

**AECON GROUP INC. SECOND QUARTER REPORT 2005**

Six months ended June 30, 2005

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***AECON***

Dear fellow shareholders,

As we enter the second half of 2005, the anticipated turnaround in Aecon's financial results continues. Our operating results from continuing operations showed improvement in both the second quarter and first half compared to last year. Our Infrastructure and Buildings segments generated first half operating profits after recording losses in 2004. Our Industrial segment, while just at the breakeven point at mid year, gained momentum in the second quarter and is expected to report a stronger year end profit contribution than it did last year.

Not only are our core construction operations performing better but the continuing ramp-up of our highway concession in Israel and the imminent financial close of our airport concession in Ecuador add to our optimism for the future.

In the second quarter, revenue from continuing operations grew by 7% over the same quarter last year, bringing our first half revenues to \$456 million. Operating income from continuing operations (net income from operations before extraordinary items, interest and income taxes) more than doubled in the quarter to \$4.4 million and income before income taxes and discontinued operations grew to \$1.9 million.

Our \$4.8 million operating loss in the first half is a \$3 million improvement over last year. Our net loss for the half was \$6.7 million but had Aecon's accounting for income taxes remained the same in 2005 as in previous years (and a valuation allowance against future tax assets not been required) the net loss in the first half would have been \$2.9 million - a substantial improvement from the \$6.5 million loss before discontinued operations recorded in the first half last year.

As we look toward the second half, I expect to see year end earnings improvements in each of our three segments as compared to the results reported last year.

### Infrastructure

While completion of the Cross Israel Highway, the Nathpa Jhakri project and the Toulmoustou hydro-electric project in Quebec have resulted in somewhat lower Infrastructure revenues in 2005 than we saw in 2004, operating results in the first half of the year were better than those posted in 2004.

Income before interest and income taxes in the first half of 2005 grew to \$4.2 million, an increase of \$5.0 million over last year, despite a \$0.5 million decline in the second quarter.

Strong improvements posted in roadbuilding and utilities operations in the first half combined to offset declines due to reduced activity in Israel and India and \$2.5 million related to foreign exchange. This strong performance is expected to continue for the balance of the year.

I'm pleased to report that tolling and highway operations are functioning well on the Cross Israel Highway with average traffic volumes in June 2005 reaching 70,000 cars per day - continuing in the range anticipated. The expected internal rate of return on the project after tax remains in the 14% range assuming full exercise of the State and lender options. In addition, signing of the remaining financing documents for the Quito Airport project is expected to occur later this month, with satisfaction of the final conditions precedent and flow of funds expected in the fourth quarter.

For 2005, the Infrastructure segment is expected to show increased earnings as compared to last year. The improved roadbuilding results achieved in the first half of 2005 are expected to continue throughout the second half of the year as the strong volumes experienced to date continue to be supported by a healthy backlog. Similarly, the year-over-year improvement in volumes and operating results experienced in the utilities sector are expected to hold throughout the balance of the year.

Aecon's Quebec civil operations, while still facing many of the challenges experienced last year, are also expected to record stronger results in the second half of 2005 than were reported in 2004. Outside of Quebec, Aecon's heavy civil construction operations are expected to show a loss in the second half as volume reductions resulting from completion of the Cross Israel Highway and the Nathpa Jhakri hydro-electric project in India have not yet been fully replaced. This volume is expected to soon be replaced by the Quito Airport project.

### Buildings

The largest improvement in our results this year has been in the Buildings segment, which is clearly rebounding from its very difficult year in 2004. The Buildings segment has generated both top and bottom line improvements in the first half of the year and I fully expect this segment to report a return to profitability at year end.

While operating income in the Buildings segment was a modest \$0.6 million in the first half, this represents a \$4.4 million improvement over 2004 when the segment incurred losses each quarter. Over half of this improvement came from the Greater Toronto Area (GTA), while the Montreal and Ottawa regions each generated improvements in excess of \$1 million.

Operations in the GTA are expected to remain profitable in the second half of the year as changes implemented in 2004, including improved risk management practices and re-focused business development activities, continue to have a positive impact on results. Similarly, operations in the Ottawa and Montreal markets, both of which were significantly impacted last year by acquisitions, are expected to maintain the substantial improvement achieved in the first half.

The Seattle business unit, which was one of the few bright spots in Aecon's Buildings segment last year, is expected to make a profit contribution again this year, although delays in planned casino projects are expected to result in lower volumes and a slightly lower operating profit this year.

### Industrial

Revenues in the Industrial segment increased in the first half of 2005 as compared to the first half of last year but, as anticipated, operating results were not able to keep pace with the very strong first half reported in 2004. It remains my expectation that this trend will shift in the second half and that by year end we will see stronger revenues and earnings than reported last year.

In fact this shift has already begun to take shape as operating income of \$2.3 million in the second quarter erased the losses posted in the first quarter and produced a breakeven first half.

Profit margins from our Western Canadian operations declined in the first half as a result of the mix of work performed this year. In 2004, we produced mostly high margin module and fabrication assembly work whereas in the first half of 2005 much of the work was lower margin site construction work. In the coming months, pipe fabrication and module related work in Western Canada are expected to be very active, significantly improving the outlook for this business unit. Similarly, Innovative Steam technologies (IST) was unable to translate increased revenues in the first half into significant profit contributions as changes in product mix and higher overhead costs in the first quarter reduced operating results.

Pipe fabrication in Ontario and Eastern Canada was the only area where the Industrial sector had significantly better results than last year, reducing its first half loss by over \$1 million as compared to last year.

I expect the segment's improvement in the second half to be led by the Western Operations business unit as higher volumes from the oilsands projects in Northern Alberta drive improved results. Aecon has established a strong presence in this market, with industrial construction now added to its ongoing capabilities in pipe fabrication and module assembly. This increased presence positions Aecon very well for continued growth in the growing oilsands market where billions of dollars are expected to be invested each year over the next decade.

IST is expected to reach breakeven again in 2005. After reporting strong sales in the first three quarters of 2004, IST was caught in a sales slowdown which lasted through much of the first half of 2005 and resulted in a substantial depletion of backlog. It now appears that this sales slowdown is ending and IST expects to close the year with a healthy backlog once again. And pipe fabrication operations in Ontario are expected to continue their substantial year-over-year improvement, with profit contributions anticipated this year following losses in 2004.

Industrial's construction business unit is also expected to generate positive profit contributions, although likely not as large as those recorded in 2004. Within industrial construction, the nuclear sector holds substantial promise for Aecon as Ontario's well publicized need for increased generation capacity is already starting to lead to more demand. Aecon is well positioned to capture significant work in this market, most of which is likely to take place in 2006 and beyond.

In summary, while we are not yet fully satisfied with our performance - I believe if we can continue to manage the risks we've identified, we will see a significant improvement in Aecon's bottom line results and a return to profitability in 2005.

On behalf of the Board of Directors,

John M. Beck  
Chairman and Chief Executive Officer  
August 10, 2005

## Management's Discussion and Analysis of operating results and financial condition ("MD&A")

The following discussion and analysis of the consolidated results of operations and financial condition of Aecon Group Inc. ("Aecon") should be read in conjunction with the Company's Interim Consolidated Financial Statements and Notes (which have not been reviewed by the Company's external auditors) and in conjunction with the Company's annual MD&A for 2004. This interim MD&A has been prepared as of August 10, 2005. Additional information on Aecon is available through the System for Electronic Document Analysis and Retrieval (SEDAR) at [www.sedar.com](http://www.sedar.com) and includes the Company's Annual Information Form and other security filings.

### RESULTS OF OPERATIONS BEFORE DISCONTINUED OPERATIONS

The following commentary, unless otherwise indicated, discusses the results of operations before discontinued operations.

#### Introduction

Aecon operates in three principal segments within the construction industry – Infrastructure, Buildings and Industrial.

The construction industry in Canada is seasonal in nature due to weather conditions, with less work performed in the winter and early spring months. Accordingly, Aecon experiences a seasonal pattern in its operating results with the first quarter of the year typically reflecting lower revenues and profits than the other three quarters. Therefore, results in any one quarter are not necessarily indicative of results in any other quarter or for the year as a whole.

#### Consolidated

##### Financial Highlights

millions	Three months ended June 30			Six months ended June 30		
	<u>2005</u>	<u>2004</u>	<u>% Change</u>	<u>2005</u>	<u>2004</u>	<u>% Change</u>
Revenues	283.0	264.7	6.9%	455.9	453.7	0.5%
Operating profit/(loss)*	4.4	1.7	170.0%	(4.8)	(7.8)	38.3%
Extraordinary gain before income taxes				4.1	0	
<b>Income/(loss) before interest and income taxes</b>	4.4	1.7	170.0%	(0.7)	(7.8)	91.4%
Interest expense, net	2.5	0.9	(197.7)%	4.3	1.8	(139.4)%
<b>Income/(loss) before income taxes</b>	<u>1.9</u>	<u>0.8</u>	<u>140.5%</u>	<u>(5.0)</u>	<u>(9.6)</u>	<u>49.1%</u>
Return on Revenue	1.6%	0.6%	166.7%	(1.1)%	(1.7)%	35.3%
Backlog - June 30	<u>\$ 530.0</u>	<u>\$ 568.7</u>	<u>(6.8)%</u>			

\*Operating profit/(loss) represents the profit/(loss) from operations before extraordinary items and before interest, income taxes and discontinued operations

Revenues from continuing operations for the three months ended June 30, 2005 amounted to \$283.0 million, representing an increase of \$18.3 million or 6.9% over the same period last year. Revenues increased in each of the Buildings and Industrial segments by \$9.5 million and \$15.1 million respectively, while Infrastructure revenues were down \$6.3 million in the quarter.

For the first half of the year, revenues from continuing operations of \$455.9 million were higher than 2004 by \$2.2 million, as small increases in the Industrial and Buildings segments offset a small decline in Infrastructure revenues. Results for each of the three principal operating segments are discussed separately under Reporting Segments.

Operating margins (revenues less costs and expenses) as a percentage of revenues increased from 5.7% in the second quarter of 2004 to 6.2% in the current quarter, reflecting an increase in returns from the Infrastructure and Buildings segments offset partly by a decline in returns from the Industrial segment. Foreign exchange was a factor; excluding the impact of foreign exchange operating margins would have been 6.3% in 2005 compared to 5.7% in 2004. A foreign exchange loss of \$0.5 million, which reduced operating margins in the quarter, compares to a loss of \$0.1 million in the same period last year.

Operating margins for the six months in 2005 were 5.0% compared to 4.7% in 2004. Exclusive of the impact of foreign exchange, operating margins would have been 5.1% and 4.5% respectively. A foreign exchange loss of \$0.3 million in the first half of 2005 compares to a gain of \$0.9 million in the corresponding period last year. Similar to the second quarter, improved returns were produced by the Infrastructure and Buildings segments, while lower returns were earned by the Industrial segment.

In addition to foreign exchange gains and losses impacting operating margins, they also impact marketing, general and administrative expenses (“MG&A”). While the foreign exchange amounts included in the calculation of operating margins principally results from the periodic revaluation of undistributed profits in the Company’s joint venture projects in Israel and India, the MG&A amounts relate to the translation up to April 28, 2004 of deposits used to fund Aecon’s investment in the concessionaire operating the Cross Israel Highway, as well as the impact of translating various foreign currency investments and borrowings. Foreign exchange reported within MG&A amounted to a loss of \$0.2 million in the second quarter of 2005 versus a gain of \$0.6 million in 2004, while for the six months a loss of \$0.3 million was recorded compared to a gain of \$0.8 million last year. Comparing 2005 results to 2004, excluding the impact of foreign exchange, pre-tax earnings in the second quarter would have been \$1.1 million higher than the same quarter last year, while pre-tax earnings for the first six months would have been \$2.2 million higher. On an after-tax basis, the increases would have been \$0.9 million in the second quarter and \$2.0 for the six months. Aecon’s investment in the concessionaire operating the Cross Israel Highway, amounting to \$41.3 million is being accounted for at cost and will not therefore be subject to revaluation for changes in future exchange rates. This significantly reduces the amount of foreign exchange gains and losses that might otherwise be reported by Aecon.

Marketing, general and administrative expenses amounted to \$12.0 million in the second quarter of 2005, which was \$0.2 million higher than the same quarter last year. Foreign exchange, as previously noted, had a negative year-over-year impact of \$0.8 million. After removing the effect of foreign exchange, MG&A was \$0.6 million lower than 2004, principally because of costs of \$0.2 million in

2004 related to the consolidation of three Aecon area offices into one location as well as 2004 costs of \$0.5 million associated with Aecon's proposed going private transaction. For the six months MG&A was \$0.9 million lower than 2004. After removing the effect of exchange and the impact on 2004 expenses of the one-time costs of \$0.7 million (noted above), as well as a charge of \$2.6 million incurred in the first quarter of 2004 to cover the cost of terminating the lease on Aecon's former premises at Midland Avenue in Toronto, MG&A would be higher by \$1.3 million. The \$1.3 million increase primarily pertains to higher salaries, benefits and severances costs.

Depreciation and amortization amounted to \$2.0 million for the second quarter and \$3.7 million for the first six months, essentially unchanged from the same periods last year.

Net interest expense increased by \$1.7 million in the second quarter to \$2.5 million and rose by \$2.5 million in the six months to \$4.3 million. Interest on convertible debt, which was \$1.7 million higher in the second quarter and \$2.3 million higher in the six months, was the principal contributor to the increases. The Company had two new issues of convertible debentures, \$30.0 million in November 2004 and \$32.5 million in March 2005.

In the fourth quarter of 2004, the Company provided a valuation allowance against the net future tax assets that had been recorded at December 31, 2003 and against future tax assets that would otherwise have been recorded in 2004 with respect to its Canadian controlled operations. Consistent with this accounting treatment, future tax assets in respect of further tax losses incurred in 2005 from Canadian controlled operations will be offset by a valuation allowance whereas tax on income from Canadian controlled operations will be offset by a reduction in previously recorded valuation allowances.

Since the Company incurred losses of \$12.9 million in its Canadian operations in the first three months of 2005, an additional valuation allowance of \$4.5 million was provided against the future tax assets that would otherwise have been recorded. However, in the second quarter ended June 30, 2005, the Company recorded income of \$1.7 million from its Canadian controlled operations. As a result, the valuation allowance balance was reduced by \$0.7 million in order to offset the tax provision of \$0.7 million that would otherwise have been recorded.

Based on the foregoing, for the second quarter ended June 30, 2005 a tax expense of \$0.3 million (2004 - \$0.3 million) was recorded on pre-tax income before extraordinary items and discontinued operations of \$1.9 million (2004 - \$0.8 million). The 2004 income tax expense relates to income from all operations whereas the 2005 tax expense effectively excludes a provision for income taxes of \$0.8 million on income from Canadian controlled corporations because the provision that would otherwise have been recorded is offset by a reduction of the same amount in the valuation allowance balance.

For the six months ended June 30, 2005, a tax expense of \$1.1 million (2004 - recovery \$3.1 million) was recorded on pre-tax losses before extraordinary items and discontinued operations of \$9.1 million (2004 - \$9.6 million). Similar to the second quarter, the 2004 income tax recovery relates to losses from all operations whereas the 2005 tax expense effectively excludes a provision for income taxes recoverable of \$3.8 million because the provision that would otherwise have been recorded is offset by an increase of the same amount in the valuation allowance balance.



Set out below, in tabular form, is a reconciliation between the expected tax recoveries in 2005 and 2004 at statutory income tax rates and the actual reported tax expense in 2005 and tax recovery in 2004 (dollars in thousands).

	<b>Six months ended June 30th</b>	
	<b>2005</b>	<b>2004</b>
Loss before income taxes and extraordinary items	\$ 9,079	\$ 9,550
Statutory income tax rate	36.1%	36.1%
Expected income tax recovery	<u>3,279</u>	<u>3,449</u>
Effect on income tax of:		
Valuation allowance against current year's future tax assets	3,832	-
Provincial and foreign rate differentials	54	263
Non-deductible expenses	217	212
Large corporations tax	225	225
Foreign exchange translation (gains) losses	103	(462)
Other	(67)	204
	<u>4,364</u>	<u>442</u>
Income tax expense (recovery)	<u>\$ 1,085</u>	<u>\$ (3,007)</u>

Backlog at June 30, 2005 was \$530.0 million or \$38.6 million lower than the same date last year. On a segment basis, there was a decline of \$98 million in the Infrastructure segment which was partially offset by increases of \$45.1 million and \$14.7 million in the Buildings and Industrial segments respectively. The decline within the Infrastructure segment was mostly within roadbuilding operations and mostly represents a variance due to accelerated work off and the timing of new awards backlog, and thus no negative trend is actually believed to be evident. New contract awards of \$223.1 million were booked in the second quarter, which compares with \$254.6 million in 2004, while for the first six months of 2005 contract awards of \$420.9 million were awarded compared to \$475.9 million in 2004 with the majority seen within the Buildings segment. The decline in awards for the second quarter and the first six months of 2005 compared to the same periods in 2004 was due to lower awards in the Infrastructure and Buildings segments, which exceeded the increase in contract awards posted by the Industrial segment. Further details for each of the segments are included in the discussion below under Reporting Segments.

At June 30, 2005, major projects backlog, which previously was represented by Aecon's two large international projects in India and Israel, is now down to \$4.9 million as these two projects are now basically complete. The financial close of the Quito Airport project in Ecuador is projected to add approximately \$250 million to major projects backlog.

## **DISCONTINUED OPERATIONS**

In 2004, Aecon sold its 38.75% interest in Canatom NPM Inc., which had been a part of the Industrial segment. Also in 2004, Aecon sold its Footage Tools division and its one-third interest in a small joint venture, both of which were part of the Infrastructure segment. Income from these discontinued operations during the second quarter of 2004 amounted to \$2.7 million before income taxes and \$1.9

million after income taxes, while income for the first six months of 2004 amounted to \$9.9 million before income taxes and \$6.5 million after income taxes (see note 9 to the Interim Consolidated Financial Statements).

## Reporting segments

### Infrastructure

#### Financial Highlights

millions	Three months ended June 30			Six months ended June 30		
	<u>2005</u>	<u>2004</u>	<u>% Change</u>	<u>2005</u>	<u>2004</u>	<u>% Change</u>
Revenues	\$ 107.4	\$ 113.3	(5.2)%	\$ 165.0	\$ 168.3	(1.9)%
Segment operating profit/(loss)	4.7	5.2	(8.6)%	0.1	(0.8)	n/a
Extraordinary gain before income taxes				4.1		
Income before interest and income taxes	4.7	5.2	(9.6)%	4.2	(0.8)	n/a
Return on Revenue	4.4%	4.6%	(4.4)%	0.1%	(2.1)%	n/a
Backlog - June 30	\$ 141.4	\$ 239.9	(41.1)%			

Overall, revenues from the Infrastructure segment decreased marginally in the second quarter as revenue gains in roadbuilding and utilities operations were offset by declines from the segment's Quebec operations and other heavy civil operations.

Revenues of \$51.5 million from roadbuilding operations were \$20.1 million higher than last year, reflecting a much higher volume of activity generally driven in part because of exceptional weather conditions experienced during the months of May and June, but also because of the unusually low volumes last year when Ontario roadbuilding operations suffered because of a three-week labour disruption in June 2004, delays in starting existing work and the awarding of new work because of changes in the municipal and provincial governments in the fall of 2003, and the delay in a \$22 million project to construct a fixed link bridge to the Toronto Island Airport. Utilities operations generated revenues of \$34.4 million compared to \$27.8 million in the second quarter of last year. Lighting installation work at Toronto airport and communications work, primarily cable installation, were the principal contributors to the revenue increase. Revenues from the segment's Quebec operations dropped by \$19.5 million, mostly as a result of the substantial completion of a hydroelectric dam project in Toulouste. This project generated revenues of \$19.0 million in the second quarter of last year compared to \$1.4 million this year. Other heavy civil operations posted a \$14.7 million decrease in revenues from last year when the now completed Cross Israel Highway project in Israel and the Nathpa Jhakri project in India generated combined revenues of \$16.6 million.

For the six months, Infrastructure revenues decreased marginally from \$168.3 million in 2004 to \$165.0 million this year. Similar to the second quarter, gains in revenues of \$24.6 million from roadbuilding operations and \$13.4 million from utilities operations were offset by declines of \$12.6 million from Quebec operations and \$28.6 million from other heavy civil operations. The reasons for the year-over-year revenue changes are essentially the same as those cited for the second quarter changes outlined above.

Income before interest and income taxes from the Infrastructure segment was \$4.7 million in the quarter, which is \$0.5 million below the same quarter last year, as increases in earnings of \$4.6 million from roadbuilding operations and \$1.7 million from utilities operations were offset by a \$2.4 million decline in earnings from Quebec operations and a \$4.4 million decline from other heavy civil operations. On a quarter-over-quarter comparison, several large items affected the results between 2005 and 2004. Earnings from roadbuilding operations in 2005 include gains of \$3.5 million related to claim settlements, whereas there were no claim settlements in the same quarter last year. In 2004, Quebec operations recorded a profit of \$2.3 million on the Eastmain hydroelectric project in Quebec, whereas, as a result of a decision taken in the fourth quarter of 2004 to reduce the profit estimate on this project to \$0, no profit from this project has been recorded in 2005. Included in other heavy civil operations in the second quarter of 2005 was a gain of \$0.9 million from the sale of a 40% interest in the company that has a 51% interest in the entity that operates the Cross Israel Highway and a gain of \$0.5 million related to the partial recovery of bid costs incurred in the second half of 2004. In the same quarter last year other heavy civil operations recorded \$4.0 million in earnings from the Cross Israel Highway project as a result of an increase in the expected profit at completion of the project. Foreign exchange also affected the comparison between 2005 and 2004 as net gains of \$1.1 million in 2004 were replaced by net losses of \$0.5 million in 2005. On a net basis, the above items resulted in a quarter-over-quarter decrease in earnings of \$3.0 million, which was only partly offset by higher earnings of \$2.6 million from the balance of Infrastructure's operations.

For the six months, income before interest and income taxes amounted to \$4.2 million which is a \$5.0 million improvement over the loss of \$0.8 million incurred in 2004. A significant component of the improvement relates to an extraordinary gain of \$4.1 million resulting from the acquisition by Aecon of its partner's share in a joint venture whose interests include a one-third share in the joint venture that constructed the Cross Israel Highway. Excluding the extraordinary gain, earnings from the Infrastructure segment are \$0.9 million ahead of last year, with the \$0.5 million decline in second quarter profits being offset by a \$1.4 million improvement in first quarter profits. On a sector basis, earnings from roadbuilding operations improved by \$4.6 million and earnings from utilities operations improved by \$2.2 million. In addition to improved volumes for both these sectors, roadbuilding operations also benefited from claim settlements of \$3.5 million (noted above and included within the \$4.6 million improvement), while utilities operations benefited from better equipment utilization. Earnings from Quebec operations were better by \$0.1 million. The improvement was partly due to losses of \$1.5 million recorded in 2004 on a substantially completed highway construction project in Quebec. There was also a \$0.8 million profit adjustment in the first quarter of 2005 resulting from the close-out of a project that was completed in 2003 and a \$0.4 million contribution from a claim settlement in the quarter. Partly offsetting these improvements was a drop in earnings of \$2.3 million from the Eastmain project (noted above) and an increase of \$0.2 million in overheads and administrative costs. Other heavy civil operations incurred a loss of \$0.9 million in the first half of 2005 compared to a profit of \$5.6 million last year. Of the \$6.5 million decline, foreign exchange differences accounted for \$2.5 million. The balance of \$4.0 million resulted primarily from lower earnings from the now completed construction of the Cross Israel project.

It was noted in the MD&A covering the results for the first quarter of 2005 that the Eastmain project, in which Aecon has a 50% joint venture interest, had incurred significant cost overruns that, if unresolved, would project Aecon to incur a loss of upwards of \$10 million on this project. It was also pointed out that because the cost overruns were almost totally because of delays caused by the client

and because of significant client requested changes to many aspects of the project's scope, management believed that it would be successful in recovering these costs from the client and would ultimately report a profit on the project. However, because of the magnitude of the cost overruns and the considerable amount of time it would take to negotiate their recovery with the client, management considered it prudent, pending the outcome of these negotiations, to reduce its profit estimate from this project to \$0, which was done in the fourth quarter of 2004.

During the second quarter, resulting from the impacts of these same client caused delays and additional changes, the estimated costs to complete the project increased. The latest estimate shows that costs at completion for this project will be approximately \$41.0 million higher than the current contract price of \$132.6 million (the original contract price was \$107.6 million), which is an increase of approximately \$21.0 million in the cost of completion estimate at the time of writing the first quarter MD&A. Notwithstanding the significant increase in the cost of completion estimate, management still believes that it will recover the full amount of these incremental costs. However, the timeline to complete the negotiations for recovery of these amounts will likely now be longer.

The cost impacts of these client delays and scope changes are "unpriced change orders", which are change orders for which the client has agreed it is responsible but where the value of such unpriced change orders has not yet been agreed to. Therefore, in accordance with its accounting policy for unpriced change orders, until the value of an unpriced change order is agreed with the client, the amount included in revenues for unpriced change order is limited to the amount for which recovery is probable. As of June 30, 2005, revenues of \$15.1 million have been recorded to date in respect of Aecon's share of these unpriced change orders, which are included on Aecon's consolidated balance sheet as "deferred contract costs and unbilled revenue". Should the unpriced change orders related to this project no longer be considered probable of recovery and the Company is unsuccessful in recovering these cost overruns from the client, the financial results would be negatively impacted by charges to income of up to approximately \$21.0 million. Amounts not recovered through change orders would result in claims by Aecon against the client, which are recognized for accounting purposes only when the amounts are resolved or received.

In June 2005, the joint venture involved in the construction of the Nathpa Jhakri Project in India, in which Aecon has a 45% interest, was advised by the owner, Satluj Jal Vidyut Nigam Ltd. ("SJVN") (formerly Nathpa Jhakri Power Corporation Limited) of their intention to levy liquidated damages against the joint venture in the amount of \$ 32.4 million (at current exchange rates) for not completing the contract on time. However, since the delay in the completion of the project was caused by numerous items outside of the joint venture's control and contractual responsibility, including, among many other things, a catastrophic flood in 2002, the joint venture believes that these liquidated damages are unwarranted. The joint venture also believes that even in the unlikely situation that it was responsible for some part of the delay, this did not result in any damages to SJVN. The joint venture's conclusion regarding the impermissibility of SJVN to impose liquidated damages is supported by two independent legal opinions. Moreover, the joint venture has already submitted claims of approximately \$ 93.5 million (of which \$10 .2 million, at current exchange rates, had been previously received by the joint venture and is included in the joint venture's profit estimate for this project) against SJVN, the most significant of which is to cover the joint venture's costs of delays related to these same matters. Based on all of the above, no provision has been made for the liquidated damages, nor, in accordance with Aecon's accounting policy, which is to recognize

revenue from claims only when resolved, has any amount been recognized for potential recoveries under the claims.

Backlog of \$141.4 million at the end of June 2005 declined by \$98.4 million from the same time last year. While there was a reduction of \$21.5 million in Quebec operations, mostly related to two hydroelectric projects, the largest decline - \$73.4 million - occurred in roadbuilding operations. The decline in roadbuilding backlog is in part due to the backlog balance at the beginning of 2004, which included several large multi-year projects, being much higher than at the beginning of 2005, and is also due to the much higher work-off of backlog in 2005 compared to 2004, mostly because of excellent weather conditions. New contract awards of \$102.2 million were booked in the second quarter of 2005, which compares with \$150.5 million in the second quarter of 2004, while new contract awards of \$152.7 million for the first six months of 2005 compares to \$189.2 million in 2004. The decline in awards for the second quarter and the first six months of 2005 compared to the same periods in 2004 relates principally due to roadbuilding operations, where awards from one quarter to the next can be significantly different because of timing. Witness to this is the fact that roadbuilding awards in July 2005 are significantly higher than the same month last year, reversing the trend that was evident in the first and second quarters of 2005. It is notable that significant commitments made to Aecon based on partnering agreements do not necessarily show up as firm backlog for external reporting purposes primarily due to the degree of uncertainty regarding the exact amount of work than can be expected. The effective backlog is therefore greater than what is reported to the extent that the expected volume of committed work is significant.

## ***Buildings***

### **Financial Highlights**

millions	Three months ended June 30			Six months ended June 30		
	<u>2005</u>	<u>2004</u>	<u>% Change</u>	<u>2005</u>	<u>2004</u>	<u>% Change</u>
Revenues	\$ 108.2	\$ 98.7	9.6%	\$ 185.3	\$ 182.3	1.7%
Segment operating profit/(loss)	0.4	(2.1)	n/a	0.6	(3.8)	n/a
Return on Revenue	0.4%	(2.1)%	n/a	0.3%	(2.1)%	n/a
Backlog - June 30	<u>\$ 304.8</u>	<u>\$ 259.7</u>	<u>17.4%</u>			

Revenues in the Buildings segment increased by \$9.5 million or 9.6% from the same quarter last year. The volume of work performed in the GTA was \$12.9 million higher than last year, while there was a \$6.4 million revenue increase from Montreal operations. Revenues generated in the United States through the segment's Seattle office declined by \$9.9 million. Revenues from the balance of the Buildings operations were up by \$0.1 million. For the six months, revenues were up \$3.1 million, with increased volumes from the GTA and Montreal of \$15.1 million and \$13.5 million respectively, while revenues from Seattle were down \$20.2 million. Other operations were down \$5.2 million. The increased volumes from the GTA for both the second quarter and year-to-date are due principally to work on two very large projects, whereas no similar type projects were in progress last year. The revenue increase from Montreal for the quarter is mostly attributable to new work, while the year-to-date increase reflects a combination of new work and the acquisition of Cegerco CCI Inc. in the second quarter of 2004. The decline in revenues from Seattle reflects a combination of delays in awards for casino projects and less new work generally.

Operating results in the second quarter were significantly better than last year. An operating profit of \$0.4 million was realized in the quarter compared to an operating loss of \$2.1 million in 2004. Approximately \$1.2 million of the improvement relates to losses incurred last year in Ottawa by Westeinde Construction Ltd. (“Westeinde”), which was acquired in November 2003. Consistent with the increase in revenues, operating profits from the GTA and Montreal were \$0.7 million and \$1.0 million higher respectively than the second quarter last year. Similarly, the decline in revenues from Seattle caused a small \$0.2 million drop in operating profit compared to last year. Profit from the balance of operations was down \$0.2 million.

For the six months, the Buildings segment generated an operating profit of \$0.6 million compared to an operating loss of \$3.8 million last year. Of the \$4.4 million improvement, \$1.6 million relates to Westeinde, \$2.4 million to the GTA and \$1.3 million to Montreal, all for reasons similar to those cited above for the second quarter improvement. In addition, the GTA incurred a loss of \$1.5 million in the first quarter last year on a college renovation project.

Backlog of \$304.8 million at the end of June 2005 was \$45.1 million or 17.3% higher than the end of June 2004, with the Toronto and Montreal markets showing the most increase. Toronto backlog was \$59.2 million ahead of last year due largely to the award in the second half of 2004 of the Terminal 3 expansion project at Pearson Airport, the award in October 2004 of the Ferrero design/build contract for a chocolate factory in Brantford and the award in February 2005 of Phase 2 of a construction project for the University of Guelph. At the end of June 2005, backlog related to these three projects was \$159.0 million. Montreal backlog was ahead of last year by \$17.4 million because of two concurrent jobs at Trudeau International Airport in Montreal which totaled \$16.9 million at the end of June 2005. A net backlog reduction of \$31.6 million occurred in all other operations, although most of the decrease was attributable to Seattle where a \$38.7 million contract for a new casino was awarded in March 2004, with no corresponding award during the second quarter or first half of 2005. In total, new contract awards of \$40.3 million in the second quarter of 2005 and \$144.7 million in the second half of 2005, compare with \$58.2 million and \$199.1 million respectively for the same periods in 2004. The decline in awards for the second quarter relates mostly to the segment’s Seattle and Ottawa operations while the decline in awards for the first six months of 2005 relates mostly to Seattle, which had the \$38.7 million new casino award in 2004 with no corresponding award this year.

## ***Industrial***

### **Financial Highlights**

millions	Three months ended June 30			Six months ended June 30		
	<u>2005</u>	<u>2004</u>	<u>% Change</u>	<u>2005</u>	<u>2004</u>	<u>% Change</u>
Revenues	\$ 68.7	\$ 53.5	28.3%	\$ 107.7	\$ 104.3	3.2%
Segment operating profit/(loss)	2.3	1.8	33.2%	—	5.1	(100.4)%
Return on Revenue	3.4%	3.3%	3.0%	0.0%	4.9%	(100.0)%
Backlog - June 30	\$ 83.8	\$ 69.1	21.3%			

Revenues of \$68.7 million from the Industrial segment in the second quarter of 2005 were \$15.2 million or 28.3% higher than the same quarter in 2004. Revenues from Innovative Steam Technologies (“IST”), which sells and licenses the technology for once-through steam generators (“OTSG”), were up from \$4.4 million in 2004 to \$7.0 million in 2005. During the second quarter, IST was working on two OTSG units whereas there was very little production activity during the same quarter last year while engineering work was being done in preparation for production in the second half of 2004.

Other sectors within the Industrial segment, with the exception of Construction activities (all of which are in Ontario), also generated higher revenues than 2004. The most significant increase occurred in Western Canada where revenues of \$31.6 million were \$17.5 million ahead of last year, due primarily to major demolition and refurbishment work resulting from a significant fire in January 2005 at an oilsands facility in Fort McMurray, Alberta. Fabrication revenues in Ontario and Eastern Canada were also substantially higher, going from \$4.0 million last year to \$8.3 million in the current quarter. The increase resulted from a large contract which utilized most of the sector’s plant capacity in Ontario and from the contribution of a new fabrication joint venture in Eastern Canada which commenced operations in the second quarter of 2004. Revenues from Construction operations were down \$9.0 million or 29.2% from the prior year. In the second quarter of 2004 Construction volumes were extraordinarily high as one project in particular, a \$31.0 million power contract in New Brunswick, generated revenues of \$10.1 million or approximately 32% of this sector’s revenues. The absence of a similar type project in 2005 brought revenue levels in the second quarter of this year back to more normal levels.

For the six months, revenues from the Industrial segment were \$107.7 million compared to \$104.3 million in 2004. IST revenues of \$14.4 million were 51.9% higher than 2004. During the first half of 2005, IST worked on seven OTSG units as compared to four units in the same period last year. Revenues from Western Canada were up by \$7.8 million or 24.2%, primarily resulting from the previously mentioned demolition and refurbishment work being done at an oilsands facility. In addition to this type of work, considerable further work has been committed to Aecon from this client based on a long-term supplier-of-choice agreement. Fabrication revenues in Ontario and Eastern Canada were favourable by \$6.8 million or 83.2%, for essentially the same reasons noted above for the second quarter variance. Revenues from Construction activities were down 29.6%, going from \$54.6 million in 2004 to \$38.4 million. As noted above, revenues suffered from not having a large project in 2005 similar to the New Brunswick contract in 2004 which generated revenues of \$18.6 million for the first half of 2004.

Operating profit of the Industrial segment was \$2.3 million in the quarter which compares with profit of \$1.8 million reported in 2004. Consistent with the increase in revenues, IST reported earnings of \$0.7 million compared to a loss of \$0.6 million in the second quarter of 2004. Of the \$1.3 million improvement, \$0.4 million arose from the cancellation of a licensing agreement with a German company for the exclusive use of IST’s OTSG technology. Under the agreement, IST was to supply fin tubes for OTSG sales and was to receive royalty payments based on sales. However, because no sales under the agreement were made and because there was a change in ownership of the licensee, IST exercised its right to terminate the license agreement in April 2005. The \$0.4 million gain represents the unamortized balance of an upfront fee IST received from the licensee when the license agreement was originally signed. Also consistent with higher reported revenues in the quarter,

improved earnings were generated by the segment's Western operations where a profit of \$1.6 million for the quarter was \$0.9 million or 134% higher than last year. Similarly, the large revenue increase from Fabrication work in Ontario and Eastern Canada resulted in better results, going from a loss of \$1.1 million in 2004 to a loss of \$0.5 million in 2005. The only Industrial sector not to record improved results in the quarter was Construction operations. Triggered principally by the 29.2% drop in revenues, this sector's profit declined from \$2.7 million in 2004 to \$0.5 million in the second quarter of 2005. In addition, this unit incurred losses and reduced previously reported profits on jobs which, compared to the second quarter last year, resulted in a decrease in profit of \$0.7 million.

For the six months, the Industrial segment reported break-even results compared to a profit of \$5.1 million last year. Despite the large increase in revenues, IST performed only marginally better than last year as the \$1.3 million decline in first quarter profits due to changes in product mix and higher overhead costs, offset the \$1.3 million improvement in profits in the second quarter. Similarly, despite a \$7.8 million increase in revenues from Western Canada operations, profit fell short of last year by \$1.8 million mostly because of lower volumes in the first quarter of 2005 and lower profit margins in both the first and second quarters of 2005. The work mix for Western Operations is comprised of pipe fabrication, module assembly and field construction, with each work type having different contract margins. In 2004, Western Operations was performing mostly high margin module and fabrication assembly work whereas in the first half of 2005 the focus was on lower margin site construction work while fabrication and module related work, which started with a lower level of activity than last year, is expected to be very active in the last half of the year. The largest decline in profits came from Construction operations where profits of \$4.9 million in 2004 were replaced by profits of \$0.5 million in 2005. As noted previously, volumes in 2004 were boosted by a project in New Brunswick. Operating profit from this project in the first half of last year and unusually high margins earned on two other large projects contributed to the very strong performance in 2004. This work was only partially replaced in 2005 and at more normal margin levels. Fabrication activities in Ontario and Eastern Canada was the only area where the Industrial sector had better results than last year, going from a loss of \$2.2 million in 2004 to a lesser loss of \$1.1 million in 2005. The improved results reflect the large increase in revenues compared to last year

Backlog at June 30 of \$83.8 million was \$14.7 million higher than last year as large increases in the Construction and Western Canada sectors exceeded a decline in IST backlog. Construction backlog was up \$10.2 million or 33.4%, principally as a result of a \$17.0 million award from Bruce Power in the second quarter, while backlog in Western Canada increased by \$26.4 million or 91.8%, primarily because of a \$21.0 million opti module contract that was awarded in December 2004 on which work has just recently commenced. IST backlog fell from \$35.5 million at June 30, 2004 to \$8.8 million at June 30, 2005. At the end of June 2004 IST had seven contracts in backlog for eleven OTSGs compared to two contracts in backlog for three OTSGs at the end of June 2005. While a slow sales period occurred for IST for the period November 2004 to May 2005, this slowdown is believed to be a result of project by project delays, rather than a fundamental shift in the market. IST has more recently confirmed some additional contract awards and there exists a large number of new contract opportunities that provide confidence of improved backlog expectations by the end of the year. In total, new contract awards of \$81.8 million in the second quarter and \$123.6 million for the first six months of 2005, compare to \$46.8 million and \$88.7 million respectively for the same periods in 2004. With the exception of IST where awards in the second quarter and first half of 2005 were down from the same periods last year, awards in all other Industrial sectors increased in both the second



quarter and the first six months of 2005. The \$35 million increase in backlog awards in the second quarter of 2005 came from Construction, which was up by \$24.7 million, Western Canada, which was up by \$15.4 million and Fabrication, which was up by \$5.6 million. IST backlog declined by \$10.7 million. The increase of \$34.3 million in backlog awards for the first six months compared to the same period last year arose principally in the second quarter of 2005. It is notable that significant commitments made to Aecon based on partnering agreements do not necessarily show up as firm backlog for external reporting purposes primarily due to the degree of uncertainty regarding the exact amount of work than can be expected. The effective backlog is therefore greater than what is reported to the extent that the expected volume of committed work is significant. This is certainly the case in the Western Operations and to a lesser extent within the Fabrication and Construction operations that are active in eastern Canada.

### ***Corporate and Other***

Net corporate expenses amounted to \$3.0 million in the second quarter, which compares to \$3.2 million last year. Without the impact of foreign exchange, there would have been a \$0.2 million increase. For the first six months net corporate expenses amounted to \$5.5 million compared to \$8.3 million in 2004. After removing the effect of foreign exchange (a loss of \$0.6 million in 2004 versus a loss of \$0.4 million in 2005) and the impact on 2004 expenses of the one-time costs of \$0.7 million and \$2.6 million referenced in the discussion above on the Company's consolidated results, corporate expenses would be higher by \$0.7 million. Higher salary and pension costs account for most of the \$0.7 million increase.

### **Discontinued Operations**

See note 9 to the Company's Interim Consolidated Financial Statements.

### **Quarterly Financial Data**

The reader is referred to the Company's 2004 Management Discussion and Analysis for a summary of the results of the eight quarters that ended on December 31, 2004. The following table summarizes results for the first two quarters of 2005 and 2004 (in millions of dollars, except per share amounts).

	2005		2004	
	Quarter 1	Quarter 2	Quarter 1	Quarter 2
Revenues	\$ 172.9	\$ 283.0	\$ 189.0	\$ 264.7
Net income (loss)	(8.4)	1.7	(2.4)	2.4
Earnings (loss) per share:				
Basic	(0.29)	0.06	(0.10)	0.08
Diluted	(0.29)	0.05	(0.10)	0.08

## FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

Cash, cash equivalents and restricted cash at June 30, 2005 totaled \$33.0 million, which compares with \$50.1 million at the end of 2004. Of these amounts, \$16.8 million and \$19.1 million, respectively, were on deposit in joint venture and affiliate bank accounts, which Aecon cannot access directly. Restricted cash of \$10.8 million at June 30, 2005 represents cash which was deposited as collateral for letters of credit issued by Aecon. As such, this cash was not available for general operating purposes. Marketable securities and term deposits of \$14.6 million (December 31, 2004 - \$15.6 million) were held within joint ventures and these securities cannot be accessed directly by Aecon.

Cash used in operating activities amounted to \$35.5 million in the quarter ended June 30, 2005, compared to cash used in the same quarter last year of \$2.7 million. For the six months, cash of \$44.4 million was used for operating activities versus \$3.8 million in 2004. Changes in other balances related to operations, which represents funds used or provided on account of changes in working capital balances, resulted in a use of funds of \$39.6 million in the quarter versus a use of \$9.0 million in 2004. As can be seen from note 5 to the Interim Consolidated Financial Statements, higher investments in accounts receivable and deferred contract costs and unbilled revenues were the principal contributors to the large cash outflow in the quarter. The \$53.9 million increase in accounts receivable in the quarter, where such an increase is expected because of the seasonal nature of some of Aecon's operating activities, was \$16.1 million higher than the increase in the same quarter last year mostly because of the focused collection efforts in the second quarter of 2004 to reduce the amount invested by the Industrial segment in accounts receivable. The \$20.4 million increase in deferred contract costs and unbilled revenue in the second quarter was \$22.3 million higher than last year's change.

There were two principal reasons for the quarter-over-quarter variance. Firstly, deferred contract costs and unbilled revenues within the Infrastructure segment's Quebec operations increased by \$4.9 million in the second quarter of 2005 versus a drop of \$6.5 million in the same quarter last year, primarily as a result of the build-up in unbilled revenue in 2005 related to the Eastmain hydroelectric project and a decline in unbilled revenues in 2004 due to the settlement of requests for additional compensation on the Tournestouc hydroelectric project; and secondly, deferred contract costs and unbilled revenues in the Industrial segment increased by \$13.8 million in the second quarter of 2005 compared to a decrease of \$1.2 million in 2004. Whereas a large investment in working capital was required in 2005 for the demolition and refurbishment work at an oilsands facility in Alberta, the segment was successful last year in generating advance billings on one of its major projects. The major offsets to the increased investments in accounts receivable and deferred contract costs and unbilled revenue were an increase of \$7.7 million in accounts payable and accrued liabilities and an \$8.5 million reduction in deferred revenue drawdowns.

For the six months, cash used in operating activities amounted to \$44.4 million, which is \$40.6 million higher than 2004. Referring again to note 5 to the Interim Consolidated Financial Statements it can be seen that changes in other balances related to operations caused \$38.6 million of the increase with the major contributors to this increase being deferred contract costs and unbilled revenue, and deferred revenue. Deferred contract costs and unbilled revenues in the Industrial segment increased by \$15.1 million in the first six months of 2005 compared to a decrease of \$2.8 million in 2004,

largely due to the oilsands project noted above. Lower year-over-year investments in deferred contract costs and unbilled revenues by the Infrastructure and Buildings segments partly offset the increase in the Industrial segment. Deferred revenues, which represent advance billings for work not yet performed, declined during the first six months by \$17.4 million in contrast to an increase of \$0.9 million in 2004. The \$18.3 million unfavourable swing arose principally within the IST division of the Industrial segment where deferred revenues decreased by \$6.4 million in the first six months of 2005 compared to an increase of \$7.9 million last year. The sharp decline in IST deferred revenues is due to the lack of new bookings through the first five months of 2005. However, as noted in the Outlook section this situation is expected to improve over the balance of 2005.

Investing activities resulted in a use of cash of \$11.8 million in the three months ended June 30, 2005, which compares with a \$2.1 million use of funds in 2004. The largest use of cash was a \$10.8 million deposit with a financial institution to collateralize letters of credit issued by Aecon. Proceeds from the sale of property, plant, equipment and investments include \$0.9 million from sale by Aecon of a 40% interest in the company that has a 51% interest in the entity that operates the Cross Israel Highway. The \$1.5 million increase in other assets represents development costs incurred during the quarter on the Quito airport project. For the six months, cash used in investing activities amounted to \$15.6 million, which compares with cash used of \$13.1 million in 2004. In addition to the \$10.8 million that was deposited to collateralize letters of credit, the other most significant item in this period was the \$4.4 million outlay to increase Aecon's investment in Derech Eretz Highways (1997) Ltd., the concessionaire of the Cross Israel Highway, from 22.2% to 25%. This investment, which totals \$41.3 million at June 30, 2005, is shown on the consolidated balance sheet as a Long-Term Investment.

Cash generated from financing activities during the quarter amounted to \$25.7 million, compared to \$9.4 million in the same quarter of 2004. During the second quarter of 2005 the Company issued long term debt of \$23.0 million by drawing down fully on its revolving term loan facility (which is described in detail in note 9(a) to the Company's 2004 Consolidated Financial Statements). Also of note in the quarter Hochtief AG, the parent of the Company's largest shareholder, provided a \$3 million loan to Aecon to support a portion of Aecon's working capital contribution requirements to the Eastmain Joint-Venture, a hydroelectric power house project in Northern Quebec which is being completed by a 50/50 joint venture between Aecon and Hochtief. This loan is repayable in December 2005 and pursuant to the joint venture agreement is provided at a rate of Prime plus 3.0%. Given that additional but temporary working capital investment is required in this joint venture in the coming months, a separate bank line will be pursued by the joint venture, which would decrease the need to rely on Hochtief to meet further working capital requirements for this joint venture. For the six months, cash provided from financing activities amounted to \$31.9 million, compared to \$18.8 million in 2004. In the first quarter, the Company paid \$3.2 million to bring its bank borrowings to zero.

Also in the first quarter, issuances of long-term debt amounted to \$23.0 million and repayments totaled \$45.6 million. Thus, for the first six months issuances amounted to \$45.9 million and repayments amounted to \$46.9 million. Gross long-term debt issuances and repayments were affected by a series of draw-downs and repayments under the revolving term facility. Also in the first six months, a \$31.0 million convertible debenture financing was completed, the full details of which can be found in note 11 to the Interim Consolidated Financial Statements.

At June 30, 2005 long-term debt and convertible debentures, including the current portion, totaled \$115.5 million, compared to \$80.5 million at the end of 2004 and \$51.3 million at June 30, 2004. Borrowings under the revolving term loan, which amounted to \$21.9 million at December 31, 2004, were \$23.0 million at June 30, 2005.

Bank indebtedness of \$8.9 million at the end of the current quarter includes \$8.7 million for Aecon's 45% share of funds borrowed within the Nathpa Jhakri hydroelectric project joint venture in India and a small tender loan of \$0.2 million.

Interest bearing debt amounted to \$124.4 million at June 30, 2005, compared to \$92.4 million at December 31, 2004 and \$77.1 million at June 30, 2004, the composition of which is as follows (\$ millions):

	<u>June 30, 2005</u>	<u>Dec.31,2004</u>	<u>June 30, 2004</u>
Bank indebtedness	\$ 8.9	\$ 11.9	\$ 25.8
Current portion of long-term debt	9.1	4.5	15.0
Convertible debenture - current	7.6	-	
Long-term debt	40.1	40.4	28.8
Convertible debenture	58.7	35.6	7.5
Total	<u>\$ 124.4</u>	<u>\$ 92.4</u>	<u>\$ 77.1</u>

Aecon has a revolving term loan to fund working capital and operating requirements. The revolving term facility matures on November 22, 2017 and has an annuity style amortization schedule. The amount of the revolving term loan was established by reference to the appraised value of certain real estate and aggregate reserve assets, which serve as primary collateral for the loan. On the seventh anniversary, which is on November 22, 2009, the lender can reduce the committed facility to restore the agreed ratio between the then available committed facility and the then appraised value of the collateral assets, and can request that a repayment be made if the then total outstanding advances exceed the reduced committed facility. The revolving term loan provides Aecon with a very flexible and stable source of operating funding.

The \$59.6 million proceeds generated from the November 2004 and March 2005 convertible debenture financings provide Aecon with a significantly improved liquidity base and with a substantial and important reduction in its reliance on bank credit which was increasingly difficult to secure with manageable terms.

Aecon suspended its multi-bank credit facility in May 2005 and commenced discussions with one of its banks to establish a new more modest bank line to assist with very short-term changes in working capital balances and to support Aecon's ongoing letters of credit requirements. We expect to have such a facility in place within the third quarter, providing an operating loan of \$7.5 million as well as a tender line facility of \$1 million.

The convertible debenture financings, combined with the revolving term loan facility, and the modest bank line, should be sufficient to finance its ongoing operations. However, in order to reduce the strain on the Company's financial resources during the summer and fall, and to ensure that sufficient financial resources exist to fully participate in the Quito Airport project, Aecon continues to examine

various alternatives to further improve its liquidity and working capital position. Also, the Company will continue to work diligently to reduce its investments in accounts receivable and deferred contract costs and unbilled revenues. Success in this area could have a significant positive impact on Aecon's liquidity position.

To fund investments in property, plant and equipment, Aecon has access to several committed and uncommitted equipment financing and leasing facilities. Remaining availability under these lines of credit is expected to be sufficient to meet Aecon's remaining anticipated requirements for 2005.

Aecon's surety capacity remains sufficient to meet its needs. However, surety capacity and pricing has become a constraining issue broadly within the industry and Aecon is not immune to these impacts.

## **CHANGES IN ACCOUNTING POLICIES**

AcG 15 is the Canadian equivalent of the United States' FIN 46R and modifies the principles used in determining when and by whom entities are consolidated. Existing consolidation rules are considered to be unsatisfactory as they do not properly address Special Purpose Entities or other structures where control is pre-arranged and voting control doesn't reflect the underlying economic risks and rewards. Broadly speaking, if a company is exposed to more than 50% of the economic risks of a variable interest entity, it is presumed to control the entity and must consolidate it, notwithstanding that its voting interest may be minimal. Two consolidation "models" are established under AcG 15 – a Voting Interest Model ("VOI") and a Variable Interest Model ("VIE"). The VOI model has been the standard for purposes of determining control and in order to continue to use the VOI model it must be demonstrated that equity holders as a group control the entity and that they are truly at risk. One of the tests is that there must be a minimum amount of equity, as it appears in the financial statements of the entity being assessed. If the VOI tests are not met, the VIE model would be used. Proportionate consolidation is not permitted under the VIE model. Application of this new standard is extremely complex. Aecon has assessed AcG 15 and concluded that it will not result in any change to the manner in which it consolidates its current operations.

The CICA Handbook section related to Financial Instruments now includes a new interpretation which helps clarify the classification of a financial instrument as between debt or equity. None of Aecon's existing financial instruments will be classified differently as a result of this addition to the Handbook.

## **SUPPLEMENTAL DISCLOSURES**

### **Contractual Obligations**

At December 31, 2004, the Company had commitments totalling \$142.8 million for equipment and premises under operating leases requiring minimum payments and for principal repayment obligations under long-term debt. The only material change since then has been the additional obligation, effective March 17, 2005, with respect to the issuance of a \$32.5 consolidated debenture, full details of which are included in note 11 to the first quarter 2005 Interim Consolidated Financial Statements.

At June 30, 2005, Aecon had contractual obligations to complete construction contracts which were in progress. The revenue value of these contracts, which represents backlog, was \$530.5 million.

### **Off-Balance Sheet Arrangements**

In connection with its joint venture operations in India and Israel, Aecon has provided various financial and performance guarantees and letters of credit, which are described in note 6 to the Consolidated Financial Statements.

There was no material change in the funded status of Aecon's pension plans during the first six months of 2005. Details relating to Aecon's defined benefit plans are set out in note 18 to the Company's 2004 Consolidated Financial Statements.

Aecon from time to time enters into forward contracts and other foreign exchange hedging products to manage its exposure to changes in exchange rates related to transactions denominated in currencies other than the Canadian dollar. At June 30, 2005, the Company had net outstanding contracts to sell US \$6.0 million (March 31, 2005 – sell US \$8.7 million; December 31, 2004 – sell US \$9.7 million), on which there was an unrealized exchange gain of \$0.1 million (March 31, 2005 - \$0.3 million; December 31, 2004 - \$0.6 million). Financial instruments are discussed in note 20 to the Company's 2004 Consolidated Financial Statements.

### **Related Party Transactions**

Aecon from time to time receives financial support from Hochtief AG and its subsidiary companies ("Hochtief"), which is Aecon's largest shareholder. At June 30, 2005, Aecon was indebted to Hochtief for \$7.7 million in the form of a convertible subordinated debenture as described in note 11 to the Company's 2004 Consolidated Financial Statements and \$3.0 million in the form of an unsecured short term loan, which is repayable in December 2005. Hochtief AG has issued guarantees in support of the financial and performance related obligations of the Nathpa Jhakri hydroelectric project in India in which Aecon has a joint venture interest. Aecon paid Hochtief AG \$0.1 million during the first quarter and first six months of 2005 in connection with these guarantees. Aecon and Hochtief are also joint venture partners in a hydroelectric project in Quebec.

Complete details of related party transactions and balances can be found in note 14 to the Interim Consolidated Financial Statements

### **Critical Accounting Estimates**

The reader is referred to the detailed discussion on Critical Accounting estimates as outlined in the notes to the Company's 2004 Consolidated Financial Statements.

## Outstanding Share Data

Aecon is authorized to issue an unlimited number of common shares. The following are details of common shares outstanding and securities that are convertible into common shares.

(in thousands of dollars, except share amounts)

	<u>June 30, 2005</u>	<u>August 10, 2005</u>
Number of common shares outstanding	31,075,609	31,180,609
Paid-up capital of common shares outstanding (1)	\$ 95,833	\$ 95,985
Outstanding securities exchangeable or convertible into common shares:		
Number of employee stock options outstanding	630,000	525,000
Number of common shares issuable on exercise of employee stock options	630,000	525,000
Increase in paid-up capital on exercise of employee stock options	\$ 2,785	\$ 2,407
Principal amount of convertible debentures outstanding (see note 11 to the Company's 2004 Consolidated Financial Statements)	\$ 70,231	\$ 70,231
Number of common shares issuable on conversion of convertible debenture	10,423,884	10,423,884
Increase in paid-up capital on conversion of convertible debenture	\$ 70,231	\$ 70,231

(1) As described in note 2 to the Company's 2004 Consolidated Financial Statements, in accordance with the recommendations of The Canadian Institute of Chartered Accountants share capital has been reduced by \$857 thousand at June 30, 2005 and \$1,083 thousand at August 10, 2005 on account of share purchase loans receivable from employees.

## OUTLOOK

Aecon's expectations for 2005 remain generally consistent with those published at the end of the first quarter and include an anticipated year-over-year improvement in each of the company's three segments.

Within Aecon's Infrastructure segment, the improved roadbuilding results achieved in the first half of 2005 are expected to continue throughout the second half of the year. While first half results included a claim settlement not expected to be repeated in the second half, the strong volumes experienced to date continue to be supported by a healthy backlog and profit contributions in the balance of the year are expected to continue at a pace ahead of last year.

The year-over-year improvement in volumes and operating results experienced in the utilities sector are expected to hold throughout the balance of the year. The ongoing improvement seen in the telecom sector and the recently announced expansion of Aecon's strategic relationship with Expertech are both expected to contribute to second half results.

Aecon's Quebec civil operations, while still facing many of the challenges experienced last year, are expected to record improved results in the second half of 2005 than were reported in 2004. As noted earlier, management decided in the fourth quarter of last year to reduce the profit estimate on its key project in Quebec, the Eastmain hydroelectric project, to zero. This revision resulted in the reversal of previously recorded profits and, combined with project losses on other Quebec civil projects, resulted in a significant loss in 2004. Management believes that the Aecon/Hochtief joint venture building the project will be successful in recovering from the client the value of unpriced change orders associated with the Eastmain project but acknowledges that an ongoing risk remains with respect to this project.

Outside of Quebec, Aecon's heavy civil construction operations are still expected to show a small loss in the second half as volume reductions resulting from completion of the Cross Israel Highway and the Nathpa Jhakri hydroelectric project in India have not yet been fully replaced.

An important part of Aecon's plan to replace this volume is achieving financial close on the Quito Airport project. A number of the commercial documents required for the project were signed in June, with the balance expected to be signed before the end of August. Satisfaction of the final conditions precedent and the flow of project financing are expected to take place in the fourth quarter, with construction to commence shortly thereafter. Under Aecon's accounting policy for large multi-year contracts, construction profit is recognized only when progress reaches a stage of completion sufficient to reasonably determine the probable results (generally when the contract is 20% complete), which is expected to occur on the Quito project in late 2006.

In the Buildings segment, the improved operating results reported in the first half of 2005 are expected to continue throughout the year, resulting in a turnaround in results from the segment in 2005. It is expected that Aecon will continue to maintain sufficient surety capacity to satisfy anticipated requirements for the Buildings group and that a return to profitability will be realized in the Buildings segment this year.

Operations in the Greater Toronto Area, which represent over half of Aecon's volume in the Buildings segment, are expected to remain profitable in the second half of the year as changes implemented in 2004, including augmentation of risk management practices and re-focusing of business development activities, continue to have a positive impact on results.

Similarly, operations in the Ottawa and Montreal markets, both of which were significantly impacted last year by acquisitions, are expected to maintain the substantial improvement achieved in the first half. After reporting significant losses in 2004, operations in Montreal are expected to generate a strong contribution this year, while operations in Ottawa are expected to break even this year after a very difficult year in 2004. The Seattle business unit, which was one of the few bright spots in Aecon's Buildings segment last year, is expected to make a profit contribution again this year, although delays in planned casino projects are expected to result in lower volumes and a slightly lower operating profit this year.

In the Industrial segment, IST is expected to reach breakeven again in 2005. After reporting strong sales in the first three quarters of 2004, IST was caught in a sales slowdown which lasted through much of the first half of 2005 and resulted in a substantial depletion of backlog. It now appears that this sales slowdown is ending and IST expects to close the year with a healthy backlog once again.



As anticipated, results from Aecon's industrial construction and fabrication business did not match the first half results posted in 2004 but expectations remain that year end results will show an improvement over last year.

The largest profit contribution in this segment is expected to come from operations in Western Canada as higher volumes from the oilsands projects in Northern Alberta drive improved results. Aecon has established a strong presence in this market, with industrial construction now added to its ongoing capabilities in pipe fabrication and module assembly. This increased presence positions Aecon very well for continued growth in the oilsands market where billions of dollars are expected to be invested each year over the next decade.

Pipe fabrication operations in Ontario are expected to show substantial year-over-year improvement, with profit contributions anticipated this year following losses in 2004. Industrial's construction business unit is also expected to generate positive profit contributions, although likely not as large as those recorded in 2004. Within industrial construction, the nuclear sector holds substantial promise for Aecon as Ontario's well publicized need for increased generation capacity is already starting to lead to more demand. Aecon is well positioned to capture significant work in this market, most of which is likely to take place in 2006 and beyond.

Aecon's consolidated backlog was \$530 million at June 30, 2005, a decrease of \$39 million from the backlog reported at the same time last year. While backlog has grown in the Buildings and Industrial segments, this growth did not offset a decline in Infrastructure backlog as strong work-off in roadbuilding operations this year and an unusually high roadbuilding backlog in 2004, combined with declines in Quebec civil operations, caused a significant year-over-year decline in Infrastructure backlog. This depletion of Aecon's backlog is expected to be reversed when the anticipated financial close of the Quito Airport project will add approximately \$250 million to backlog. Not included in backlog, but important to Aecon's prospects, are the revenues expected from Aecon's growing alliances and supplier-of-choice arrangements, largely in the industrial and utilities sectors.

In summary, and subject to the risks identified above, Aecon's operating results in the first half of the year reinforce management's expectations of significantly improved results and a return to profitability in 2005.

## **FORWARD-LOOKING INFORMATION**

In various places in Management's Discussion and Analysis and in other sections of this document, management's expectations regarding future performance of Aecon was discussed. These "forward-looking" statements are based on currently available competitive, financial and economic data and operating plans, but are subject to risks and uncertainties. Forward-looking statements include information concerning possible or assumed future results of operations or financial position of Aecon, as well as statements preceded by, followed by, or that include the words "believes", "expects", "anticipates", "estimates", "projects", "intends", "should" or similar expressions. Important factors, in addition to those discussed in this document, could affect the future results of Aecon and could cause those results to differ materially from those expressed in any forward-looking statements.

# **Aecon Group Inc.**

Consolidated Financial Statements

June 30, 2005 and 2004



## **Notice To Reader**

The management of Aecon Group Inc. is responsible for the preparation of the accompanying interim consolidated financial statements. The interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada and are considered by management to present fairly the financial position, operating results and cash flows of the Company.

These interim financial statements have not been reviewed by an auditor. These interim consolidated financial statements are unaudited and include all adjustments, consisting of normal and recurring items, that management considers necessary for a fair presentation of the consolidated financial position, results of operations and cash flows.

(signed) John M. Beck, Chief Executive Officer

(signed) Scott C. Balfour, Chief Financial Officer

# Aecon Group Inc.

## Consolidated Balance Sheets

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(in thousands of dollars) (unaudited)

	<b>June 30, 2005</b>	<b>December 31, 2004</b>
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 22,176	\$ 50,139
Restricted cash (note 3)	10,821	-
Marketable securities and term deposits	14,621	15,583
Accounts receivable	156,680	140,878
Holdbacks receivable	41,411	43,255
Deferred contract costs and unbilled revenue	70,881	55,242
Inventories	8,187	8,754
Prepaid expenses	2,227	1,545
	<hr/>	<hr/>
	<b>327,004</b>	<b>315,396</b>
<b>Property, plant and equipment</b>	<b>58,380</b>	<b>58,983</b>
<b>Future income tax assets</b>	<b>11,092</b>	<b>12,095</b>
<b>Long-term investment</b> (note 13)	<b>41,273</b>	<b>36,925</b>
<b>Other assets</b>	<b>36,948</b>	<b>31,928</b>
	<hr/>	<hr/>
	<b>\$ 474,697</b>	<b>\$ 455,327</b>
	<hr/>	<hr/>

# Aecon Group Inc.

## Consolidated Balance Sheets ...continued

(in thousands of dollars) (unaudited)

	June 30, 2005	December 31, 2004
<b>Liabilities</b>		
<b>Current liabilities</b>		
Bank indebtedness	\$ 8,898	\$ 11,905
Accounts payable and accrued liabilities	164,786	151,263
Holdbacks payable	24,306	29,719
Deferred revenue	29,042	45,891
Income taxes payable	3,678	4,752
Future income tax liabilities	13,465	13,790
Loan from a related party (note 14 (d))	3,000	-
Current portion of long-term debt	6,047	4,477
Convertible debenture (note 12 and note 14 (c))	7,621	-
	<hr/> 260,843	261,797
<b>Long-term debt</b>	40,132	40,352
<b>Other liabilities</b>	2,351	2,441
<b>Other income tax liabilities</b>	12,138	12,138
<b>Convertible debentures</b> (note 12)	58,745	35,643
	<hr/> 374,209	352,371
<b>Shareholders' Equity</b>		
<b>Capital stock</b> (note 4)	95,833	93,829
<b>Contributed surplus</b> (note 4)	269	190
<b>Convertible debentures</b> (note 12)	4,982	2,826
<b>(Deficit) retained earnings</b>	(596)	6,111
	<hr/> 100,488	102,956
	<hr/> \$ 474,697	\$ 455,327

Approved by the Board of Directors

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(signed) John M. Beck, Director

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(signed) Scott C. Balfour, Director

# Aecon Group Inc.

## Consolidated Statements of Operations

For the Three Months ended June 30, 2005 and 2004

(in thousands of dollars, except per share amounts) (unaudited)

	2005	2004
<b>Revenues</b>	<b>\$ 282,978</b>	<b>\$ 264,705</b>
<b>Costs and expenses</b>	<b>265,503</b>	<b>249,613</b>
<b>Marketing, general and administrative expenses</b>	<b>12,029</b>	<b>11,851</b>
<b>Depreciation and amortization</b>	<b>1,968</b>	<b>2,012</b>
<b>Gain on sale of assets and investments</b>	<b>(989)</b>	<b>(428)</b>
<b>Interest expense, net</b>	<b>2,542</b>	<b>855</b>
	<b>281,053</b>	<b>263,903</b>
<b>Income before income taxes and discontinued operations</b>	<b>1,925</b>	<b>802</b>
<b>Income taxes (recovery) (note 5)</b>		
Current	<b>255</b>	<b>2,290</b>
Future	<b>-</b>	<b>(1,957)</b>
	<b>255</b>	<b>333</b>
Income before discontinued operations	<b>1,670</b>	<b>469</b>
Income from discontinued operations (note 9)	<b>-</b>	<b>1,912</b>
<b>Net income for the period</b>	<b>\$ 1,670</b>	<b>\$ 2,381</b>
<b>Earnings per share before discontinued operations (note 4)</b>		
Basic	<b>\$ 0.06</b>	<b>\$ 0.02</b>
Diluted	<b>\$ 0.05</b>	<b>\$ 0.02</b>
<b>Net earnings per share (note 4)</b>		
Basic	<b>\$ 0.06</b>	<b>\$ 0.08</b>
Diluted	<b>\$ 0.05</b>	<b>\$ 0.08</b>
<b>Average number of shares outstanding (note 4)</b>		
Basic	<b>29,279,582</b>	<b>28,472,357</b>
Diluted	<b>32,992,960</b>	<b>32,704,367</b>

# Aecon Group Inc.

## Consolidated Statements of Operations

For the Six Months ended June 30, 2005 and 2004

(in thousands of dollars, except per share amounts) (unaudited)

	2005	2004
<b>Revenues</b>	\$ 455,850	\$ 453,719
<b>Costs and expenses</b>	433,083	432,354
<b>Marketing, general and administrative expenses</b> (note 10)	24,846	25,767
<b>Depreciation and amortization</b>	3,734	3,759
<b>Gain on sale of assets and investments</b>	(1,012)	(398)
<b>Interest expense, net</b>	4,278	1,787
	<u>464,929</u>	<u>463,269</u>
<b>Loss before income taxes, extraordinary items and discontinued operations</b>	<u>(9,079)</u>	<u>(9,550)</u>
<b>Income taxes (recovery)</b> (note 5)		
Current	1,085	2,955
Future	-	(6,032)
	<u>1,085</u>	<u>(3,077)</u>
Loss before extraordinary items and discontinued operations	(10,164)	(6,473)
Extraordinary gain, net of income taxes (note 13)	3,444	-
Loss before discontinued operations	(6,720)	(6,473)
Income from discontinued operations (note 9)	-	6,492
<b>Net (loss) income for the period</b>	<u>\$ (6,720)</u>	<u>\$ 19</u>
<b>Loss per share before extraordinary items and discontinued operations</b> (note 4)		
Basic	\$ (0.35)	\$ (0.24)
Diluted	\$ (0.35)	\$ (0.24)
<b>Net (loss) earnings per share</b> (note 4)		
Basic	\$ (0.23)	\$ -
Diluted	\$ (0.23)	\$ -
<b>Average number of shares outstanding</b> (note 4)		
Basic	29,292,929	26,501,758
Diluted	33,031,797	30,651,981



# **Aecon Group Inc.**

## **Consolidated Statements of Retained Earnings For the Three Months ended June 30, 2005 and 2004**

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(in thousands of dollars) (unaudited)

	<b>2005</b>		<b>2004</b>
<b>(Deficit) retained earnings - beginning of period</b>	<b>\$ (2,272)</b>	<b>\$</b>	<b>45,357</b>
<b>Add (deduct)</b>			
<b>Net income for the period</b>	<b>1,670</b>		<b>2,381</b>
<b>Interest received on share purchase loans</b>	<b>6</b>		<b>6</b>
			<hr/>
<b>(Deficit) retained earnings - end of period</b>	<b>\$ (596)</b>	<b>\$</b>	<b>47,744</b>

# **Aecon Group Inc.**

## **Consolidated Statements of Retained Earnings For the Six Months ended June 30, 2005 and 2004**

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(in thousands of dollars) (unaudited)

	<b>2005</b>		<b>2004</b>
<b>Retained earnings - beginning of period</b>	<b>\$ 6,111</b>	<b>\$</b>	<b>47,712</b>
<b>Add (deduct)</b>			
<b>Net (loss) income for the period</b>	<b>(6,720)</b>		<b>19</b>
<b>Interest received on share purchase loans</b>	<b>13</b>		<b>13</b>
<b>(Deficit) retained earnings - end of period</b>	<b>\$ (596)</b>	<b>\$</b>	<b>47,744</b>

# Aecon Group Inc.

## Consolidated Statements of Cash Flows

For the Three Months ended June 30, 2005 and 2004

(in thousands of dollars) (unaudited)

	2005	2004
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Income before discontinued operations	\$ 1,670	\$ 469
Items not affecting cash -		
Depreciation and amortization	1,968	2,012
Gain on sale of assets and investments	(989)	(428)
Deferred financing charges amortization	454	-
Loss on foreign exchange	690	926
Notional interest representing accretion	235	28
Future income taxes	-	(1,957)
	<u>4,028</u>	<u>1,050</u>
Change in other balances relating to operations (note 6)	(39,553)	(9,020)
Discontinued operations	-	5,229
	<u>(35,525)</u>	<u>(2,741)</u>
<b>Investing activities</b>		
Cash collateral for letters of credit (note 3)	(10,821)	-
Purchase of property, plant and equipment	(900)	(1,876)
Proceeds on sale of property, plant, equipment, and investments	1,546	1,195
Acquisition (note 13)	(192)	(400)
Proceeds on sale of joint venture (note 9)	-	1,188
Increase in long-term investment (note 13)	-	(1,427)
Increase in other assets	(1,463)	(804)
	<u>(11,830)</u>	<u>(2,124)</u>
<b>Financing activities</b>		
Increase in bank indebtedness	41	11,209
Short term loan from a related party (note 14 (d))	3,000	-
Issuance of long-term debt	22,974	747
Repayments of long-term debt	(1,342)	(2,871)
Issuance of capital stock (note 4)	990	338
Interest received on share purchase loans	6	6
	<u>25,669</u>	<u>9,429</u>
<b>(Decrease) increase in cash and cash equivalents</b>	<b>(21,686)</b>	<b>4,564</b>
<b>Effects of foreign exchange on cash balances</b>	<b>155</b>	<b>(151)</b>
<b>Cash and cash equivalents - beginning of period</b>	<b>43,707</b>	<b>27,726</b>
<b>Cash and cash equivalents - end of period</b>	<b>\$ 22,176</b>	<b>\$ 32,139</b>
<b>Supplementary disclosure (note 6)</b>		

# Aecon Group Inc.

## Consolidated Statements of Cash Flows For the Six Months ended June 30, 2005 and 2004

(in thousands of dollars) (unaudited)

	2005		2004
<b>Cash provided by (used in)</b>			
<b>Operating activities</b>			
Loss before discontinued operations	\$ (6,720)	\$	(6,473)
Items not affecting cash -			
Depreciation and amortization	3,734		3,759
Gain on sale of assets and investments	(1,012)		(398)
Deferred financing charges amortization	537		-
Extraordinary gain (note 13)	(4,122)		-
Loss (gain) on foreign exchange	742		(273)
Notional interest representing accretion	379		55
Future income taxes	678		(6,032)
	<u>(5,784)</u>		<u>(9,362)</u>
Change in other balances relating to operations (note 6)	(38,600)		238
Discontinued operations	-		5,360
	<u>(44,384)</u>		<u>(3,764)</u>
<b>Investing activities</b>			
Cash collateral for letters of credit (note 3)	(10,821)		-
Purchase of property, plant and equipment	(1,717)		(2,452)
Proceeds on sale of property, plant, equipment, and investments	1,977		1,333
Acquisition (note 13)	(192)		(1,075)
Proceeds on sale of joint venture (note 9)	-		1,188
Increase in long-term investment (note 13)	(4,348)		(14,551)
Increase in other assets	(2,407)		(1,886)
Proceeds from disposition of other assets (note 6)	-		4,326
Cash acquired on acquisition of a subsidiary, net of consideration paid (note 13)	1,896		-
Discontinued operations	-		12
	<u>(15,612)</u>		<u>(13,105)</u>
<b>Financing activities</b>			
(Decrease) in bank indebtedness	(3,206)		(4,712)
Short term loan from a related party (note 14 (d))	3,000		-
Issuance of long-term debt	45,948		3,691
Repayments of long-term debt	(46,906)		(4,143)
Issuance of capital stock (note 4)	2,004		23,913
Interest received on share purchase loans	13		13
Net proceeds from issuance of convertible debenture	31,016		-
Discontinued operations	-		28
	<u>31,869</u>		<u>18,790</u>
<b>(Decrease) increase in cash and cash equivalents</b>	<b>(28,127)</b>		<b>1,921</b>
<b>Effects of foreign exchange on cash balances</b>	<b>164</b>		<b>767</b>
<b>Cash and cash equivalents - beginning of period</b>	<b>50,139</b>		<b>29,451</b>
<b>Cash and cash equivalents - end of period</b>	<b>\$ 22,176</b>	<b>\$</b>	<b>32,139</b>
<b>Supplementary disclosure (note 6)</b>			

# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2005 and 2004

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(in thousands of dollars, except per share amounts) (unaudited)

### 1. Summary of significant accounting policies

These unaudited interim consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles for interim financial statements. They do not include all of the disclosures required by generally accepted accounting principles for annual financial statements and accordingly, the interim financial information should be read in conjunction with the Company's annual financial statements. The interim financial information has been prepared using the same accounting policies as set out in note 1 to the Consolidated Financial Statements for the year ended December 31, 2004, except for those accounting policies adopted on January 1, 2005 as described in note 2 hereunder. In the opinion of management these statements include all adjustments, consisting of normal and recurring items that are necessary for a fair presentation of the consolidated financial position, results of operations and cash flows.

The construction industry in Canada is seasonal in nature due to weather conditions, with less work performed in the winter and early spring months. Accordingly, the Company experiences a seasonal pattern in its operating results with the first half of the year typically reflecting lower revenues and profits than the second half of the year. Results for the three-month and six-month periods ended June 30, 2005 are not necessarily indicative of results expected for the full fiscal year or any other future period.

### 2. Changes in accounting policies

AcG 15 is the Canadian equivalent of the United States' FIN 46R and modifies the principles used in determining when and by whom entities are consolidated. Existing consolidation rules are considered to be unsatisfactory as they do not properly address Special Purpose Entities or other structures where control is pre-arranged and voting control doesn't reflect the underlying economic risks and rewards. In general, if a company is exposed to more than 50% of the economic risks of a variable interest entity, it is presumed to control the entity and must consolidate it, notwithstanding that its voting interest may be minimal. Two consolidation "models" are established under AcG 15 – a Voting Interest Model (VOI) and a Variable Interest Model (VIE). The VOI model has been the standard for purposes of determining control and in order to continue to use the VOI model it must be demonstrated that equity holders as a group control the entity and that they are truly at risk. One of the tests is that there must be a minimum amount of equity, as it appears in the financial statements of the entity being assessed. If the VOI tests are not met, the VIE model would be used. Proportionate consolidation is not permitted under the VIE model. Aecon's assessment is that AcG 15 will not result in any change to the manner in which it currently consolidates its operations.

The Canadian Institute of Chartered Accountants ("CICA") Handbook section related to Financial Instruments now includes a new interpretation which helps clarify the classification of a financial instrument as between debt or equity. None of Aecon's existing financial instruments will be classified differently as a result of this addition to the Handbook.

### 3. Restricted cash

At June 30, 2005, the Company had \$10,821 (December 31, 2004 – Nil) which was deposited as collateral for letters of credits issued by the Company and was not available for general operating purposes.

# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2005 and 2004

(in thousands of dollars, except per share amounts) (unaudited)

### 4. Capital stock

	2005		2004	
	Number of shares issued	Amount	Number of shares issued	Amount
Balance – January 1	30,524,609	\$ 93,829	25,308,542	\$ 68,216
Common shares issued on exercise of options	276,000	1,014	64,667	234
Common shares issued less expenses of \$809 (i)	-	-	4,600,000	23,341
Balance – March 31	30,800,609	94,843	29,973,209	91,791
Common shares issued on exercise of options	275,000	990	70,900	261
Adjustment of expenses related to common shares issued in first quarter (i)	-	-	-	77
Balance – June 30	31,075,609	\$ 95,833	30,044,109	\$ 92,129

(i) On March 18, 2004, the Company issued 4,600,000 common shares at \$5.25 per share. Net proceeds, after deducting agents' fees and estimated expenses of the issue were approximately \$23,418. Hochtief Canada Inc. ("HCI"), the Company's largest shareholder, exercised its pre-emptive right in connection with this offering and acquired 2,214,440 common shares, thus maintaining its proportionate interest.

The Company is authorized to issue an unlimited number of common shares.

On June 21, 2005, the Company's shareholders approved a new stock option plan (the 2005 Stock Option Plan) to replace the previous 1998 Stock Option Plan. The aggregate number of common shares that can be issued under the 2005 shall not exceed 2,500,000. As at June 30, 2005, no options have been issued under the 2005 Plan. Similar to the 1998 Plan, each option issuance under the 2005 Plan shall specify the period for which the option thereunder is exercisable (which in no event shall exceed ten years from the date of grant) and shall provide that the option shall expire at the end of such period. The company's Board of Directors will determine the vesting period on the dates of option grants.

The granting of options under the 1998 Stock Option Plan ceased effective June 21, 2005. However, this does not affect the rights granted under this plan to the holders of 630,000 options that were previously issued and remain outstanding under this plan. Details of common shares issued upon the exercise of options under the 1998 Plan, as well as details of changes in the balance of options outstanding are detailed below:

# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2005 and 2004

(in thousands of dollars, except per share amounts) (unaudited)

	2005		2004	
	Shares	Weighted average exercise price	Shares	Weighted average exercise price
Options outstanding - January 1	1,181,000	\$ 4.05	1,780,400	\$ 3.76
Exercised	(276,000)	3.67	(64,667)	3.62
Forfeited	-	-	(83,333)	5.40
Options outstanding - March 31	905,000	4.19	1,632,400	3.69
Granted	-	-	-	-
Exercised	(275,000)	3.60	(70,900)	3.68
Forfeited	-	-	(50,000)	3.60
Options outstanding – June 30	630,000	\$ 4.42	1,511,500	\$ 3.69
Options exercisable at end of period	446,666	\$ 3.69	1,494,833	\$ 3.64

Options were exercised during the three months ended June 30, 2005 for 275,000 shares (2004 – 70,900) for which share capital was increased by \$990 (2004 - \$261). For the six months ended June 30, 2005, 551,000 options were exercised (2004 – 135,567) for which share capital was increased by \$2,004 (2004 - \$495). Options currently outstanding have the following exercise prices and expiry dates:

Options granted in	Number of shares	Exercise price	Expiry date
2000	105,000	\$ 3.60	July 20, 2005
2001	200,000	3.60	March 5, 2006
2001	75,000	3.60	April 9, 2006
2003	100,000	4.75	April 1, 2008
2004	100,000	6.30	August 3, 2009
2004	50,000	6.20	November 30, 2009

The options granted have a term of five years from the date of grant and vest on the anniversary date of the grant at the rate of one-third per annum of the total number of share options granted.

The Company adopted fair value accounting for options granted to employees after 2001. During the three months ended June 30, 2005, compensation expense of \$39 (2004 - \$16) was recorded with respect to the expensing of stock options and Contributed Surplus was increased by the same amount. During the six months ended June 30, 2005, compensation expense of \$79 (2004 - \$32) was recognized and Contributed Surplus was increased by the same amount, on account of options outstanding. During the six months ended June 30, 2004, 75,000 options that were granted in 2002 were cancelled which resulted in a reduction in compensation expense of \$124 and a decrease in Contributed Surplus of the same amount.

# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2005 and 2004

(in thousands of dollars, except per share amounts) (unaudited)

Details of the calculations of income and loss per share are set out below. For purposes of calculating basic income or loss per share the number of common shares has been reduced by 1,522,063 common shares on account of share purchase loans receivable from employees. For purposes of calculating diluted income or loss per share, these shares have been treated as options.

### Three months ended June 30

	<b>2005</b>		
	<b>Income (numerator)</b>	<b>Shares (denominator)</b>	<b>Per share</b>
<b>Net income per share</b>			
Net income for the period	\$ 1,670	29,279,582	\$ 0.06
Effect of dilutive securities			
Options	-	1,565,810	-
Convertible secured subordinated debenture bearing interest at prime rate plus 1.0% maturing on June 30, 2006	83	2,147,568	-
	<u>\$ 1,753</u>	<u>32,992,960</u>	<u>\$ 0.05</u>

	<b>2004</b>		
	<b>Income (numerator)</b>	<b>Shares (denominator)</b>	<b>Per share</b>
<b>Net income per share</b>			
Net income for the period	\$ 2,381	28,472,357	\$ 0.08
Effect of dilutive securities			
Options	-	2,084,442	-
Convertible secured subordinated debenture bearing interest at prime rate plus 1.0% maturing on June 30, 2006	77	2,147,568	-
	<u>\$ 2,458</u>	<u>32,704,367</u>	<u>\$ 0.08</u>



# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2005 and 2004

(in thousands of dollars, except per share amounts) (unaudited)

### Earnings per share before discontinued operations

Income before discontinued operations	\$	469	28,472,357	\$	0.02
Effect of dilutive securities					
Options		-	2,084,442		-
Convertible secured subordinated debenture bearing interest at prime rate plus 1.0% maturing on June 30, 2006		77	2,147,568		-
	\$	546	32,704,367	\$	0.02

### Six months ended June 30

2005

		Loss (numerator)	Shares (denominator)		Per share
<b>Net loss per share</b>					
Net loss for the period	\$	(6,720)	29,292,929	\$	(0.23)
Effect of dilutive securities (i)					
Options		-	1,591,300		-
Convertible secured subordinated debenture bearing interest at prime rate plus 1.0% maturing on June 30, 2006		165	2,147,568		-
	\$	(6,555)	33,031,797	\$	(0.23)

### Loss per share before extraordinary items and discontinued operations

Loss before extraordinary items and discontinued operations	\$	(10,164)	29,292,929	\$	(0.35)
Effect of dilutive securities (i)					
Options		-	1,591,300		-
Convertible secured subordinated debenture bearing interest at prime rate plus 1.0% maturing on June 30, 2006		165	2,147,568		-
	\$	(9,999)	33,031,797	\$	(0.35)

# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2005 and 2004

(in thousands of dollars, except per share amounts) (unaudited)

	2004		
	Income (loss) (numerator)	Shares (denominator)	Per share
<b>Net income per share</b>			
Net income for the period	\$ 19	26,501,758	\$ -
Effect of dilutive securities			
Options	-	2,002,655	-
Convertible secured subordinated debenture bearing interest at prime rate plus 1.0% maturing on June 30, 2006	157	2,147,568	
	<u>\$ 176</u>	<u>30,651,981</u>	<u>\$ -</u>
<b>Loss per share before extraordinary items and discontinued operations</b>			
Loss before extraordinary items and discontinued operations	\$ (6,473)	26,501,758	\$ (0.24)
Effect of dilutive securities (i)			
Options	-	2,002,655	-
Convertible secured subordinated debenture bearing interest at prime rate plus 1.0% maturing on June 30, 2006	157	2,147,568	-
	<u>\$ (6,316)</u>	<u>30,651,981</u>	<u>\$ (0.24)</u>

(i) As the impact of dilutive securities would be to decrease the loss per share, they are excluded for purposes of the calculation of diluted loss per share.

In the three months ended June 30, 2005, basic earnings per share from extraordinary items amounted to Nil (2004 - Nil), and diluted earnings per share from extraordinary gain amounted to Nil (2004 - Nil). In the six months ended June 30, 2005, basic earnings per share from extraordinary items amounted to \$0.12 (2004 - Nil), and diluted earnings per share from extraordinary gain amounted to \$0.12 (2004 - Nil).

In the three months ended June 30, 2005, basic earnings per share from discontinued operations amounted to Nil (2004 - \$0.06 per share), and diluted earnings per share from discontinued operations amounted to Nil (2004 - \$0.06). In the six months ended June 30, 2005, basic earnings per share from discontinued operations amounted to Nil (2004 - \$0.24 per share), and diluted earnings per share from discontinued operations amounted to Nil (2004 - \$0.24).

# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2005 and 2004

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(in thousands of dollars, except per share amounts) (unaudited)

### 5. Income Taxes

In the fourth quarter of 2004, the Company provided a valuation allowance against the net future tax assets that had been recorded at December 31, 2003 and against future tax assets that would otherwise have been recorded in 2004 with respect to its Canadian controlled operations. Consistent with this accounting treatment, future tax assets in respect of any further tax losses incurred in 2005 from Canadian controlled operations will be offset by a valuation allowance whereas a provision for tax on income from Canadian controlled operations will be offset by a reduction in previously recorded valuation allowances.

Set out below, in tabular form, is a reconciliation between the expected tax recoveries in 2005 and 2004 at statutory rates and the reported tax expense in 2005 and tax recovery in 2004.

	<b>Six months ended June 30</b>	
	<b>2005</b>	<b>2004</b>
Loss before income taxes, extraordinary items and discontinued operations	\$ 9,079	\$ 9,550
Statutory income tax rate	36.1%	36.1%
Expected income tax recovery	(3,279)	(3,449)
Effect on income tax of:		
Valuation allowance against current year's future tax assets	3,832	-
Provincial and foreign rate differentials	54	263
Non-deductible expenses	217	212
Large corporations tax	225	225
Foreign exchange translation (gains) losses	103	(462)
Other	(67)	204
	<u>4,364</u>	<u>442</u>
Income tax expense (recovery)	\$ 1,085	\$ (3,007)

# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2005 and 2004

(in thousands of dollars, except per share amounts) (unaudited)

### 6. Cash flow information

Change in other balances relating to operations:

	Three months to June 30		Six months to June 30	
	2005	2004	2005	2004
(Increase) decrease in:				
Marketable securities	\$ (828)	\$ 5,811	\$ 1,127	\$ 7,116
Accounts receivable	(53,913)	(37,840)	(14,350)	(14,611)
Holdbacks receivable	(8,675)	(2,549)	1,873	(24)
Deferred contract costs and unbilled revenue	(20,387)	1,869	(13,447)	468
Inventories	(204)	(2,324)	567	(2,094)
Prepaid expenses	522	(1,690)	(972)	(1,461)
Increase (decrease) in:				
Accounts payable and accrued liabilities	44,562	36,827	10,754	5,661
Holdbacks payable	1,843	(1,501)	(5,616)	3,867
Deferred revenue	(534)	(9,030)	(17,410)	936
Income taxes payable	(1,939)	1,407	(1,126)	380
	<u>\$ (39,553)</u>	<u>\$ (9,020)</u>	<u>\$ (38,600)</u>	<u>\$ 238</u>

Other supplementary information:

	Three months to June 30		Six months to June 30	
	2005	2004	2005	2004
Cash interest paid	\$ 1,982	\$ 1,156	\$ 2,695	\$ 2,389
Cash income taxes paid	\$ 149	\$ 921	\$ 2,515	\$ 1,782

Property, plant and equipment acquired and financed by means of capital leases during the three months ended June 30, 2005 amounted to \$1,963 (2004 - \$338) and \$2,308 (2004 - \$638) for the six months ended June 30, 2005.

During the six months ended June 30, 2004, the Company received \$4,326 upon the transfer to a new partner of a portion of its interest in the Quito, Ecuador airport project.

### 7. Guarantees

The Company has outstanding guarantees and letters of credit amounting to \$26,988 (December 31, 2004 - \$29,644) in support of financial and performance related obligations for the Nathpa Jhakri Hydro-electric Project in India, which has also been guaranteed by Hochtief AG ("Hochtief"), the parent of the Company's principal shareholder. The Company and Hochtief have signed an indemnity agreement whereby the Company has agreed to pay Hochtief any amounts Hochtief is required to pay pursuant to this guarantee.

In connection with the Cross Israel Highway project, the Company has provided two joint and several guarantees, a continuous guarantee, which guarantees the performance of the concessionaire in which the

# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2005 and 2004

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(in thousands of dollars, except per share amounts) (unaudited)

Company has a 25% interest (December 31, 2004 – 22.20%) and a leakage guarantee, which is a guarantee by the operator of the toll highway, in which the Company has a 31% interest (December 31, 2004 – 34%), to the concessionaire and covers toll capture and collection rates generated from users of the highway during the operating period. These guarantees extend to the end of the concession period which ends in 2029. The continuous guarantee is in the amount of \$16,546 (December 31, 2004 - \$16,227) and is renewed annually to its full amount, irrespective of any drawings made thereunder. The leakage guarantee came into effect when construction was completed and is renewable annually for the lesser of \$11,869 (December 2004 - \$12,276) or 6% of annual toll revenue.

In addition, the Company has also issued, in the normal conduct of operations, guarantees amounting to \$10,630 (December 31, 2004 - \$7,186) in support of financial and performance related obligations. These guarantees are secured by cash held in interest bearing accounts. Furthermore, the Company has issued an advance payment guarantee in the amount of \$3,000 (December 31, 2004 – \$3,000) for the Eastmain Powerhouse project (this guarantee is counter guaranteed by Hochtief), and a performance guarantee of \$5,071 (December 31, 2004 – \$5,572) for the DSD Wuppertal project in Germany supported by a guarantee issued to Aecon by Export Development Corporation.

Under the terms of many of the Company's joint ventures' contracts with project owners, each of the partners is joint and severally liable for performance under the contracts. Circumstances that could lead to a loss include a partner's inability to contribute additional funds to the venture in the event that the project incurs a loss or additional costs that the Company could incur should the partner fail to provide the contractually committed services and resources. At June 30, 2005, the value of uncompleted work for which Aecon's joint venture partners are responsible, and which Aecon could be responsible for assuming, amounted to approximately \$82,000 (December 31, 2004 - \$115,000), a substantial portion of which is supported by performance bonds. In the event that Aecon assumed this additional work it would have the right to receive the partner's share of billings to the project owners pursuant to the joint venture contract.

The Company has, over time, sold portions of its business. Pursuant to the sale agreements, the Company may have to indemnify the purchaser against liabilities related to events prior to the sale, such as tax, environmental, litigation and employment matters or related to representations made by the company. The company is unable to estimate the potential liability for these types of indemnification guarantees as the amounts are dependent on the outcome of future contingent events, the nature and likelihood of which cannot be determined at this time. However the maximum guarantee is not to exceed the proceeds from disposal. Historically, the Company has not made any significant indemnification payments under such agreements.

### 8. Segmented information and business concentration

The Company has three reportable segments: Infrastructure, Buildings and Industrial. This segmentation reflects the Company's current structure and management. The Corporate and Other category in the summary below includes corporate costs and other activities not directly allocable to segments and also includes inter-segment eliminations.

# **Aecon Group Inc.**

## Notes to Consolidated Financial Statements

**June 30, 2005 and 2004**

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(in thousands of dollars, except per share amounts) (unaudited)

### *Infrastructure*

This segment includes all aspects of the construction of infrastructure including roads and highways, expressways and toll routes, dams and tunnels, bridges, airports, marine facilities, transit systems and power projects as well as utility distribution systems including natural gas, telecommunications and electrical networks, water and sewer mains, traffic signals and highway lighting. Activities within this segment also include the development, design, construction, operation and financing of infrastructure projects by way of build-operate-transfer, build-own-operate-transfer or public-private partnership contract structures.

### *Buildings*

This segment is active in the construction of commercial and institutional buildings principally in Canada and the north-western United States and selected international projects.

### *Industrial*

This segment includes all of the Company's industrial manufacturing and industrial construction activities. These operations include the fabrication of small and large bore pipe and module assembly for the petrochemical industry, and the design and manufacture of once-through heat recovery steam generators for industrial and power plant applications. Also included are the Company's industrial construction, installation and maintenance activities where the Company has special expertise in the power, automotive and steel industries.

# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2005 and 2004

(in thousands of dollars, except per share amounts) (unaudited)

Information by reportable segments is as follows:

as at June 30 and the three months then ended

	<b>2005</b>				
	<b>Infrastructure</b>	<b>Buildings</b>	<b>Industrial</b>	<b>Corporate and Other</b>	<b>Total</b>
Revenues	\$ 107,358	\$ 108,191	\$ 68,690	\$ (1,261)	\$ 282,978
EBITDA (i)	\$ 5,874	\$ 514	\$ 2,831	\$ (2,784)	\$ 6,435
Depreciation and amortization	1,156	101	493	218	1,968
Segment operating profit (loss)	\$ 4,718	\$ 413	\$ 2,338	\$ (3,002)	\$ 4,467
Interest and income taxes					(2,797)
Net income				\$	1,670
Total assets	\$ 228,809	\$ 109,019	\$ 81,802	\$ 55,067	\$ 474,697
Intangible assets and goodwill	\$ 2,676	\$ 1,923	\$ 3,750	\$ -	\$ 8,349
Capital expenditures	\$ 305	\$ 41	\$ 397	\$ 157	\$ 900
Cash flow from continuing operations	\$ 5,284	\$ 514	\$ 2,831	\$ (4,601)	\$ 4,028

# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2005 and 2004

(in thousands of dollars, except per share amounts) (unaudited)

	<b>2004</b>				
	<b>Infrastructure</b>	<b>Buildings</b>	<b>Industrial</b>	<b>Corporate and Other</b>	<b>Total</b>
Revenues	\$ 113,280	\$ 98,694	\$ 53,543	\$ (812)	\$ 264,705
EBITDA (i)	\$ 6,320	\$ (1,820)	\$ 2,191	\$ (3,022)	\$ 3,669
Depreciation and amortization	1,145	270	437	160	2,012
Segment operating profit (loss)	\$ 5,175	\$ (2,090)	\$ 1,754	\$ (3,182)	\$ 1,657
Interest and income taxes					(1,188)
Income from continuing operations				\$	469
Segment operating profit from discontinued operations	\$ 511	\$ -	\$ 2,145	\$ -	\$ 2,656
Interest and income taxes					(744)
Income from discontinued operations				\$	1,912
Net income				\$	2,381
Total assets	\$ 241,519	\$ 92,386	\$ 65,908	\$ 78,764	\$ 478,577
Assets of discontinued operations	\$ 1,787	\$ -	\$ 10,483	\$ -	\$ 12,270
Intangible assets and goodwill	\$ 2,812	\$ 4,167	\$ 3,750	\$ -	\$ 10,729
Capital expenditures	\$ 27	\$ 159	\$ 1,306	\$ 384	\$ 1,876
Cash flow from continuing operations	\$ 6,882	\$ (1,809)	\$ 2,068	\$ (6,091)	\$ 1,050



# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2005 and 2004

(in thousands of dollars, except per share amounts) (unaudited)

as at June 30 and the six months then ended

	2005				
	Infrastructure	Buildings	Industrial	Corporate and Other	Total
Revenues	\$ 164,993	\$ 185,342	\$ 107,714	\$ (2,199)	\$ 455,850
EBITDA (i)	\$ 2,270	\$ 859	\$ 910	\$ (5,106)	\$ (1,067)
Depreciation and amortization	2,155	213	933	433	3,734
Segment operating profit (loss)	\$ 115	\$ 646	\$ (23)	\$ (5,539)	\$ (4,801)
Interest and income taxes					(5,363)
Loss before extraordinary items					\$ (10,164)
Extraordinary gain	\$ 4,122	\$ -	\$ -	\$ -	\$ 4,122
Income taxes					(678)
Extraordinary gain, net of income taxes					\$ 3,444
Net loss					\$ (6,720)
Capital expenditures	\$ 757	\$ 114	\$ 560	\$ 286	\$ 1,717
Cash flow from continuing operations	\$ 1,387	\$ 859	\$ 962	\$ (8,992)	\$ (5,784)

# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2005 and 2004

(in thousands of dollars, except per share amounts) (unaudited)

	<b>2004</b>				
	<b>Infrastructure</b>	<b>Buildings</b>	<b>Industrial</b>	<b>Corporate and Other</b>	<b>Total</b>
Revenues	\$ 168,274	\$ 182,270	\$ 104,342	\$ (1,167)	\$ 453,719
EBITDA (i)	\$ 1,354	\$ (3,401)	\$ 5,974	\$ (7,931)	\$ (4,004)
Depreciation and amortization	2,175	395	850	339	3,759
Segment operating (loss) profit	\$ (821)	\$ (3,796)	\$ 5,124	\$ (8,270)	\$ (7,763)
Interest and income taxes					1,290
Loss from continuing operations				\$	(6,473)
Segment operating profit from discontinued operations	\$ 295	\$ -	\$ 9,540	\$ -	\$ 9,835
Interest and income taxes					(3,343)
Income from discontinued operations				\$	6,492
Net income				\$	19
Capital expenditures	\$ 479	\$ 195	\$ 1,533	\$ 245	\$ 2,452
Cash flow from continuing operations	\$ 834	\$ (3,390)	\$ 5,843	\$ (12,649)	\$ (9,362)

- i. EBITDA represents earnings or loss before interest, income taxes, depreciation and amortization. Segment operating profit (loss) represents net income (loss) before interest and income taxes. Cash flow from operations is before the change in other balances related to operations. EBITDA, operating profit (loss), and cash flow from operations are not measures that have any standardized meaning prescribed by GAAP and are considered non-GAAP measures. Therefore, these measures may not be comparable to similar measures presented by other companies. These measures have been described and presented in order to provide shareholders and potential investors with additional information regarding the Company's finances and results of operations.

## 9. Discontinued operations

In the fourth quarter of 2004, the Company sold its 38.75% interest in Canatom NPM Inc. (Canatom) that was part of the Company's Industrial segment. For the three months ended June 30, 2004, the Company's proportionate share of revenues, expenses and net income from this joint venture were as follows: revenues of

# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2005 and 2004

(in thousands of dollars, except per share amounts) (unaudited)

\$4,228; expenses other than income taxes of \$2,049; net income of \$1,525. For the six months ended June 30, 2004, the Company's proportionate share of revenues, expenses and net income from this joint venture were as follows: revenues of \$12,818; expenses other than income taxes of \$3,225; net income of \$6,261.

In the fourth quarter of 2004, the Company sold its Footage Tools division that was part of the Company's Infrastructure segment. For the three months ended June 30, 2004, the Company's revenues, expenses and net income from this division were as follows: revenues of \$1,092; expenses other than income taxes of \$863; net income of \$229. For the six months ended June 30, 2004, the Company's revenues, expenses and net income from this division were as follows: revenues of \$1,979; expenses other than income taxes of \$1,660; net income of \$319.

In the second quarter of 2004, the Company sold its one-third interest in a joint venture that was part of the Company's Infrastructure segment. Net proceeds from the sale were \$1,188 and the after-tax gain from the sale amounted to \$259. For the three months ended June 30, 2004, the Company's proportionate share of revenues, expenses and net loss from this joint venture were as follows: revenues of \$52; expenses other than income taxes of \$153; net loss of \$101. For the six months ended June 30, 2004, the Company's proportionate share of revenues, expenses and net loss from this joint venture were as follows: revenues of \$52; expenses other than income taxes of \$468; net loss of \$347.

In the first quarter of 2004, the Company sold its interest in Europort Poland Sp. z o.o., SC Infrastructure (Poland) Sp. z o.o, and related affiliated companies (Europort). Proceeds from disposition were nominal.

Included as Discontinued Operations in the Consolidated Statements of Operations and Consolidated Statements of Cash Flows are the results of operations and cash flows related to these operations.

The table below summarizes income from discontinued operations:

	<b>Three months to June 30 2004</b>	<b>Six months to June 30 2004</b>
Revenues	\$ 5,372	\$ 14,849
Expenses	(2,679)	(4,967)
Income before income taxes	2,693	9,882
Income taxes	781	3,390
Income	<u>\$ 1,912</u>	<u>\$ 6,492</u>

Certain comparative figures have been reclassified, consistent with the presentation of discontinued operations.

### 10. Lease termination cost

During the first quarter of 2004, the Company reached agreement with its landlord to terminate, effective July 5, 2004, the lease on the Company's premises at 3660 Midland Avenue in Toronto. By exercising its right to terminate the lease before the lease termination date, the Company was required to pay the sum of \$2,550 to the landlord of the premises, which payment, in accordance with Canadian generally accepted accounting principles, has been charged to operations in the six months ended June 30, 2004 and included in Corporate and Other.

# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2005 and 2004

(in thousands of dollars, except per share amounts) (unaudited)

### 11. Employee future benefit expenses

Employee future benefit expenses for the three and six months ended June 30, 2005 are as follows:

	Three months ended June 30		Six months ended June 30	
	2005	2004	2005	2004
Defined benefit plan expense:				
Company sponsored pension plans	\$ 481	\$ 378	\$ 967	\$ 757
Defined contribution plan expense:				
Company sponsored pension plans	490	451	882	767
Multi-employer pension plans	6,159	3,542	9,699	6,482
Total employee future benefit expenses	<u>\$ 7,130</u>	<u>\$ 4,371</u>	<u>\$ 11,548</u>	<u>\$ 8,006</u>

### 12. Convertible debentures

In the first quarter of 2005, the Company entered into an agreement with a syndicate of underwriters pursuant to which the underwriters purchased \$32,500 in unsecured, subordinated convertible debentures on an underwritten private placement basis.

The convertible debentures will mature on March 17, 2010 and will accrue interest at the rate of 8.25% per annum payable on a semi-annual basis. At the holder's option, the convertible debentures may be converted into common shares at any time up to the maturity date at a conversion price of \$7.60 for each common share, subject to adjustment in certain circumstances.

The convertible debentures will not be redeemable before March 18, 2008. From March 18, 2008 through the maturity date the Company may, at its option, redeem the convertible debentures, in whole or in part, at par plus accrued and unpaid interest provided that the weighted average closing price of the common shares on the Toronto Stock Exchange during a specified period prior to redemption is not less than 125% of the conversion price.

Subject to specified conditions, the Company will have the right to repay the outstanding principal amount of the convertible debentures, on maturity or redemption, through the issuance of common shares of the Company. The Company also has the option to satisfy its obligation to pay interest through the issuance and sale of additional common shares of the Company on a private placement basis. Additionally, the Company will have the option, subject to prior agreement of the holders, to settle its obligations on conversion by way of a cash payment of equal value.

In determining the amount of the debt and equity components of the convertible debenture, the carrying amount of the financial liability is first determined by discounting the stream of future payments of interest and principal at the rate of interest prevailing at the date of issue for instruments of similar term and risk. The equity component equals the amount determined by deducting from the carrying amount of the compound instrument the amount of the debt component.

# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2005 and 2004

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(in thousands of dollars, except per share amounts) (unaudited)

Convertible subordinated debentures:

	<b>2005</b>
Debt component:	
Balance – beginning of period	\$ 35,643
Notional interest representing accretion	379
Debenture issued during the first quarter	30,344
Balance – end of period	<u>\$ 66,366</u>
Reported as:	
Current liability	7,621
Long term liability	58,745
	<u>\$ 66,366</u>
Equity component:	
Balance – beginning of period	\$ 2,826
Debenture issued during the first quarter	2,156
Balance – end of period	<u>\$ 4,982</u>

### 13. Acquisition

On January 24, 2005, the Company acquired its partner's share in the joint venture that holds 33.33% in the construction joint venture, of which one of its projects was the Cross Israel Highway.

The following is a summary of the acquisition:

#### Net assets acquired

Cash	\$ 3,416
Working capital	533
Long term receivable	1,693
	<u>\$ 5,642</u>

#### Consideration

Cash	\$ 1,520
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#### Extraordinary gain before income taxes

Income taxes	\$ 4,122
	678
<b>Extraordinary gain after income taxes</b>	<u>\$ 3,444</u>

As the fair value of the financial and current net assets acquired exceeded the amount paid, the Company recorded an extraordinary gain of \$4,122 before income taxes, and \$3,444 net of income taxes on this transaction. Also, since the cash acquired of \$3,416 exceeded the consideration paid of \$1,520, the Company's overall cash position improved by \$1,896.

# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2005 and 2004

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(in thousands of dollars, except per share amounts) (unaudited)

In addition, the Company increased its investment in Derech Eretz Highways (1997) Ltd. (“Derech Eretz”), the company owning the concession rights for the Cross Israel Highway, from 22.2% to 25%. The purchase price for the increased stake was \$4,348 (US\$3,500). Pursuant to certain agreements with the State of Israel and the project lenders, Aecon’s interest in Derech Eretz would be diluted to approximately 11% if certain options granted to these parties are exercised.

In the second quarter of 2004, the Company acquired the assets and operations of Cegerco CCI Inc., a general contracting company in the Montreal region, specializing in the construction and management of institutional, commercial and pharmaceutical building projects. The purchase price on closing was \$784, in which, \$400 was in cash and \$384 was in the form of short-term note payable. The acquisition was accounted for using the purchase method and the results of operations are included from the date of acquisition.

The following is a summary of the acquisition:

### Net assets acquired

Non-cash working capital	\$	19
Property, plant and equipment		265
Intangible assets		500
	\$	<u>784</u>

### Consideration

Cash	\$	400
Short-term note payable		384
	\$	<u>784</u>

In the second quarter of 2005, the Company paid \$192 with respect to the short-term note payable of \$384 recorded in connection with the acquisition of Cegerco CCI Inc.

At December 31, 2003, the Company recorded amounts payable of \$1,503 to the vendors of Westeinde Construction Ltd. in connection with the acquisition of that company. In the six months ended June 30, 2004, the Company paid \$675 with respect to this liability.

## 14. Related party transactions and balances

In addition to related party transactions described elsewhere in the notes to these consolidated financial statements, the following summarizes additional transactions during the period. Related party transactions are recorded at their exchange amounts.

- (a) Hochtief, the parent of HCI, has issued guarantees in support of the financial and performance related obligations of the Nathpa Jhakri hydro-electric project in India in which the Company has a joint venture interest (note 6). The Company paid Hochtief \$137 during the six months ended June 30, 2005 (2004 - \$189) in connection with these guarantees.
- (b) The Company is in a joint venture with Hochtief on the Eastmain hydro-electric powerhouse project in Quebec.

# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2005 and 2004

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(in thousands of dollars, except per share amounts) (unaudited)

- (c) At June 30, 2005, the Company was indebted to HCI for \$7,731 (December 31, 2004 - \$7,731) in the form of a convertible subordinated debenture as described in note 11 to the Company's 2004 consolidated financial statements.
- (d) At June 30, 2005, the Company was indebted to Hochtief for a total of \$3,000 in the form of a short term unsecured loan and is repayable no later than December 31, 2005. The loan was provided to support a portion of the Company's working capital contribution requirements to the Eastmain joint venture, the hydro electric power house project in Northern Quebec. The loan shall be repaid in Canadian funds and interest to be accrued and compound quarterly. Interest is due on expiry of the loan and calculated on the basis of the amount outstanding loan at prime rate plus 3.0%.
- (e) During the six months ended June 30, 2005, the Company paid HCI \$201 of interest and fees (2004 - \$597) in connection with the convertible subordinated debenture and the stand-by facility in 2004.
- (f) At June 30, 2005, the Company had a receivable of \$394 (December 31, 2004 - \$290) from Hochtief PPP Solutions GmbH with respect to bid costs, pursuant to an arrangement in place for the sharing of such costs.
- (g) An officer and director of the Company purchased \$100, and a company controlled by a director and his wife purchased \$600, and the wife of a director purchased \$100 of the Company's \$32,500 convertible debenture financing, which was completed on March 17, 2005.
- (h) On July 21, 2004 the shareholders voted not to approve a proposed amalgamation that would have resulted in HCI holding all of the outstanding shares of the Company and taking the Company private. The Company incurred legal, valuation and related costs of \$1,046 in connection with the proposed amalgamation. HCI has agreed to reimburse the Company for \$520 of these costs and the net expense of \$512 has been recorded in the three months ended June 30, 2004.
- (i) During the three months ended June 30, 2005, the Company paid legal fees in the amount of \$83 (2004 - \$4), and \$160 during the six months ended June 30, 2005 (2004 - \$126) to a firm in which a director of the Company is a partner.
- (j) During the three months ended June 30, 2005, the Company paid professional fees in the amount of \$24 (2004 - \$25), and \$50 during the six months ended June 30, 2005 (2004 - \$25) to a consulting company in which a director of the Company is a partner.

### 15. Contingency

In June 2005, the joint venture involved in the construction of the Nathpa Jhakri Project in India, in which the Company has a 45% interest, was advised by the owner, Satluj Jal Vidyut Nigam Ltd. ("SJVN") (formerly Nathpa Jhakri Power Corporation Limited) of their intention to levy liquidated damages against the joint venture in the amount of \$32,395 (at current exchange rates) for not completing the contract on time. However, since the delay in the completion of the project was caused by numerous items outside of the joint venture's control and contractual responsibility, including, among many other things, a catastrophic flood in 2002, the joint venture believes that these liquidated damages are unwarranted. The joint venture also believes that even

# **Aecon Group Inc.**

## Notes to Consolidated Financial Statements

**June 30, 2005 and 2004**

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(in thousands of dollars, except per share amounts) (unaudited)

in the unlikely situation that it was responsible for some part of the delay; this did not result in any damages to SJVN. The joint venture's conclusion regarding the impermissibility of SJVN to impose liquidated damages is supported by two independent legal opinions. Moreover, the joint venture has already submitted claims of approximately \$93,468 (of which \$10,170, at current exchange rates, had been previously received by the joint venture and is included in the joint venture's profit estimate for this project) against SJVN, the most significant of which is to cover the joint venture's costs of delays related to these same matters. Based on all of the above, no provision has been made for the liquidated damages, nor, in accordance with the Company's accounting policy, which is to recognize revenue from claims only when resolved, has any amount been recognized for potential recoveries under the claims.

### **16. Comparative figures**

Certain comparative figures have been reclassified to conform to the presentation adopted in the three months and six months ended June 30, 2005.



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