects of changing rates and volumes (changes in the average balances) on the Company s net interest income. Information is provided with respect to (i) effects on interest income attributable to changes in rate (changes in rate multiplied by prior volume); (ii) effects on interest income attributable to changes in volume (changes in volume multiplied by prior rate); and (iii) the net change.

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	Three Months Ended September 30, 2006 Compared to Three Months Ended September 30, 2005 Increase (decrease) due to			Nine Months Ended September 30, 2006 Compared to Nine Months Ended September 30, 2005 Increase (decrease) due to		
	Rate	Volume	Net	Rate	Volume	Net
	(in thousands)					
Interest-earning assets:						
Cash and cash equivalents	$ (56)	$ 62	$ 6	$ 6	$ 59	$ 65
Federal funds sold	12	2	14	26	6	32
Investment securities	30	117	147	103	320	423
Loans receivable, net(1)	751	1,677	2,428	3,621	4,298	7,919
Total interest-earning assets	737	1,858	2,595	3,756	4,683	8,439
Interest-bearing liabilities:						
Transaction accounts	$ 53	$ 69	$ 122	$ 132	$ 215	$ 347
Retail certificates of deposit	172	611	783	502	1,640	2,142
Wholesale/brokered certificates of deposit	(670)	630	(40)	(263)	526	263
Borrowings	419	1,484	1,903	1,630	3,661	5,291
Subordinated debentures		49	49		146	