

Aecon Group Inc. › Second Quarter Report 2006

2

Six months ended June 30, 2006

***AECON***



## **Dear Fellow Shareholders,**

Aecon's second quarter results continue to track generally along the lines expected, with strengths in our core markets and steady improvements in margin percentages. Aecon continues to be well positioned to continue this improvement and to capitalize on a very robust Canadian construction market.

Aecon's expectations for 2006 remain generally consistent with those published at the end of the first quarter and include a return to profitability in 2006 driven primarily by improved operating margins.

Aecon has historically experienced 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. This historical trend is expected to be repeated in 2006 and we continue to expect improved bottom line results as the year progresses.

During the second quarter we secured \$414 million in new contract awards compared to \$223 million in the second quarter of 2005, an increase of \$191 million or 86 per cent. This strong new business performance drove Aecon's backlog at June 30, 2006, to \$812 million – the highest it has been in almost five years.

Notably, the healthy and growing construction market in Canada and a disciplined focus in our bidding activities have allowed us to grow not only the size of our backlog, but also the margin percentages embedded in this future revenue. This theme of driving margins rather than volume continues to be at the core of management's focus as we bid and negotiate the work that will appear in our operating results in future quarters.

## **Segment Outlook**

Within the Infrastructure segment, we continue to expect another strong year from Aecon's roadbuilding operations. With the Province of Ontario placing a greater focus on infrastructure development, an increased number of new projects are being tendered for bid. This, combined with a trend toward improved margins in this sector, should result in increased profit contributions in 2006.

In the utilities sector, Aecon's strong alliance with Union Gas and Expertech among others, continues to drive expectations for improved profit contributions. While Aecon continues to expect only modest profit contributions during its first year back in the Alberta civil market, early indications suggest that Aecon's re-entry into this market holds potential in the near term, with at least three new projects expected to be underway by the end of the year.

Internationally, construction of the new airport in Quito, Ecuador and expansion of the Cross Israel Highway continue to be Aecon's primary activities in the segment.

Prior to this quarter, Aecon reported its concession operations within its Infrastructure segment. However, with the recent achievement of financial close of the Quito airport concession, ownership and operations of concessions now becomes a material portion of Aecon's overall operations. As a result, we have decided that the breakout of these operations into a new segment will improve the quality of information provided to shareholders.

While the investments reported in the Concessions segment continue to grow in value, this increasing value will not be fully reflected in earnings until certain project milestones are reached or when a portion of an investment is monetized. The small amount that is expected to be earned in 2006 from the operation of the existing Quito airport, combined with the fees earned from other concession operations in Israel and Canada, are not expected to offset the overhead and other costs incurred by this segment. However, more meaningful contributions are expected from the existing Quito airport during the remainder of the construction period. In addition, the Cross Israel Highway is performing well and traffic is ramping up as anticipated notwithstanding current events in the region.

In the Buildings segment, the recovery that began in 2005 is continuing and remains on track to report improved margin levels and increased profit contributions in 2006. Profit contributions from Buildings work in the Toronto region are expected to increase in 2006, due in part to strong results from Aecon's work at Pearson International Airport and the University of Guelph.

Profit contributions from the Toronto and Seattle business units are expected to increase in 2006, while overall profit contributions from the Buildings segment's other business units are expected to approximate those reported in 2005, with some business units recording a modest increase in profit contributions and others posting a modest decline.

The outlook for Aecon's Industrial segment continues to strengthen, led by solid improvements in the Fabrication, Western Canada and Atlantic Canada business units.

Western Canadian operations, which provided much of the segment's growth last year, are expected to produce increased profit contributions again this year due to solid margin growth and final settlement of outstanding issues related to two large contracts.

The industrial construction market in Ontario is expected to have another solid year, although profit contributions will fall likely just short of the strong 2005 results. The province's plans for increased generating capacity, as well as the Bruce Power nuclear restart project, are helping to drive Aecon's growing backlog in this sector to historically high levels. Innovative Steam Technologies (IST) continues to track a high volume of contract prospects, but delays persist from customers in finalizing the booking of new orders. Unfortunately, it appears that IST is likely to report an operating loss in 2006.

**Conclusion**

Overall, I continue to believe that the ongoing strength of Aecon's core markets and the operational improvements now in place will result in increased margins and a positive net income for Aecon in 2006.

Thank you for your continued support of Aecon.

(signed) John M. Beck  
Chairman and Chief Executive Officer  
August 9, 2006

**Aecon Group Inc.**

**Management's Discussion and Analysis  
of Operating Results and Financial Condition**

**June 30, 2006**

## **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 2005. This interim MD&A has been prepared as of August 8, 2006. 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 securities and continuous disclosure filings.

### **Introduction**

Aecon operates in four principal segments within the construction industry – Infrastructure, Buildings, Industrial and Concessions. Prior to this quarter, Aecon reported its concession operations (principally its investment in the Cross Israel highway) within its Infrastructure segment. However, with the recent achievement of financial close of a concession agreement to operate the existing and new airports in Quito, Ecuador, concession operations became a significant portion of Aecon's overall operations. As a result, it was decided that the breakout of these operations into a new segment improves the quality of the information that is provided to shareholders.

The Infrastructure segment includes all aspects of the construction of both public and private infrastructure, including roads and highways, principally within the Province of Ontario, as well as toll highways, dams, tunnels, bridges, airports, marine facilities, transit systems and hydroelectric power projects, domestically and internationally. This segment includes the mining, manufacture, and supply of asphalt and aggregate products, and the construction and/or installation of utility distribution systems for natural gas, telecommunications and electrical networks, as well as water and sewer mains, traffic signals and highway lighting, also principally within the Province of Ontario. Services provided in the Infrastructure segment include construction of large civil infrastructure projects in Canada and, on a selective basis, internationally.

The Buildings segment specializes in the construction and renovation of commercial, institutional and multi-family residential buildings, including retail complexes, office buildings, airport terminals, entertainment facilities, schools, embassies, hospitals, and high rise condominium buildings among others. Work in this segment is concentrated primarily in Canada and the northwestern United States. Services include general contracting and fee for service construction management, as well as building renovation and facilities management.

The Industrial segment encompasses all of Aecon's industrial construction and manufacturing activities including in-plant construction and module assembly in the manufacturing, energy, petrochemical, steel and automotive sectors. Activities in this sector also include the construction of alternative, fossil fuel, cogeneration power plants and in-plant construction of nuclear power plants as well as the fabrication of small and large diameter specialty pipe and the design and manufacture of once-through heat recovery steam generators for industrial and power plant applications. Although activity in this segment is concentrated primarily in Canada, with selected projects in the United

States and Europe, Aecon sells and installs once-through steam generators throughout the world through its Innovative Steam Technologies division.

Activities within the Concessions segment include the development, operation and financing of infrastructure projects by way of build-operate-transfer, build-own-operate-transfer or public-private partnership contract structures. This segment focuses primarily on the operations, management, maintenance and enhancement of investments held by the Company in infrastructure concessions - currently these comprise investments in the Cross Israel Toll Highway and Quito International Airport Project concession companies. This segment includes the operations of the Highway 104 toll plaza in Atlantic Canada. This segment also has a development function whereby it monitors and, where appropriate, brings the diverse capabilities and strengths within the Aecon group and within Aecon's strategic partners to the development of domestic and international public-private partnership concession projects in which Aecon may play a role as an investor, constructor and/or operator.

The construction industry in Canada is seasonal in nature for companies like Aecon, who do a significant portion of their work outdoors (particularly road construction and utilities work) and, as a result, less work is performed in the winter and early spring months than in the summer and fall months. Accordingly, Aecon has historically experienced 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. Therefore, results in any one quarter are not necessarily indicative of results in any other quarter or for the year as a whole.

The MD&A presents certain non-GAAP financial measures to assist readers in understanding the Company's performance. Non-GAAP financial measures are measures that either exclude or include amounts that are not excluded or included in the most directly comparable measure calculated and presented in accordance with GAAP.



## CONSOLIDATED FINANCIAL HIGHLIGHTS

\$ millions	Three Months Ended June 30		Six Months Ended June 30	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Revenues	\$ 258.7	\$ 283.0	\$ 459.3	\$ 455.9
Gross margin <sup>(1)</sup>	17.6	17	24.0	23.0
Operating profit (loss) <sup>(2)</sup>	0.9	4.5	(7.6)	(4.8)
Interest expense	1.8	2.5	4.2	4.3
Income taxes	0.1	0.3	0.2	1.1
Extraordinary gain, net of income taxes	-	-	-	3.4
Net income (loss) for the period	(1.0)	1.7	(11.9)	(6.7)
Return on revenue <sup>(3)</sup>	<u>0.3%</u>	1.6%	<u>(1.6)%</u>	(1.1)%
Backlog - June 30 <sup>(4)</sup>	<u>\$ 811.7</u>	\$ 530.0		

- (1) Gross margin is calculated as revenues less direct costs and expenses (before deducting MG&A, foreign exchange, interest, gains (losses) on sales, income taxes and extraordinary items).
- (2) Operating profit (loss) represents the profit (loss) from operations, before interest, income taxes and extraordinary items.
- (3) Return on revenue is calculated as operating profit (loss) as a percentage of revenues.
- (4) Included in backlog at June 30, 2006, is \$133 million related to the new Quito airport project. Although Aecon's 50% share of the construction revenues from this project are estimated at \$230 million, the amount reported as backlog has been reduced by \$97 million or 42.3%. This reduction is to reflect the fact that since Aecon has a 42.3% interest in the concession joint venture for which the new airport is being constructed, it cannot report backlog that effectively arises from transacting with itself.

Revenues in the second quarter of 2006 were \$258.7 million, representing a decrease of \$24.2 million over last year. Revenues increased in the Infrastructure and Concessions segments by \$4.7 million and \$1.3 million, respectively, and decreased in the Buildings and Industrial segments by \$28.0 million and \$0.9 million, respectively. For the first six months of the year, revenues of \$459.3 million were higher than 2005 by \$3.5 million, as increases in the Infrastructure, Concessions and Industrial segments offset a decline in Buildings revenues. Results for each of the four principal operating segments are discussed separately under Reporting Segments.

Gross margins (revenues less costs and expenses) as a percentage of revenues increased from 6.3% in the second quarter of 2005 to 6.8% in the current quarter, reflecting increased margins from the Industrial and Buildings segments partly offset by a decline in the Infrastructure segment. For the six months, gross margins increased from 5.1% to 5.2%. The second quarter decline in gross margin in the Infrastructure segment resulted primarily from lower claim settlements in 2006 versus 2005. On the other hand, claim settlements had a favourable impact on the second quarter 2006 results for Buildings. Marketing, general and administrative expenses ("MG&A") amounted to \$13.8 million in the second quarter of 2006, which is \$1.9 million higher than the same period last year. This increase

results from a number of items including the expansion of operations in western Canada, higher incentive accruals, higher stock option compensation expenses, and increased Bill 198 compliance costs in the Corporate group. As well, the 2005 results included bid recovery costs of \$0.5 million whereas 2006 had no such amount. For the six months, MG&A amounted to \$26.8 million, which is \$2.2 million higher than the same period last year. The \$2.2 million increase arose essentially for the same reasons cited above for the second quarter. As a result of these increases, MG&A costs as a percentage of revenues increased in the second quarter from 4.2% in 2005 to 5.3% in 2006, and for the six months from 5.4% in 2005 to 5.8% in 2006. Combined, the higher gross margins and higher MG&A contributed to lower overall returns on revenues.

Net interest expense in the current quarter of \$1.8 million is \$0.7 million lower than the same quarter last year, and interest expense of \$4.2 million for the six months is \$0.1 million lower than last year. The principal contributor to the decrease in the second quarter was the temporary repayment of the Company's revolving term loan (\$21.9 million) from the net proceeds of a \$27.7 million equity issue in March 2006. Also, lower interest costs were incurred as a result of the conversion into common shares in March 2006 of all the remaining balance of convertible debentures held by the Company's largest shareholder. The second quarter decrease was offset by \$0.6 million of year-over-year increases in interest costs in the first quarter of 2006 that arose as a result of the March 2005 issuance of \$32.5 million of convertible debentures.

In 2005 and 2004, the Company provided a valuation allowance against the net future tax assets that had been previously recorded and against future tax assets that would otherwise have been recorded in respect of its Canadian controlled operations. Consistent with this accounting treatment, future tax assets in respect of further tax losses incurred in 2006 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.

Set out below, in tabular form, is a reconciliation between the expected tax recoveries in 2006 and 2005 at statutory income tax rates and the actual reported tax expense in 2006 and 2005 (in thousands of dollars).

	<b>Six months ended June 30</b>	
	<b>2006</b>	<b>2005</b>
Loss before income taxes and extraordinary items	\$ 11,737	\$ 9,079
Statutory income tax rate	<b>36.1%</b>	36.1%
Expected income tax recovery	<b>(4,237)</b>	(3,279)
Effect on income tax of:		
Valuation allowance against current year's future tax assets	<b>3,722</b>	3,832
Provincial and foreign rate differentials	<b>86</b>	54
Non-deductible expenses	<b>268</b>	217
Large corporations tax	-	225
Foreign exchange translation losses	<b>229</b>	103
Foreign losses for which there is no tax recovery	<b>132</b>	-
Other	<b>(2)</b>	(67)
	<b>4,435</b>	4,364
Income tax expense	<b>\$ 198</b>	\$ 1,085

Income tax expense for the six months of 2006 amounted to \$0.2 million (2005 - \$1.1 million) on a pre-tax loss of \$11.7 million (2005 - pre-tax loss of \$9.1 million) before extraordinary item. Although normally the Company would have recorded an income tax recovery for the six months of \$4.2 million (2005 - \$3.3 million) on losses reported in both periods, since most of the losses came from its Canadian operations on which no tax recovery can be recorded, income tax expense and the net loss for the quarter were \$4.4 million higher (2005 - \$4.4 million) than otherwise would have been. Should Aecon report income from its Canadian operations during the remainder of 2006, any provision for tax on this income will be reduced by unrecognized tax losses. Based on the foregoing, for the second quarter ended June 30, 2006, a tax expense of \$0.1 million (2005 - \$0.3 million) was recorded on a pre-tax loss of \$0.9 million (2005 - pre-tax profit of \$1.9 million).

Included in Aecon's results for both 2006 and 2005 are certain items of income and expense that had a significant net income impact. The table below summarizes these items.

\$ millions	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30</b>		<b>June 30</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
<b><u>Income/(expense):</u></b>				
Gain on sales of assets	<b>0.1</b>	1.0	<b>0.1</b>	1.0
Foreign exchange losses	<b>(1.0)</b>	(0.6)	<b>(1.0)</b>	(0.5)
Extraordinary gain, net of taxes	-	-	-	3.4
<b>Total income impact</b>	<b>(0.9)</b>	0.4	<b>(0.9)</b>	3.9

Net loss for the quarter ended June 30, 2006 was \$1.0 million representing a \$2.7 million decline in earnings compared to the same period in 2005. As noted in the table above, included in the second quarter results for 2005 were \$0.4 million of net gains from foreign exchange and sales of assets compared to net losses of \$0.9 million in 2006. Without these impacts, the \$2.7 million decline in earnings would have been \$1.4 million. For the six months ended June 30, 2006, there was a net loss of \$11.9 million compared to a net loss of \$6.7 million in 2005, representing a \$5.2 million decline in earnings. Similar to the second quarter results, included in the net loss for the first six months of 2005 were \$0.5 million in net gains from foreign exchange and sales of assets compared to \$0.9 million of losses in 2006. Also, the results for the first six months of 2005 included an after-tax extraordinary gain of \$3.4 million. Without the impact of these gains, losses and extraordinary item, the \$5.2 million decline in earnings would have been \$0.4 million.

Backlog at June 30, 2006, was \$812 million or \$282 million higher than the same time last year. On a segment basis, there were increases in the Infrastructure and Industrial segments of \$309 million and \$100 million respectively, and a decline in the Buildings segment of \$127 million. New contract awards of \$414 million were booked in the current quarter, which compares with \$223 million in 2005, and total new contract awards of \$694 million booked in the first six months, compared to \$421 million in 2005. The increase in awards in the first six months was due to higher awards in the Infrastructure and Industrial segments, which exceeded the decline in awards in the Buildings segment. Further details for each of the segments are included in the discussion below under Reporting Segments. The margins expected to be earned from backlog is continuing to show a positive upward trend relative to prior years.

At June 30, 2006, major projects backlog was \$135 million which is \$130 million higher than last year, with the increase resulting from the addition to backlog of the revenues that are expected to flow from the construction of the Quito airport.

It is notable that significant and increasing commitments made to Aecon based on general contracts, supplier of choice and alliance 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. For example, Aecon has contractual arrangements with its two largest clients in the utilities sector that include geographic mandates for Aecon in certain parts of Ontario. Under these agreements, any work awarded by the client that is within the specified geographic area, and that meets the specifications and conditions in the contract, is awarded to Aecon as supplier of choice through the simple issuance of a purchase order. While it is possible to estimate with some confidence the minimum value of work likely to be awarded under these contracts, Aecon does not include work awarded under these contracts in backlog until the purchase orders have been issued. The effective backlog at any given time is therefore greater than what is reported to the extent that the expected volume of committed work under these general contracts and partnering agreements, for which purchase orders have not been issued, is significant. Because it is one of Aecon's strategic directives to focus on general contract, supplier of choice and partnering arrangements with clients, the amount of effective backlog that is excluded from reported backlog will continue to increase.

## REPORTING SEGMENTS

### INFRASTRUCTURE

#### Financial Highlights<sup>(1)&(3)</sup>

\$ millions	Three Months Ended June 30		Six Months Ended June 30	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
<b>Revenues</b>	\$ 108.4	\$ 103.7	\$ 164.3	\$ 159.0
<b>Segment operating profit (loss)</b>	<u>2.0</u>	<u>4.7</u>	<u>(2.5)</u>	<u>1.3</u>
<b>Return on revenue</b>	<u>1.9%</u>	<u>4.5%</u>	<u>(1.5)%</u>	<u>0.8%</u>
<b>Backlog - June 30<sup>(2)</sup></b>	<u>\$ 450.6</u>	<u>\$ 141.4</u>		

- (1) Certain prior period comparative figures have been reclassified to conform to the new segment definitions currently being used as described in the introduction section.
- (2) Included in backlog at June 30, 2006, is \$133 million related to the new Quito airport project. Although Aecon's 50% share of the construction revenues from this project are estimated at \$230 million, the amount reported as backlog has been reduced by \$97 million or 42.3%. This reduction is to reflect the fact that since Aecon has a 42.3% interest in the concession joint venture for which the new airport is being constructed, it cannot report backlog that effectively arises from transacting with itself.
- (3) Not included in the Financial Highlights table above is a first quarter 2005 extraordinary gain of \$3.4 million after income taxes 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.

Revenues from the Infrastructure segment increased from \$103.7 million in the second quarter of 2005 to \$108.4 million in the same period of 2006, as revenue gains of \$12.2 million from roadbuilding operations and \$4.6 million from utilities operations offset revenue declines of \$11.8 million from the segment's Quebec operations and \$0.2 million from other heavy civil operations. In the Infrastructure segment, the focus is on profitable growth with a strategic focus to develop civil capacity in the Alberta marketplace.

The significant increase in revenues from roadbuilding operations was driven by higher backlog levels and favourable weather conditions. The Province of Ontario, as noted in the 2006 Ontario Provincial Budget, is placing a greater focus on infrastructure development in the province, leading to more new projects being tendered for bid. The roadbuilding division has been very successful in its tendering activities in 2006, obtaining \$130 million in new contracts awards in the second quarter of this year and \$267 million in the first half of 2006. These higher backlog levels combined with favourable weather conditions have allowed for accelerated work schedules on many projects. As a result, work on projects such as the QEW Redhill, Highway 407 ETR, and Highway 401 Woodstock have accounted for approximately \$34 million of revenues in the current quarter. This higher roadbuilding construction activity also benefited the material and aggregates division and resulted in a \$6 million year-over-year increase in volumes this quarter.

Second quarter revenues from the segment's Quebec operations of \$3.1 million declined by \$11.8 million, mostly as a result of the Eastmain project reaching substantial completion in 2006 and a decision to reduce new project pursuits in the civil sector within Quebec.

For the six months ended June 30, 2006, the Infrastructure segment reported revenues of \$164.3 million compared to revenues of \$159.0 million last year. Of the \$5.3 million increase, roadbuilding, and utilities, were up \$20.5 million, and \$9.0 million, respectively, while revenues in the Quebec and other heavy civil operations were down \$23.8 million and \$0.4 million, respectively, versus last year. The year to date fluctuations in roadbuilding and Quebec operations arose principally for the reasons cited in the second quarter commentary above. The \$9.0 million increase in utilities revenues reflects mostly higher volumes of communications and gas pipeline installation work.

Infrastructure operating results for the second quarter of 2006 of \$2.0 million were \$2.6 million lower than in 2005. Increased operating profits of \$0.7 million in the utilities sector and \$0.6 million from Quebec operations, were offset by declines in operating profits in the roadbuilding and other heavy civil operations of \$2.2 million and \$1.7 million, respectively. On a quarter-over-quarter comparison, several large items affected the results between 2006 and 2005. Earnings from roadbuilding operations in 2005 included gains of \$3.5 million related to claim settlements, whereas claim settlements in 2006 were significantly lower. Without the impacts of these settlements in the second quarter of 2005, roadbuilding operating results in 2006 would have been higher than last year, mostly on account of higher volumes. The improvement in the utilities sector was favourably impacted by claim settlements of \$1.3 million in 2006 whereas 2005 included no similar items. The decline in other heavy civil operating results was impacted by a gain in 2005 of \$0.5 million related to the partial recovery of bid costs incurred in the second half of 2004, and a decline in construction profits from the India and Cross Israel Highway projects, which are now complete.

For the six months, the Infrastructure segment incurred operating losses of \$2.5 million compared to an operating profit of \$1.3 million profit in 2005. Increased operating profits in the utilities operations of \$0.3 million were offset by declines in operating profits in roadbuilding, Quebec, and other heavy civil operations of \$1.5 million, \$0.4 million, and \$2.2 million, respectively.

After excluding the net impact of claim settlements in roadbuilding operations in 2006 and 2005, as noted above, operating profits on a year-over-year basis were higher, primarily as a result of the significant increases in volume experienced this year.

For the first six months of 2006, the utilities operating results benefited from various claim settlements of \$1.3 million, as noted above. The impact of these claims along with higher current year revenues were partially offset by higher direct overhead costs of \$1.1 million, primarily incurred in the substantial ramp up of work by Aecon's utilities engineering and utilities locates businesses this past year, both of which have recently been very successful in expanding their scope and scale of operations, and by lower margins in the first quarter in certain operating units.

The decline in operating results in Quebec in the six-month period stems from a decision to reduce new civil project pursuits in the Quebec market.

Of the decline in other heavy civil operations, \$0.5 million relates to 2005 bid cost recoveries discussed above. Also, as anticipated, other heavy civil operations reported a decline in profit as construction profit from the India and Cross Israel Highway projects dropped \$1.7 million with the completion of these projects.

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 \$28.0 million (original request for payment from SJVN) for not completing the contract on time. 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 claims for liquidated damages are unwarranted and without legal merit. The joint venture also believes that even in the unlikely situation that it might be found responsible (through arbitration hearings that are currently in progress) for some part of the delay, since this delay did not result in any damages to SJVN then, as a matter of law, liquidated damages cannot be enforced. The joint venture’s conclusion regarding the impermissibility of SJVN to enforce liquidated damages is supported by two independent legal opinions. The joint venture had previously submitted for arbitration claims of approximately \$111.7 million against SJVN, the most significant of which is to cover the joint venture’s cost of delays related to these same matters. This is in addition to \$8.8 million, which was previously received by the joint venture and is included in the joint venture’s profit estimate for this project. These submissions have been subsequently revised to an amount of \$88.5 million as a result of findings during the course of the arbitration proceeding. 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 revenues from claims only when resolved, has any amount been recognized for potential recoveries under the claims.

It should be noted that all amounts quoted in the preceding paragraph are based on foreign currency amounts which have been translated to Canadian dollars at exchange rates effective on June 30, 2006.

The Company’s MD&A covering the results for the year ended December 31, 2005 (the “2005 MD&A”) included a detailed discussion on the Company’s participation in the Eastmain project in Quebec, in which Aecon has a 50% joint venture interest, and the Nathpa Jhakri project in India, in which Aecon has a 45% interest. Other than as noted above, no material developments with respect to these projects has occurred since then and management believes that its accounting for these projects, which was described in the 2005 MD&A, is still appropriate.

Backlog at the end of June 2006 was \$451 million, which represents a \$309 million increase from the same time last year. Consistent with the higher backlog, new contract awards of \$309 million and \$498 million were booked in the current quarter and first six months of 2006, respectively. This represents a current quarter award increase of \$212 million over 2005, and a six-month award increase of \$354 million. The majority of the increase in awards and backlog relates to roadbuilding operations where several major contract awards totaling \$201 million were received in the first half of 2006, and to the Quito International Airport Project which, as a result of financial close in June 2006, added \$133 million to Aecon’s backlog. As previously noted, since a portion of the construction revenues from the new Quito airport, equivalent to Aecon’s percentage investment in the Quito

airport concession, are viewed as being earned from construction work undertaken for our own use, such revenues, and the profits thereon, will not be recognized as construction revenues and profits for consolidated reporting purposes, nor will such revenues be included in reported backlog. The construction profits not recognized will be accounted for as a reduction in the cost of the new airport concession right and will be effectively recognized in income by way of lower amortization expenses over the life of the new airport concession asset.

As discussed in the Consolidated Financial Highlights section, significant commitments made to Aecon based on general contracts, supplier of choice and alliance agreements do not necessarily show up as firm backlog. 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	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>June 30</b>		<b>June 30</b>	
	<b><u>2006</u></b>	<b><u>2005</u></b>	<b><u>2006</u></b>	<b><u>2005</u></b>
<b>Revenues</b>	<b>\$ 80.2</b>	<b>\$ 108.2</b>	<b>\$ 167.5</b>	<b>\$ 185.3</b>
<b>Segment operating profit</b>	<b>1.2</b>	<b>0.4</b>	<b>0.7</b>	<b>0.6</b>
<b>Return on revenue</b>	<b>1.5%</b>	<b>0.4%</b>	<b>0.4%</b>	<b>0.3%</b>
<b>Backlog - June 30</b>	<b>\$ 177.7</b>	<b>\$ 304.8</b>		

Revenues in the Buildings segment were \$80.2 million in the current quarter, a \$28.0 million decrease over the same period in 2005. In our Buildings group, the strategic focus has been on margin enhancement rather than revenue growth, including more emphasis on design-build, construction management and ongoing programmed interiors and renovations work. Revenues of \$42.7 million from the segment's Toronto operations continue to represent the largest component of this segment's revenues. The Toronto, Ottawa and Montreal operations had the largest single reductions in revenue this quarter compared to 2005 with reductions of \$26.8 million, \$9.9 million, and \$6.2 million, respectively. The lower revenues in Toronto are primarily the result of peak production on a number of large lump sum projects in 2005 compared with lower production levels towards the close out of these same projects in 2006 and also a reduction in new work. Lower revenues in the Ottawa and Montreal operations are the result of fewer new work awards in the first six months of 2006. Partially offsetting these declines was an increase of \$11.4 million in revenues from the division's Seattle operations which arose as a result of stronger backlog to start the year and additional awards on projects that had been delayed last year.

For the six months ended June 30, 2006, the Buildings segment reported revenues of \$167.5 million compared to revenues of \$185.3 million last year. Of the \$17.9 million decline, the Toronto, Ottawa and Montreal operations were down \$25.1 million, \$10.5 million and \$6.3 million, respectively, all for reasons similar to those cited above for the second quarter reduction. Similar to the second quarter increase, revenues in the Seattle operations for the first half of 2006 are up \$17.9 million year-over-year.



Operating results for the second quarter of 2006 were \$1.2 million or \$0.8 million higher than last year. The Toronto and Seattle operations reported operating profits improvements of \$0.7 million and \$0.4 million, respectively, in the quarter. The Toronto operations benefited significantly (\$1.3 million) from the favourable resolution of outstanding change orders on a large project that carried forward from 2005. These settlements offset the impact of lower revenue volumes in the Toronto operations. The Seattle improvement is directly related to the significantly higher revenue volumes experienced in the quarter. The remaining operations all combined to produce a net \$0.3 million decline in operating profits principally related to lower volumes in the quarter and the associated reduction in margins from having less new work than planned. However, operating results are expected to improve through the balance of the year, as the impact of strategic efforts to improve the financial performance of these operations continues to take hold and a restructuring and strategic refocusing of operations in the Ontario marketplace begins to produce positive results.

For the six months ended June 30, 2006, the Buildings segment generated an operating profit of \$0.7 million, nearly unchanged from the same period in 2005. Improvements in the Toronto and Seattle operations of \$0.4 million and \$0.4 million, respectively, occurred for similar reasons as noted in the second quarter results. These profits were offset by lower operating profits earned by the other Buildings operations and by a \$1.1 million unfavourable adjustment on the write down of an investment in a joint venture that occurred this year.

Backlog of \$178 million at the end of the second quarter of 2006 is \$127 million lower than last year. New contract awards of \$57 million were booked in the first six months, which compares with \$145 million in 2005. This compares with awards of \$24 million in the current quarter and \$40 million in 2005. The largest declines in awards occurred primarily in Toronto and Montreal (\$103 million combined for the first six months) and resulted from a combination of competitive pressures in these markets, a reduced focus on lump sum contract pursuits, and a strategy to pursue more negotiated contract management and design build work rather than higher risk lump sum work.

As discussed in the Consolidated Financial Highlights section, commitments made to Aecon based on construction management advisory agreements, general contracts, supplier of choice and alliance agreements do not necessarily show up as firm backlog. The effective backlog is therefore greater than what is reported to the extent that the expected volume of committed work is significant.

## **INDUSTRIAL**

### **Financial Highlights**

\$ millions	<b>Three Months Ended June 30</b>		<b>Six Months Ended June 30</b>	
	<b><u>2006</u></b>	<b><u>2005</u></b>	<b><u>2006</u></b>	<b><u>2005</u></b>
<b>Revenues</b>	<b>\$ 67.8</b>	<b>\$ 68.7</b>	<b>\$ 120.8</b>	<b>\$ 107.7</b>
<b>Segment operating profit</b>	<b>2.1</b>	<b>2.3</b>	<b>2.5</b>	<b>-</b>
<b>Return on revenue</b>	<b>3.1%</b>	<b>3.4%</b>	<b>2.1%</b>	<b>-%</b>
<b>Backlog - June 30</b>	<b>\$ 183.4</b>	<b>\$ 83.8</b>		

Second quarter revenues in the Industrial segment of \$67.8 million were \$0.9 million lower than the same quarter in 2005. In the Industrial segment, the focus is on profitable growth with particular emphasis on Alberta and Ontario-based energy development projects.

Quarterly revenues of \$30.0 million from construction operations in Ontario were up \$8.1 million or 36.9% from the prior year, mostly as a result of increases in work performed for customers in the petrochemical and nuclear sectors offset by a decline in revenues from customers in the automotive sector. Aecon has consciously chosen to focus on only a few core automotive clients rather than pursue generally lower margin work in a highly competitive automotive market.

Current quarter revenues from the segment's western Canada operations were \$28.4 million versus \$31.6 million in 2005. The second quarter of 2005 included a significant amount of demolition and rebuild work performed on a partnering agreement basis on the Suncor site in Fort McMurray after a fire in January 2005. In 2006, our ongoing supplier of choice relationship with Suncor, and a number of other and new client relationships, combined with new project opportunities, have allowed Aecon to maintain strong volumes and earnings levels in this market. Offsetting the declines in site construction work in 2006 was an increase in the volume of module assembly and pipe fabrication work performed in western Canada for customers such as OPTI and ConocoPhillips Canada.

Fabrication revenues in Ontario and eastern Canada in the current quarter of \$8.9 million were \$0.6 million higher than 2005 primarily from volume growth in eastern Canada.

Revenues of \$1.8 million from Innovative Steam Technologies ("IST"), which sells and licenses the technology for once through steam generators ("OTSG"), were down \$5.2 million from the prior year. This decline is due to fewer contract bookings and thus lower production levels in the quarter.

For the six months ended June 30, 2006, the Industrial segment reported revenues of \$120.8 million compared to revenues of \$107.7 million last year. Of the \$13.0 million increase, western Canada and Ontario Construction operations produced the greatest improvements with increases of \$13.5 million and \$10.5 million, respectively. Spurred on by increases in crude oil prices and strong demand for oil, western Canada revenues increased from \$39.8 million in 2005 to \$53.4 million as operations continue to benefit from the development of several oilsands and gas projects in the Fort McMurray and Long Lake regions of Alberta. In the Ontario Construction operations, volumes increased \$10.5 million year-over-year, mostly because of revenue increases from customers in the petrochemical and power/nuclear sectors. IST revenues decreased by \$9.8 million during the first half of 2006 reflecting delays from customers in booking new orders. IST continues to track a high volume of contract prospects and is in possession of two letters of intent and a contract awaiting notice to proceed, valued in excess of \$40 million. However, until formal contracts and notices to proceed are received, there is no assurance that these prospects will actually materialize as revenue in the future.

Quarterly operating results of \$2.1 million from the Industrial segment were \$0.3 million lower than in 2005.

Consistent with the increase in revenues noted above, operating profits from the Ontario Construction operations were \$1.7 million or \$1.2 million higher than last year.

Quarterly operating profits from western Canada of \$2.2 million were \$0.6 million higher than last year. Despite the noted drop in volumes, the change in revenue mix, in particular the increased proportion of higher margin fabrication and module projects performed relative to the lower margin site work it replaced, increased margins in the current quarter by \$1.2 million. These margin gains were partially offset by higher overhead costs incurred in the current quarter to support the expansion of the western operations. With the infrastructure now in place, overhead costs are expected to stabilize going forward.

Fabrication operations in Ontario and eastern Canada generated an operating profit of \$0.5 million in the second quarter of 2006, representing a \$1.0 million improvement over the loss of \$0.5 million recorded in 2005. The majority (\$0.9 million) of the improvement was produced by the Ontario Fabrication operations, which is now benefiting from the steps taken to improve profitability following a detailed strategic analysis of these operations. A smaller fabrication shop in Oakville, Ontario was closed in 2006 and the focus of the Ontario group has been on its main facility in Cambridge, with particular emphasis on operational excellence, markets and improving commercial terms with customers.

IST operating losses in the second quarter of 2006 were \$2.3 million, which is \$3.0 million worse than the same quarter last year. The decline in results was primarily volume related.

For the six months, the Industrial segment generated an operating profit of \$2.5 million compared to break even results last year. Of the \$2.5 million improvement, western Canada, Ontario Construction, and Fabrication operations were up \$4.1 million, \$0.8 million and \$0.9 million, respectively. Only IST, with a loss of \$3.5 million, compared to a loss of \$0.3 million in 2005, was down from last year. In western Canada, higher margins were the result of higher volumes, impacts from the successful renegotiation of the commercial terms of two large projects that commenced in 2005, and a more profitable mix of work, as noted above. These margin gains were partially offset by higher overhead costs incurred to accommodate the growth in operations in western Canada. The improvement in Ontario Construction operating results reflects the higher volumes in 2006 and lower bid costs. Similarly, Ontario and eastern Canada Fabrication results improved as a result of higher volumes and reduced overhead costs. For IST, the lower operating results are a direct result of the decline in revenues and reduced gross margins experienced in 2006 and discussed above.

Backlog at June 30, 2006 of \$183 million is \$100 million higher than last year. Ontario Construction backlog is up \$92 million, principally as a result of a \$204.0 million award in late 2005 to a joint venture (in which Aecon has a 50% interest) for a nuclear project in Ontario. In the western Canada operations, backlog of \$32 million at June 30, 2006 is up \$3 million from last year, fabrication backlog of \$11 million is up \$5 million, and IST backlog of \$8 million is down \$1 million. New contract awards of \$78 million in the current quarter are \$4 million lower than in 2005, and new awards of \$133 million for the six months of 2006 are \$9 million higher than 2005. The Ontario Construction and Fabrication operations have benefited from increased activity in the nuclear and gas markets in Ontario. In addition, awards in the Ontario and Alberta operations from core customers have remained strong. At the end of June 2006, IST had a total of two contracts in backlog for two OTSG boiler units and the installation of three GTI units. This results in backlog revenue of \$8 million which is expected to be worked off in 2006.

As discussed in the Consolidated Financial Highlights section, significant commitments made to Aecon based on general contracts, supplier of choice and alliance agreements do not necessarily show up as firm backlog. In western Canada operations in particular, the pipe Fabrication shop, module yard and the field construction activities in the first six months of 2006 operated at historical highs. The effective backlog is therefore greater than what is reported to the extent that the expected volume of committed work is significant.

## CONCESSIONS

### Financial Highlights<sup>(1)</sup>

\$ millions	Three Months Ended June 30		Six Months Ended June 30	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
<b>Revenues</b>	\$ 5.0	\$ 3.7	\$ 10.6	\$ 6.0
<b>Segment operating profit(loss)</b>	<b>(1.2)</b>	0.1	<b>(1.9)</b>	(1.2)
<b>Return on revenue</b>	<b>(24.2)%</b>	1.9%	<b>(18.0)%</b>	(19.4)%
<b>Backlog - June 30</b>	\$ -	\$ -		

(1) Certain prior period comparative figures have been reclassified to conform to the new segment presentation that was adopted in the second quarter of 2006 (see Introduction section of MD&A).

Revenues in the Concessions segment were \$5.0 million in the current quarter, a \$1.3 million increase over the same period in 2005. For the six months, revenues were \$10.6 million, a \$4.6 million increase over the same period in 2005. The table above includes principally the results from operating the Cross Israel Highway and Highway 104 toll plaza in Atlantic Canada. Commencing in the third quarter, the results of the Quito Airport concessionaire will also be reported. Although, for accounting purposes, the operation of the Quito concession commenced on June 28, 2006, the results for the period from June 28 to June 30, 2006, being insignificant, are not included in the table above. Aecon's long-term investment in Derech Eretz Highways (1997) Ltd. ("Derech Eretz"), the company owning the concessionaire rights to the Cross Israel Highway, is carried at cost, and as a result, income is only recognized to the extent of dividends received. As such, Aecon has not reported any revenues and profits from this investment in the above periods.

Concessions revenues consist of the following (in \$millions):

	Three Months Ended June 30		Six Months Ended June 30	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Cross Israel Highway operator	\$ 4.7	\$ 3.6	\$ 9.9	\$ 5.8
Others	<b>0.3</b>	0.1	<b>0.7</b>	0.2
	<u>\$ 5.0</u>	<u>\$ 3.7</u>	<u>\$ 10.6</u>	<u>\$ 6.0</u>

The increase in revenues from Concessions, both in the quarter and for the six months, reflects primarily the higher revenues earned by the entity that manages the operations of the Cross Israel Highway.

The operating loss for the second quarter of 2006 was \$1.2 million or \$1.3 million higher than last year, while for the six months the loss was \$1.9 million compared to \$1.2 million in 2005. The decline in second quarter 2006 Concessions operating results relates partially to a gain in 2005 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 one time costs of \$0.5 million incurred in 2006 on the Quito Airport project, combined with the anticipated low margin results from the entity that manages the operations of the Cross Israel Highway.

The Cross Israel Highway concession is expected to produce significant income only when dividends are paid or when a portion of this investment is monetized. As noted above, earnings from the operator of the Cross Israel Highway are expected to be nominal.

Aecon does not include in its reported backlog potential revenues from operations management contracts and concession agreements. The effective backlog is therefore greater than what is reported to the extent that the expected volume of committed work is significant.

For details on Aecon's investment in the Quito Airport Project, refer to note 2 of the June 30, 2006 consolidated financial statements.

### **CORPORATE AND OTHER**

Net Corporate expenses for the current quarter are \$3.2 million compared to \$3.0 million in 2005. The increase results primarily from higher compensation expense related to incentive plan accruals, stock option compensation costs, and higher compliance costs related to Bill 198 initiatives.

Net Corporate expenses for the six months are \$6.4 million compared to \$5.5 million in 2005. The increase results primarily from those items discussed above for the quarter including compensation expense of \$0.6 million related to the issuance of stock options in the first quarter.

## Quarterly Financial Data

The reader is referred to the Company's 2005 Management Discussion and Analysis for an analysis of the results of the eight quarters that ended December 31, 2005.

Set out below are revenues, net income (loss), and earnings per share for each of the most recent eight quarters (in millions of dollars, except per share amounts).

	2006		2005				2004	
	Quarter 1	Quarter 2	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Quarter 3	Quarter 4
Revenues	\$ 200.6	258.7	\$ 172.9	\$ 283.0	\$ 340.8	\$ 323.5	\$ 290.0	\$ 258.7
Net income (loss)	(10.9)	(1.0)	(8.4)	1.7	2.1	3.5	(0.9)	(40.7)
Earnings (loss) per share:								
Basic	(0.36)	(0.03)	(0.29)	0.06	0.07	0.12	(0.03)	(1.42)
Diluted	(0.36)	(0.03)	(0.29)	0.05	0.07	0.11	(0.03)	(1.42)

## **FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES**

Aecon holds a 42.3% economic interest in Corporacion Quiport S.A. ("Quiport JV"), an Ecuadorian company, whose main operations consist of (a) managing and operating the existing Quito Airport, and (b) the development, construction, operations and maintenance of the new Quito International Airport under a concession arrangement. Aecon's investment in the Quiport JV is accounted for by the proportionate consolidated method, whereby the consolidated financial statements reflect, line by line, Aecon's pro-rata share of each of the assets, liabilities, revenues, expenses and cash flows of Quiport JV. Given the significant effect of Quiport JV on Aecon's consolidated financial statements and in order to provide additional information about the Quiport JV operations and assets, which act as security for project debt, Aecon provides consolidating balance sheet and cash flow worksheets in note 11 to the June 30, 2006 consolidated financial statements as additional information about its accounts, thereby enabling the reader to have a greater understanding of Aecon's underlying assets, earnings base and financial resources.

### **Cash and Debt Balances**

Cash and cash equivalents at June 30, 2006 are \$49.3 million, which compares with \$27.0 million at the end of last year. Of these amounts, \$41.9 million and \$10.2 million, respectively, were on deposit in joint venture bank accounts, which Aecon cannot access directly. Of the joint venture balances, \$35.7 million represents Aecon's share of cash held by Quiport JV.

Restricted cash of \$8.3 million at June 30, 2006 (December 31, 2005 - \$7.5 million) represents cash that was deposited as collateral for borrowings and letters of credit issued by Aecon. As such, this cash was not available for general operating purposes.

Restricted marketable securities and term deposits of \$14.7 million (December 31, 2005 - \$15.3 million) were all held within joint ventures and, similar to cash held by joint ventures, these securities cannot be accessed directly by Aecon.

At June 30, 2006, long-term debt and convertible debentures, including the current portion, totaled \$131.4 million compared to \$108.7 million at the end of 2005. The \$22.7 million net increase results mainly from the proportionate consolidation of Aecon's share of the borrowings of \$39.3 million to finance the Quito Airport Project (which are non-recourse to Aecon), less debt repayments on the Company's revolving debt facility of \$11.8 million, and the conversion of \$7.7 million of convertible debentures by the Company's largest shareholder into common shares.

Bank indebtedness of \$8.8 million at the end of June 2006 includes \$7.9 million for Aecon's 45% share of funds borrowed within the Nathpa Jhakri hydroelectric project joint venture in India.

Interest bearing debt amounted to \$140.2 million at June 30 2006, compared to \$119.6 million at December 31, 2005, the composition of which is as follows (\$ millions):

	<u>June 30, 2006</u>		<u>Dec. 31, 2005</u>
Bank indebtedness	\$ 8.8	\$	8.3
Loan from a related party	-		2.5
Current portion of long-term debt	4.8		6.2
Convertible debentures – current	-		7.7
Long-term debt – recourse	27.7		35.7
Long-term debt - non-recourse	39.3		-
Convertible debentures	59.6		59.2
Total	<u>\$ 140.2</u>	\$	<u>119.6</u>

Aecon has a reducing revolving term loan to fund working capital and operating requirements (with a current limit of \$21.9 million). This facility, which is reported as long-term debt, had \$10.0 million outstanding at June 30, 2006, and, as such, \$11.9 million of the facility was available for drawdown to supplement Aecon's liquidity and working capital position. Aecon also had \$59.6 million outstanding in convertible debentures, details of which are described in note 5 to the June 30, 2006 consolidated financial statements. In March 2006, \$7.7 million of convertible debentures were converted into common shares.

As a result of an equity issue in March 2006, Aecon's liquidity position strengthened considerably and is expected to be sufficient to finance its operations and working capital requirements for the foreseeable future. Nonetheless, the Company continues to pursue various financing alternatives to augment its credit and liquidity base. In this regard, on July 31, 2006, the Company signed a new credit agreement with the TD Bank, which provides the Company with a \$20 million operating line, including a dedicated \$5 million letter of credit facility. Previously, Aecon had a \$7.5 million operating line with the TD bank. 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 2006.

Future equity investments of US\$20.4 million by Aecon in the Quito Airport Project are expected to be funded by cash profits from operating the existing Quito airport and the construction of the new airport.

## Summary of cash flows

(in \$millions)	Three Months Ended June 30		Six Months Ended June 30	
	2006	2005	2006	2005
<b>Cash provided by (used in):</b>				
Operating activities	\$ (27.0)	\$ (34.5)	\$ (25.3)	\$ (45.2)
Investing activities	(6.7)	(13.8)	(9.3)	(16.8)
Financing activities	54.6	25.7	57.2	31.9
Increase (decrease) in cash and cash equivalents	20.9	(22.6)	22.6	(30.1)
Effects of foreign exchange on cash balances	(0.3)	0.1	(0.3)	0.2
Cash and cash equivalents - beginning of period	28.7	42.7	27.0	50.1
Cash and cash equivalents - end of period	\$ 49.3	\$ 20.2	\$ 49.3	\$ 20.2

## Operating Activities

Cash used in operating activities of \$27.0 million in the second quarter of 2006 was \$7.5 million lower than in the same period last year. Cash used in operating activities of \$25.3 million in the first six months of 2006 was \$19.9 million lower than in the same period last year. Most of the improvement in both periods arose from a much lower investment in working capital. The Buildings segment, which experienced a significant decline in the volume of work performed in the first half of 2006, contributed to most of the decline in working capital. This decline was only partially offset by the higher requirements for working capital in the civil construction and industrial businesses, as the growth of these businesses continued in 2006. The Quito Airport project had very little impact on cash flows from operating activities this year.

## Investing Activities

For the quarter, investing activities resulted in a use of cash of \$6.7 million, which compares with cash used of \$13.8 million in 2005. An increase in other assets of \$4.5 million (mostly on account of additional start-up costs related to the Quito project) represented the largest use of cash. The major use of cash in 2005 was a \$10.8 million increase in cash that was deposited as collateral for borrowings and letters of credit issued by Aecon. This cash is classified as “restricted cash” on Aecon’s consolidated balance sheet.

For the six months ended June 30, 2006, investing activities resulted in a use of cash of \$9.3 million, which compares with cash used of \$16.8 million in 2005. Similar to the first quarter, the largest use of cash during the first six months of 2006 was associated with an increase in other assets of \$6.9 million primarily related to additional start-up costs on the Quito airport project. The major use of cash during the first six months of 2005 was a \$4.3 million increase in Aecon’s investment in Derech



Eretz Highways (1997) Ltd, (“Derech Eretz”) from 22% to 25%, and a \$10.8 million increase in “restricted cash” that was deposited as collateral for borrowings and letters of credit issued by Aecon.

Investing activities in the three months ended June 30, 2006, not requiring an immediate use of cash, included the acquisition of the concession rights (valued at \$80 million) to operate the existing and new Quito airports. In addition to the non-cash investment in the Quito airport, non-cash investments for the six months ended June 30, 2006, included a \$1.5 million increase in Aecon’s investment in Derech Eretz, the concessionaire of the Cross Israel Highway. The increased investment was financed by a loan from the other shareholders in Derech Eretz at an interest rate of 6% per annum.

## **Financing Activities**

In the quarter ended June 30, 2006, cash generated from financing activities amounted to \$54.6 million, compared to \$25.7 million in 2005. The largest component (\$39.3 million) of the increase over 2005 relates to Aecon’s proportionately consolidated share of the financing for the new Quito International Airport Project. In addition, \$10.0 million was borrowed on the Company’s revolving term facility to fund current operations. Also, the operations of the existing airport, prior to financial close, generated \$4.7 million of net operating proceeds that will be used to fund construction of the new Quito airport. This \$4.7 million, which has been treated as an ‘inducement’ for accounting purposes, is included within concession related deferred revenue in the Company’s balance sheet as at June 30, 2006, and will be amortized to earnings over the term of the new airport concession.

For the six months ended June 30, 2006, cash generated from financing activities amounted to \$57.2 million, compared to \$31.9 million in 2005. During the six months, Aecon issued 4,680,000 common shares for net proceeds of \$27.7 million plus an additional \$1 million of common shares were issued upon the exercise of stock options this year. Also issuances of long-term debt amounted to \$49.3 million while repayments totalled \$23.8 million, for a net change of \$25.5 million. Included in these borrowings was the financing for the new Quito International Airport Project (\$39.3 million) partly offset by a net repayment of \$11.9 million of long term debt outstanding on the Company’s revolving term facility. Gross long-term debt issuances and repayments were affected by a series of drawdowns and repayments under the Company’s revolving term facility. In the first six months of 2005, a \$32.5 million convertible debenture financing was completed, which yielded net proceeds of \$31.0 million.

Financing activities not resulting in an inflow of cash in the current quarter included the increase in deferred revenue of \$64 million resulting from acquisition of the concession rights to the Quito International Airport.

Aecon’s surety capacity remains sufficient to meet its needs. However, surety capacity and pricing continues to be a constraining issue broadly within the industry and Aecon is not immune to these impacts. The above-noted initiatives to further improve Aecon’s liquidity position had a positive impact on Aecon’s surety capacity. As at June 30, 2006, Aecon has significant unused capacity. In addition, Aecon is one of only a very few number of contractors in Canada that has been able to secure the ability to issue Sub-Guard insurance, which can be used as an alternative to surety for some projects, thus reducing Aecon’s overall reliance on bonding/surety.

## **NEW ACCOUNTING STANDARDS**

There were no new Canadian accounting standards adopted in 2006 in the consolidated financial statements.

## **SUPPLEMENTAL DISCLOSURES**

### **Responsibility of Management**

The Company's management maintains appropriate information systems, procedures and controls to ensure that information used internally and disclosed externally is complete, reliable and timely. The Chief Executive Officer and the Chief Financial Officer of the Company have evaluated, or caused the evaluation of, under their direct supervision, the effectiveness of the Company's disclosure controls and procedures (as defined in Multilateral Instrument 52-109, Certification of Disclosure in Issuers' Annual and Interim Filings) for the period ended June 30, 2006, and have concluded that such disclosure controls and procedures are operating effectively.

### **Contractual Obligations**

At December 31, 2005, the Company had commitments totalling \$172.8 million for equipment and premises under operating leases requiring minimum payments and principal repayment obligations under long-term debt (including the convertible debentures described in note 11 to the 2005 annual consolidated financial statements). The only material changes since then have been the Quito International Airport Project borrowings of approximately \$39 million, repayments of approximately \$12 million of debt under a revolving term credit facility, and the conversion of certain convertible debentures into equity, details of which are included in note 5 to the second quarter 2006 Interim Consolidated Financial Statements.

At June 30, 2006, Aecon had contractual obligations to complete construction contracts that were in progress. The revenue value of these contracts was \$909 million. This consists of the reported backlog of \$812 million plus an additional \$97 million representing Aecon's share of the Quito project revenues not included in reported backlog revenues.

### **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. In addition to any off-balance sheet exposures which may exist relating to Aecon's joint venture operations in India and Israel (including Derech Eretz), Aecon has a net balance sheet investment (Aecon's share of total assets less total liabilities of these joint ventures) of approximately \$13 million and \$50 million, respectively. These international joint ventures may be subject to Risks and Uncertainties such as International/Foreign Jurisdiction Factors as noted in the 2005 Annual MD&A. With respect to Aecon's operations in Quito, refer to notes 2 and 11 of the June 30, 2006 consolidated financial statements for details of various financial and performance guarantees, letters of credit provided, and investment balances.

There was no material change in the funded status of Aecon's pension plans during the first six months of 2006. Details relating to Aecon's defined benefit plans are set out in note 19 to the Company's 2005 consolidated financial statements.

From time to time Aecon 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, 2006, the Company had net outstanding contracts to sell US\$5.9 million (December 31, 2005 - sell US\$3.6 million) on which there was a net unrealized exchange gain of nil (2005 - net gain of \$0.2 million). The net unrealized exchange gain (loss) represents the estimated amount the Company would have received if it terminated the contracts at the end of the respective periods. Financial instruments are discussed in note 21 to the 2005 consolidated financial statements.

In accordance with the terms of prior acquisitions agreements, the Company is liable to make earn out incentive payments totalling an additional \$0.5 million if certain financial performance targets are achieved.

### **Related Party Transactions**

From time to time Aecon receives financial support from Hochtief AG and its subsidiary companies ("Hochtief"), Aecon's largest shareholder. In March 2006, the previously outstanding \$7.7 million of a convertible subordinated debenture was converted to equity as described in note 5 to the consolidated financial statements, and a \$2.5 million short-term unsecured loan was repaid on January 13, 2006 as described in note 13(c) to the consolidated financial statements. Hochtief AG has issued guarantees totalling \$24.8 million 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 and Hochtief are also joint venture partners in a hydroelectric project in Quebec. Note 13 to the consolidated financial statements details various other related party transactions and balances.

### **Critical Accounting Estimates**

The reader is referred to the detailed discussion on Critical Accounting estimates as outlined in the notes to the Company's 2005 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, 2006</u>	<u>August 8, 2006</u>
Number of common shares outstanding	38,283,175	38,283,175
Paid-up capital of common shares outstanding (1)	\$ 133,247	\$ 133,247
Outstanding securities exchangeable or convertible into common shares:		
Number of stock options outstanding	1,350,000	1,350,000
Number of common shares issuable on exercise of stock options	1,350,000	1,350,000
Increase in paid-up capital on exercise of stock options	\$ 8,216	\$ 8,216
Principal amount of convertible debentures outstanding (see note 5 to the Company's consolidated financial statements)	\$ 59,574	\$ 59,574
Number of common shares issuable on conversion of convertible debentures	8,276,316	8,276,316
Increase in paid-up capital on conversion of convertible debentures	\$ 59,574	\$ 59,574

(1) As described in note 7 to the Company's consolidated financial statements, in accordance with the recommendations of The Canadian Institute of Chartered Accountants, share capital has been reduced by \$1.1 million on account of share purchase loans receivable from employees.

## OUTLOOK

Aecon's expectations for 2006 remain generally consistent with those published at the end of the first quarter and include a return to profitability in 2006 driven primarily by improved operating margins.

Within the Infrastructure segment, Aecon continues to expect another strong year from its Ontario roadbuilding operations. Backlog, which has been bolstered by a number of key contract awards this year, is strong and, combined with a trend toward improved margins in this sector, is expected to result in increased profit contributions in 2006.

In the utilities sector, Aecon's strong alliances with Union Gas and Expertech continue to drive expectations for improved profit contributions this year. Also, Aecon's success earlier this year in winning new tunnelling contracts in the Greater Toronto Area is expected to result in profit contributions from the heavy civil construction sector similar to those generated in 2005.

While Aecon continues to expect only modest profit contributions during its first year in the Alberta civil market, early indications suggest that Aecon's re-entry into this market holds strong potential in the near term – with at least three new projects expected to be underway before the end of the year.

In Quebec, the wrap-up of the Eastmain hydroelectric project and the decision to scale-back bidding activity on civil construction work in the province are expected to result in modest profit contributions resulting primarily from the settlement of claims generated in previous years. The primary focus of Aecon's Quebec civil team in the second half of the year will be on resolution of the outstanding client issues on the Eastmain project, where management continues to believe that the Aecon/Hochtief joint venture will be successful in recovering the value of unpriced change orders associated with the project.

Internationally, construction of the new airport in Quito, Ecuador (which achieved financial close in the second quarter) and expansion of the Cross Israel Highway continue to be Aecon's primary focus. While construction will begin on the Quito project this year, no construction profit will be recognized in 2006 as Aecon's accounting policy for large multi-year contracts provides for construction profit to be recognized only when progress reaches a stage of completion sufficient to reasonably determine the probable results (generally when the contract is 20% complete).

In the Buildings segment, the recovery that began in 2005 is continuing, and Aecon remains on track to report improved margin levels and increased profit contributions in 2006 despite an expected decline in revenue this year.

Profit contributions from Buildings work in the Greater Toronto Area (the largest region in the segment) are expected to increase in 2006 due in part to strong results from Aecon's work at Pearson International Airport and the University of Guelph, as well as the settlement of outstanding project claims.

As reported in the first quarter, overall profit contributions from the Buildings segment's other business units are expected to approximate those reported in 2005, with some business units recording a modest increase in profit contributions and others posting a modest decline.

The outlook for Aecon's Industrial segment continues to strengthen, led by expectations of solid improvement in the segment's Fabrication, Western Canada and Atlantic Canada business units.

Another strong year is expected from the segment's Western Canadian operations, which are expected to provide increased profit contributions again this year as solid margin growth and the renegotiation of two large contracts are expected to more than offset a temporary decline in volumes. The year-over-year volume decline, due primarily to the significant amount of work conducted last year on a fire re-build project, is now expected to be much smaller than originally anticipated, and the longer term trend of increasing volumes in this sector is expected to continue.

In addition, the segment's fabrication operations in both Ontario and Atlantic Canada appear to have turned the corner, and are expected to provide profit contributions in 2006 after posting losses in 2005.

Aecon's industrial construction operations in Ontario are expected to have another solid year, although it is still expected that profit contributions will fall just short of the strong results recorded in 2005. The industrial construction market in Ontario remains strong, with the province's plans for

increased generating capacity and the Bruce Power nuclear restart project helping to drive Aecon's growing backlog in this sector to historical high levels.

IST continues to operate in a challenging sales environment characterized by a strong pipeline of sales prospects – all of which have been developing at a pace significantly slower than anticipated. This delay in closing new sales is expected to produce a significant drop in revenues this year and a net loss for IST in 2006.

While the investments reported in Aecon's Concessions segment continue to grow in value, this increasing value will not be fully reflected in earnings until certain project milestones are reached. For example, earnings from Aecon's investment in the Cross Israel Highway concession will be reflected in financial statements only when project dividend payments begin, which is not likely to be for some time, or when a portion of the investment is monetized. In the case of Aecon's investment in the Quito International Airport concession, earnings from the operation of the new airport will not be reflected in Aecon's financial statements until the airport goes into operation in 2010.

The small amount that is expected to be earned in 2006 from the operation of the existing Quito airport, combined with the fees earned from other concession operations in Israel and Canada, are not expected to offset the overhead and other costs incurred by this segment. However, improved results are expected from the existing Quito airport during the remainder of the construction period.

Traffic volumes on the Cross Israel Highway continue to ramp-up in line with expectations. It is likely, however, that construction of the highway's northern extension will not commence until 2007.

Aecon's backlog of \$804 million at June 30, 2006 was \$274 million higher than at the same time last year and \$227 million higher than at year end, with strong year-over-year increases in the Infrastructure and Industrial segments offsetting a decline in the Buildings segment. Included in backlog is \$133 million related to the new Quito airport project. Although Aecon's 50% share of the construction revenues from this project are estimated at \$230 million, the amount reported as backlog has been reduced to reflect the fact that, since Aecon has an interest in the concession joint venture for which the new airport is being constructed, it cannot report backlog that effectively arises from transacting with itself.

Not included in backlog, but important to Aecon's prospects, are the expected revenues from Aecon's growing alliance and supplier-of-choice arrangements, largely in the industrial and utilities sectors. As outlined earlier in this MD&A, Aecon's effective backlog is therefore greater than what is reported here.

Overall, management continues to believe that the ongoing strength of Aecon's core markets and the operational improvements now in place, will result in increased margins and a positive net income for Aecon in 2006.

## **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. Many factors could cause Aecon's actual results, performance or achievements to vary from those expressed or inferred herein, including without limitation, the ability of the Eastmain Joint Venture to recover the full value of unpriced change orders, the uncertain intentions of Hochtief, failure to achieve the targets associated with the Quito Airport, the achievement of lower than expected volumes of work in western Canada and the failure of IST to secure anticipated contract levels. Risk factors are discussed in greater detail in the section on "Risk Factors" in the Annual Information Form filed on March 31, 2006 and available at [www.sedar.com](http://www.sedar.com). 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, 2006 and 2005



### **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, Chairman and Chief Executive Officer

(signed) Scott C. Balfour, President and Chief Financial Officer

# Aecon Group Inc.

## Consolidated Balance Sheets

(in thousands of dollars) (unaudited)

	<u>June 30, 2006</u>	<u>December 31, 2005</u>
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 49,342	\$ 27,002
Restricted cash	8,327	7,500
Restricted marketable securities and term deposits	14,703	15,318
Accounts receivable	140,109	135,005
Holdbacks receivable	61,914	66,583
Deferred contract costs and unbilled revenue	83,019	82,058
Inventories	9,218	7,186
Prepaid expenses	7,524	1,763
	<u>374,156</u>	<u>342,415</u>
<b>Property, plant and equipment</b>	<b>53,886</b>	<b>56,116</b>
<b>Future income tax assets</b>	<b>20,100</b>	<b>20,100</b>
<b>Concession rights</b> (notes 2 and 8)	<b>80,145</b>	<b>-</b>
<b>Long-term investment</b> (note 3)	<b>42,733</b>	<b>41,273</b>
<b>Other assets</b>	<b>37,824</b>	<b>44,518</b>
	<u>\$ 608,844</u>	<u>\$ 504,422</u>

# Aecon Group Inc.

## Consolidated Balance Sheets ...continued

(in thousands of dollars) (unaudited)

	<u>June 30, 2006</u>	<u>December 31, 2005</u>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Bank indebtedness	\$ 8,787	\$ 8,312
Accounts payable and accrued liabilities	153,295	166,594
Holdbacks payable	34,715	38,021
Deferred revenue	37,464	29,274
Income taxes payable	678	1,779
Future income tax liabilities	25,510	26,275
Current portion of long-term debt	4,846	6,228
Loan from a related party (note 13 (c and d))	-	2,500
Convertible debentures (note 5)	-	7,676
	<u>265,295</u>	<u>286,659</u>
<b>Long-term debt</b> (note 2(e))	<b>67,032</b>	<b>35,671</b>
<b>Other liabilities</b>	<b>2,922</b>	<b>2,971</b>
<b>Other income tax liabilities</b>	<b>13,814</b>	<b>13,634</b>
<b>Concession related deferred revenue</b> (notes 2 (b) and 8)	<b>68,735</b>	<b>-</b>
<b>Convertible debentures</b> (notes 5 and 7)	<b>59,574</b>	<b>59,159</b>
	<u>477,372</u>	<u>398,094</u>
<b>Commitments and contingencies</b> (note 14)		
<b>Shareholders' Equity</b>		
<b>Capital stock</b> (note 7)	<b>133,247</b>	<b>95,985</b>
<b>Contributed surplus</b> (note 5)	<b>996</b>	<b>361</b>
<b>Convertible debentures</b> (notes 5 and 7)	<b>4,146</b>	<b>4,982</b>
<b>(Deficit) retained earnings</b>	<b>(6,917)</b>	<b>5,000</b>
	<u>131,472</u>	<u>106,328</u>
	<u>\$ 608,844</u>	<u>\$ 504,422</u>

Approved by the Board of Directors

(signed) John M. Beck, Director

(signed) Scott C. Balfour, Director

# Aecon Group Inc.

## Consolidated Statements of Operations

For the Three Months ended June 30, 2006 and 2005

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

	<u>2006</u>	<u>2005</u>
<b>Revenues</b>	\$ 258,739	\$ 282,978
<b>Costs and expenses</b>	<u>241,149</u>	<u>265,050</u>
	17,590	17,928
<b>Marketing, general and administrative expenses</b>	13,802	11,857
<b>Foreign exchange losses</b>	1,037	625
<b>Gain on sale of assets</b>	(80)	(989)
<b>Depreciation and amortization</b>	1,956	1,968
<b>Interest expense, net</b>	<u>1,805</u>	<u>2,542</u>
	18,520	16,003
<b>(Loss) income before income taxes</b>	<u>(930)</u>	<u>1,925</u>
<b>Income taxes</b> (note 4)		
Current	<u>58</u>	<u>255</u>
<b>Net (loss) income for the period</b>	<u>\$ (988)</u>	<u>\$ 1,670</u>
<b>Net (loss) earnings per share</b> (note 7)		
Basic	\$ (0.03)	\$ 0.06
Diluted	\$ (0.03)	\$ 0.05
<b>Average number of shares outstanding</b> (note 7)		
Basic	36,664,586	29,279,582
Diluted	38,073,526	32,992,960

# Aecon Group Inc.

## Consolidated Statements of Operations

For the Six Months ended June 30, 2006 and 2005

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

	<u>2006</u>	<u>2005</u>
<b>Revenues</b>	\$ 459,314	\$ 455,850
<b>Costs and expenses</b>	<u>435,347</u>	<u>432,820</u>
	23,967	23,030
<b>Marketing, general and administrative expenses</b>	26,811	24,571
<b>Foreign exchange losses</b>	994	538
<b>Gain on sale of assets</b>	(77)	(1,012)
<b>Depreciation and amortization</b>	3,796	3,734
<b>Interest expense, net</b>	<u>4,180</u>	<u>4,278</u>
	35,704	32,109
<b>Loss before income taxes and extraordinary item</b>	<u>(11,737)</u>	<u>(9,079)</u>
<b>Income taxes</b> (note 4)		
Current	<u>198</u>	<u>1,085</u>
Loss before extraordinary item	(11,935)	(10,164)
Extraordinary gain, net of income taxes (note 12)	-	3,444
<b>Net loss for the period</b>	<u>\$ (11,935)</u>	<u>\$ (6,720)</u>
<b>Loss per share before extraordinary item</b> (note 7)		
Basic	\$ (0.35)	\$ (0.35)
Diluted	\$ (0.35)	\$ (0.35)
<b>Net loss per share</b> (note 7)		
Basic	\$ (0.35)	\$ (0.23)
Diluted	\$ (0.35)	\$ (0.23)
<b>Average number of shares outstanding</b> (note 7)		
Basic	33,755,034	29,292,929
Diluted	36,072,150	33,031,797

# **Aecon Group Inc.**

## **Consolidated Statements of Deficit**

**For the Three Months ended June 30, 2006 and 2005**

---

(in thousands of dollars) (unaudited)

	<u>2006</u>		<u>2005</u>
<b>Deficit - beginning of period</b>	\$ (5,939)	\$	(2,272)
<b>Add (deduct):</b>			
<b>Net (loss) income for the period</b>	(988)		1,670
<b>Interest received on share purchase loans (note 7)</b>	10		6
<b>Deficit - end of period</b>	<u>\$ (6,917)</u>	<u>\$</u>	<u>(596)</u>

# **Aecon Group Inc.**

## **Consolidated Statements of Retained Earnings (Deficit)**

**For the Six Months ended June 30, 2006 and 2005**

---

(in thousands of dollars) (unaudited)

	<u>2006</u>		<u>2005</u>
<b>Retained earnings - beginning of period</b>	\$ 5,000	\$	6,111
<b>Add (deduct):</b>			
<b>Net loss for the period</b>	<b>(11,935)</b>		<b>(6,720)</b>
<b>Interest received on share purchase loans (note 7)</b>	<b>18</b>		<b>13</b>
<b>Deficit - end of period</b>	<u>\$ (6,917)</u>	<u>\$</u>	<u>(596)</u>

# Aecon Group Inc.

## Consolidated Statements of Cash Flows

For the Three Months ended June 30, 2006 and 2005

(in thousands of dollars) (unaudited)

	<u>2006</u>	<u>2005</u>
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Net (loss) income for the period	\$ (988)	\$ 1,670
Items not affecting cash -		
Depreciation and amortization	1,956	1,968
Gain on sale of assets	(80)	(989)
Deferred financing charges amortization	169	454
Unrealized loss on foreign exchange	984	690
Non-cash interest on other income tax liabilities	90	90
Notional interest representing accretion	208	235
Defined benefit pension	(151)	207
Stock-based compensation	222	39
	<u>2,410</u>	<u>4,364</u>
Change in other balances relating to operations (note 8)	<u>(29,440)</u>	<u>(38,854)</u>
	<u>(27,030)</u>	<u>(34,490)</u>
<b>Investing activities</b>		
Increase in restricted cash balances	(827)	(10,821)
Increase in restricted marketable securities and term deposits	(182)	(1,784)
Purchase of property, plant and equipment	(367)	(900)
Proceeds on sale of property, plant, and equipment	366	1,546
Acquisition (note 12)	(192)	(192)
Increase in concession rights (notes 2 (c) and 8)	(909)	-
Increase in other assets	(4,548)	(1,670)
	<u>(6,659)</u>	<u>(13,821)</u>
<b>Financing activities</b>		
Increase in bank indebtedness	816	41
Short-term loan from a related party (note 13 (d))	-	3,000
Issuance of long-term debt (note 2(e))	49,300	22,974
Repayments of long-term debt	(1,305)	(1,342)
Increase in concession related deferred revenue	4,735	-
Issuance of capital stock (note 7)	1,080	990
Interest received on share purchase loans	10	6
	<u>54,636</u>	<u>25,669</u>
<b>Increase (decrease) in cash and cash equivalents</b>	<u>20,947</u>	<u>(22,642)</u>
<b>Effects of foreign exchange on cash balances</b>	<u>(349)</u>	<u>155</u>
<b>Cash and cash equivalents - beginning of period</b>	<u>28,744</u>	<u>42,686</u>
<b>Cash and cash equivalents - end of period</b>	<u>\$ 49,342</u>	<u>\$ 20,199</u>
<b>Supplementary disclosure (note 8)</b>		



# Aecon Group Inc.

## Consolidated Statements of Cash Flows

For the Six Months ended June 30, 2006 and 2005

(in thousands of dollars) (unaudited)

	<u>2006</u>	<u>2005</u>
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Net loss for the period	\$ (11,935)	\$ (6,720)
Items not affecting cash -		
Depreciation and amortization	3,796	3,734
Gain on sale of assets	(77)	(1,012)
Deferred financing charges amortization	337	537
Extraordinary gain (note 12)	-	(4,122)
Unrealized loss on foreign exchange	1,024	742
Non-cash interest on other income tax liabilities	180	180
Notional interest representing accretion	442	379
Defined benefit pension	(306)	368
Future income taxes	-	678
Stock-based compensation	635	79
Others	32	-
	<u>(5,872)</u>	<u>(5,157)</u>
Change in other balances relating to operations (note 8)	<u>(19,473)</u>	<u>(39,986)</u>
	<u>(25,345)</u>	<u>(45,143)</u>
<b>Investing activities</b>		
Increase in restricted cash balances	(827)	(10,821)
Increase in restricted marketable securities and term deposits	(88)	(850)
Purchase of property, plant and equipment	(896)	(1,717)
Proceeds on sale of property, plant, and equipment	553	1,977
Acquisition (note 12)	(192)	(192)
Increase in concession rights (notes 2 (c) and 8)	(909)	-
Increase in long-term investment (notes 3 and 12)	-	(4,348)
Increase in other assets	(6,909)	(2,775)
Cash acquired on acquisition of a subsidiary, net of consideration paid (note 12)	-	1,896
	<u>(9,268)</u>	<u>(16,830)</u>
<b>Financing activities</b>		
Increase (decrease) in bank indebtedness	806	(3,206)
Short-term loan from a related party (note 13 (d))	-	3,000
Repayment of short term loan from a related party (note 13 (c))	(2,500)	-
Issuance of long-term debt (note 2 (e))	49,300	45,948
Repayments of long-term debt	(23,815)	(46,906)
Increase in concession related deferred revenue	4,735	-
Issuance of capital stock (note 7)	28,695	2,004
Interest received on share purchase loans	18	13
Net proceeds from issuance of convertible debentures	-	31,016
	<u>57,239</u>	<u>31,869</u>
<b>Increase (decrease) in cash and cash equivalents</b>	<b>22,626</b>	<b>(30,104)</b>
<b>Effects of foreign exchange on cash balances</b>	<b>(286)</b>	<b>164</b>
<b>Cash and cash equivalents - beginning of period</b>	<b>27,002</b>	<b>50,139</b>
<b>Cash and cash equivalents - end of period</b>	<b>\$ 49,342</b>	<b>\$ 20,199</b>
<b>Supplementary disclosure (note 8)</b>		

# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2006 and 2005

---

(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 (“GAAP”) 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, 2005. 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 for companies like Aecon, who do a significant portion of their work outdoors (principally road construction and utilities work) and, as a result, less work is performed in the winter and early spring months than in the summer and fall 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, 2006 are not necessarily indicative of results expected for the full fiscal year or any other future period.

### 2. Quito International Airport Project

The Company has recorded concession rights at June 30, 2006 as follows:

Concession rights to operate the existing Quito Airport	\$ 64,000
Concession rights to operate the new Quito Airport	16,145
	<u>\$ 80,145</u>

#### (a) Background information

The Company holds a 42.3% effective economic interest in Corporacion Quiport S.A. (“Quiport JV”), an Ecuadorian company, whose main operations consist of (a) managing and operating the existing Mariscal Sucre International Airport (the “Existing Quito Airport”) until its operations are transferred to a new airport, and (b) the development, financing, construction, operation and maintenance of the new Quito International Airport under a concession arrangement with Corporacion Aeropuerto y Zona Franca del Distrito Metropolitano de Quito (“CORPAQ”). The Company’s 42.3% effective economic interest reflects a 45.5% investment in Quiport JV less the impact of the Company’s share of a 7% carried interest granted to one of the other partners for its participation in the project. Under the concession contract with CORPAQ, Quiport JV has been granted a 35-year concession from January 27, 2006 and once the concession period expires, all the facilities will be returned to CORPAQ. Income earned from operating the Existing Quito Airport will be reinvested in the new airport.

The Company’s partners in Quiport JV are: Andrade Gutierrez Concessoes of Brazil, Airport Development Corporation of Toronto, and HAS Development Corporation of Houston, Texas, which is affiliated with the Houston Airport System. The grantor of the concession is CORPAQ, and the project's senior lenders are: USA-

# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2006 and 2005

---

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

based Overseas Private Investment Corporation, Export-Import Bank of the United States, the Inter-American Development Bank and Export Development Canada (EDC) (collectively the “Project Senior Lenders”).

The Company will invest approximately US\$34,000 in this project; US\$13,650 having been invested prior to financial close and the balance to be invested over the construction period. The Company will use its expected cash profits from construction-related activities toward financing the Company’s equity investment in Quiport JV.

On January 27, 2006, Quiport JV assumed control of Existing Quito Airport operations and on June 28, 2006 financial close was achieved and the first tranche of financing was advanced by the Project Senior Lenders.

The construction contract for the new airport was signed on June 22, 2005, and the formal construction commencement date was July 12, 2006. The New Quito Airport will be constructed under a 51-month fixed-price Engineer-Procure-Construct contract signed between CORPAQ and Canadian Commercial Corporation (“CCC”), a Crown agency of the Canadian government. CORPAQ assigned the construction contract to Quiport JV. CCC subcontracted 100% of the construction work to the Company as its Canadian supplier, which then subcontracted 100% of the construction work to a 50%-50% joint venture consisting of the Company and Brazil’s Construtora Andrade Gutierrez (the “Construction JV”). The Company will be the managing partner of the Construction JV.

### **(b) Accounting for operations of the Existing Quito Airport**

As an inducement to develop and finance the new Quito International Airport, Quiport JV has been granted the right to operate and to benefit from the operations of the Existing Quito Airport while the new airport is being constructed. In accordance with GAAP, an entity acquiring an “in kind” asset should measure the asset at fair value as at the date of acquisition. Therefore, in accounting for the right to operate the Existing Quito Airport, Quiport JV has fair valued this right and recorded an intangible asset (being the “Concession Rights”) on its balance sheet. The Company’s proportionate share of this asset has been assigned a value of \$64,000. This amount reflects a preliminary estimate made by management and will be updated prior to year end at which point management will have completed its determination of the fair value of this right. The assessment of the fair value will include an independent valuation of the inducement. Although, for accounting purposes, the operation of the concession commenced on June 28, 2006, the results for the period from June 28 to June 30, 2006, being insignificant, are not included in the results of operations in the current quarter. Quiport JV will amortize the Concession Rights over the remaining term of the right to operate the Existing Quito Airport. The offsetting concession related deferred revenue balance (being the value of the inducement received by Quiport JV to develop and finance the New Quito Airport) will be amortized to earnings over the term of the New Quito Airport concession period. Consequently, income earned from the operation of the Existing Quito Airport, which will be recognized in the normal fashion (notwithstanding that income will be reinvested in the New Quito Airport) will be reduced by the amount of the annual amortization charge related to the Existing Quito Airport Concession Rights.

As at June 28, 2006, CORPAQ also provided Quiport JV with net assets of \$4,735 – representing net proceeds received by Quiport JV between the date the concession went into effect (January 27, 2006) and the date of financial close (June 28, 2006). This amount represents an additional inducement and has been classified as concession related deferred revenue in the consolidated balance sheets. As with the other concession related

# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2006 and 2005

---

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

deferred revenue amounts noted above, this balance will be amortized to earnings over the term of the New Quito Airport concession period.

### **(c) Accounting for the costs of the New Quito Airport**

Costs incurred of \$16,145 to construct the New Quito Airport have been recorded as Concession Rights to operate the New Quito Airport. Included in this amount is \$15,236 of deferred development costs previously included in other assets and \$909 of additional construction costs incurred by Quiport JV. Amortization of the Concession Rights to operate the New Quito Airport will commence after construction of the New Quito Airport is completed. As a result, there is no amortization expense recorded in the current period results.

### **(d) Accounting for Quiport JV and Construction JV**

On June 28, 2006, the Company began accounting for these investments using the proportionate consolidation method, whereby the Company recognizes on its balance sheet, its share of the assets and liabilities of both Quiport JV and Construction JV, and in its income statement, its share of the revenues and expenses of these joint ventures.

In accordance with GAAP, the Company's share of Construction JV's revenue and profits will be reduced by the Company's proportionate ownership interest in Quiport JV. The profits eliminated will be effectively recognized over the life of the New Quito Airport concession period. Under the Company's accounting policy for large multi-year contracts, profit is recognized only when construction progress reaches a stage of completion sufficient to reasonably determine the probable results (generally when the contract is 20% complete). To date, no construction profits have been recorded on this project.

### **(e) Quiport JV long-term debt**

Upon achieving financial close of the Quito International Airport Project, US\$77,291 of senior project financing was advanced to Quiport JV by the Project Senior Lenders. The total financing commitment made by the Project Senior Lenders to Quiport JV is US\$376,388. This debt is secured by the assets of Quiport JV and is without recourse to the Company.

The financing is denominated in US dollars and is provided for a term of fifteen years from June 28, 2006 using a mix of rates of interest, both variable (some of which can be converted to fixed rates) and fixed, as follows:

- US 91 day treasury bill rate plus 4% margin (53% of the total financing commitment).
- Six month LIBOR rate plus 4.5% (20% of the total financing commitment).
- 4.9% plus exposure fee of 26.51% on disbursed amounts (17% of the total financing commitment).
- 10.32% (10% of total financing commitment).

Included in the Company's balance sheet at June 30, 2006 is the Company's proportionate share of this debt of \$39,254.

No debt repayments are scheduled to be made during the construction period.

# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2006 and 2005

---

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

### (f) Guarantees

In connection with the Quito International Airport Project, the Company has provided letters of credit in support of its remaining equity obligations of \$24,600 (US\$22,000) and for various project contingencies of \$33,700 (US\$30,200). These letters of credit are supported by guarantees issued on behalf of the Company to the issuing banks by Export Development Canada (“EDC”) and will remain in place until its equity obligations are fulfilled and the conditions giving rise to the contingencies are satisfied or cleared.

In addition, the Company and Andrade Gutierrez have provided surety bonds, guaranteed joint and severally, to cover construction and concession related performance obligations of \$74,800 (US\$67,000), an advance payment bond of \$83,100 (US\$74,500) and a retention release bond of \$23,100 (US\$20,700), in each case the Company’s share supported by guarantees issued by EDC.

### 3. Long-term investment

The long-term investment in the amount of \$42,733 at June 30, 2006 (2005 - \$41,273) represents the Company’s 25.0% investment, which is carried at cost, in the Derech Eretz Highways (1997) Ltd. (“Derech Eretz”), the company owning the concessionaire rights to the Cross Israel Highway. Under the terms of the concession contract with the State of Israel and lender agreements, the Company is required to obtain approvals in order to sell all or a portion of this investment. In addition, existing shareholders have a right of first refusal to acquire this investment in the event of a sale and also are entitled to participate on a pro rata basis in the event of a sale to a third party. Pursuant to an agreement with the State of Israel, the Company’s interest in Derech Eretz would be diluted to approximately 12% if options granted are exercised. On January 24, 2005, the Company increased its interest in Derech Eretz from 22.2% to 25%. The purchase price for the increased stake was \$4,348 (US\$3,500). On February 16, 2006, pursuant to an agreement reached with the project lenders, the shareholders of Derech Eretz purchased certain options held by lenders. The lenders options would have allowed the lenders to purchase directly from the existing shareholders a portion of their equity and subordinated debt of the concessionaire. The Company’s pro rata share of the purchase price was \$1,460 (US\$ 1,250) and was financed by a loan from the other shareholders in Derech Eretz at an interest rate of 6% per annum repayable from future distributions available to the Company from Derech Eretz or the construction joint venture.

# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2006 and 2005

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

### 4. Income Taxes

The provision for income taxes differs from the result that would be obtained by applying combined Canadian federal and provincial (Ontario) statutory income tax rates to income before income taxes. This difference results from the following:

	Six months ended June 30	
	2006	2005
Loss before income taxes and extraordinary items	\$ 11,737	\$ 9,079
Statutory income tax rate	36.1%	36.1%
Expected income tax recovery	(4,237)	(3,279)
Effect on income tax of:		
Valuation allowance against current year's future tax assets	3,722	3,832
Provincial and foreign rate differentials	86	54
Non-deductible expenses	268	217
Large corporations tax	-	225
Foreign exchange translation losses	229	103
Foreign losses for which there is no tax recovery	132	-
Other	(2)	(67)
	4,435	4,364
Income tax expense	\$ 198	\$ 1,085

# Aecon Group Inc.

## Notes to Consolidated Financial Statements June 30, 2006 and 2005

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

### 5. Convertible debentures

Convertible subordinated debentures consist of:

	June 30, 2006	December 31, 2005
Debt component:		
(a) Debentures maturing June 30, 2006	\$ -	\$ 7,676
(b) Debentures maturing November 2, 2009	28,673	28,474
(b) Debentures maturing March 17, 2010	30,901	30,685
	<u>\$ 59,574</u>	<u>\$ 66,835</u>
Reported as:		
Current liability	\$ -	\$ 7,676
Long-term liability	59,574	59,159
	<u>\$ 59,574</u>	<u>\$ 66,835</u>
Equity component:		
(a) Debentures maturing June 30, 2006	\$ -	\$ 836
(b) Debentures maturing November 2, 2009	1,990	1,990
(b) Debentures maturing March 17, 2010	2,156	2,156
	<u>\$ 4,146</u>	<u>\$ 4,982</u>

- (a) In March 2006, the Company's largest shareholder exercised its option to convert convertible debt with a face value of \$7,731 into 2,147,566 common shares at a conversion price of \$3.60 per share.
- (b) In November 2004, the Company issued \$30,000 in unsecured, subordinated convertible debentures maturing November 2, 2009. The debentures bear 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 \$7.50 for each common share, subject to adjustment in certain circumstances. The convertible debentures will not be redeemable before November 2, 2007. From November 2, 2007 through to 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.

In March 2005, the Company issued \$32,500 in unsecured, subordinated convertible debentures maturing March 17, 2010. The debentures bear 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

# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2006 and 2005

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

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 debentures, 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.

Interest expense on the debentures is composed of the interest calculated on the face value of the debentures, which amounted to \$62,500 at June 30, 2006 (December 31, 2005 - \$70,231), an annual notional interest representing the accretion of the carrying value of the debentures, and amortization of deferred financing costs. Interest recorded was as follows:

	<u>Three months ended June 30</u>		<u>Six months ended June 30</u>	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Interest expense on face value	\$ 1,278	\$ 1,390	\$ 2,654	\$ 2,217
Notional interest representing accretion	207	235	437	379
Amortization of deferred financing costs	147	148	294	231
	<u>\$ 1,632</u>	<u>\$ 1,773</u>	<u>\$ 3,385</u>	<u>\$ 2,827</u>

The liability portion of the debentures is as follows:

	<u>June 30,</u>	<u>December 31,</u>
	<u>2006</u>	<u>2005</u>
Financial liability component	\$ 58,354	\$ 65,249
Notional interest representing accretion	1,220	1,586
	<u>\$ 59,574</u>	<u>\$ 66,835</u>

## 6. Guarantees

The Company has outstanding guarantees and letters of credit amounting to \$24,811 (December 31, 2005 - \$25,668) in support of financial and performance related obligations for the Nathpa Jhakri hydroelectric 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 Company has a 25% interest, and a leakage guarantee, which is a guarantee by the operator of the toll highway,



# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2006 and 2005

---

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

in which the Company has a 30.60% interest, 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 US\$8,100 (CAD\$9,041 at current rates) (December 31, 2005 – US\$ 8,100 or CAD\$9,420) 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 NIS33,000 plus escalation to-date (CAD\$11,541 at current rates) (December 2005 – NIS33,000 plus escalation or CAD\$11,397) or 6% of annual toll revenue.

In addition to the above, the Company has provided letters of credit in the amounts of US\$ 200 (CAD\$223 at current rates), in support of working capital requirements of the operator of the toll highway, and NIS2,400 (CAD\$604 at current rates) to support a bid bond that was required by the concessionaire in connection with the construction of an extension to the Cross Israel Highway. The construction of this extension originates from an agreement reached to extend the highway and have concession rights to this extension. The Company will have a 25% interest in the construction. This letter of credit, which is secured by cash, will be in force until financing for the extension is complete and construction commences.

The Company has also issued performance guarantees of \$731 (December 31, 2005 – \$4,965) in respect of certain other international projects supported by guarantees issued to Aecon by Export Development Corporation.

In addition, the Company has issued, in the normal conduct of operations, guarantees amounting to \$10,182 (December 31, 2005 - \$10,616) in support of financial and performance related obligations for certain domestic projects of which \$5,339 (December 31, 2005 - \$5,773) are secured by cash held in interest bearing accounts.

Under the terms of many of the Company's joint venture 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, 2006, the value of uncompleted work for which the Company's joint venture partners are responsible, and which the Company could be responsible for assuming, amounted to approximately \$436,416 (December 31, 2005 - \$142,276), a substantial portion of which is supported by performance bonds. In the event that the Company 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.

Details regarding the Company's investment in the Quito International Airport project are described in note 2 (f).

# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2006 and 2005

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

### 7. Capital stock

	2006		2005	
	Number of shares issued	Amount	Number of shares issued	Amount
Balance - January 1	31,180,609	\$ 95,985	30,524,609	\$ 93,829
Common shares issued on exercise of options	275,000	990	276,000	1,014
Common shares issued less expenses of \$1,500 (i)	4,500,000	26,625	-	-
Common shares issued on conversion of debentures (ii)	2,147,566	8,567	-	-
Balance - March 31	38,103,175	132,167	30,800,609	94,843
Common shares issued less expenses of \$nil (i)	180,000	1,080	275,000	990
Balance - June 30 (iii)	38,283,175	\$ 133,247	31,075,609	\$ 95,833

- (i) On March 17, 2006, the Company issued 4,500,000 common shares at \$6.25 per share. Net proceeds, after deducting agents' fees and expenses of the issue, were approximately \$26,625. On April 18, 2006, an Over-Allotment Option was exercised and the Company issued an additional 180,000 common shares at \$6.25 per share. The exercise of the Over-Allotment Option raised the aggregate net proceeds under this offering to \$27,705.
- (ii) The Company's largest shareholder exercised its option to convert convertible debt with a face value of \$7,731 into 2,147,566 common shares at a conversion price of \$3.60 per share. In addition, share capital was increased by \$836 representing the equity portion of the convertible debentures that was previously classified as a separate component of shareholders' equity.
- (iii) In accordance with the recommendations of the CICA on accounting for share purchase loans receivable from employees, such loans except in certain circumstances are required to be presented as deductions from shareholders' equity. Accordingly, loans totalling \$1,084 (2005 - \$857) are presented as a deduction from capital stock. Interest received on such loans in the three months ending June 30 of \$10 after income taxes (2005 - \$6) and in the six months ended June 30 of \$18 after income taxes (2005 - \$13) is accounted for as a capital transaction in shareholders' equity.

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

Pursuant to an agreement in connection with the provision of bonds on the Quito International Airport Project, the Company is restricted from paying dividends, except for an aggregate of \$10,000 per fiscal year.

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 Plan shall not exceed 2,500,000. As at June 30, 2006, 1,100,000 were issued under the 2005

# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2006 and 2005

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

Plan. Similar to the 1998 Plan, each option issuance under the 2005 Plan specifies 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. Details of common shares issued upon the exercise of options under the 2005 Plan, as well as details of changes in the balance of options outstanding are detailed below:

2005 Stock Option Plan	Six months ended June 30, 2006	
	Shares	Weighted average exercise price
Options outstanding - January 1	100,000	\$ 5.51
Granted	1,000,000	6.25
Options outstanding - March 31	1,100,000	6.18
Options outstanding - June 30	1,100,000	\$ 6.18
Options exercisable at end of period	250,000	\$ 6.25

Options currently outstanding under the 2005 Stock Option Plan have the following exercise prices and expiry dates:

Options granted in	Number of shares	Exercise price	Expiry date
2005	100,000	\$5.51	November 7, 2010
2006	1,000,000	\$6.25	March 27, 2011

The options granted in 2005 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 options granted in 2006 have a term of five years from the date of grant and vest one-quarter immediately and one quarter per annum thereafter on the anniversary date of the grant.

The Company has adopted fair value accounting for options granted after 2001 to employees and records compensation expense upon the issuance of stock options under its 1998 and 2005 Stock Option Plans. The fair value is estimated on the date of grant using the Black-Scholes fair value option-pricing model and compensation expense is amortized over the three-year vesting period of the options. During the three months ended June 30, 2006, compensation expense was increased by \$206 (2005 - \$nil) and contributed surplus was increased by the same amount, on account of options granted under the 2005 Stock Option Plan. During the six months ended June 30, 2006, compensation expense of \$602 (2005 - \$nil) was recognized and contributed surplus was increased by the same amount, on account of options granted under the 2005 Stock Option Plan.

The fair value was estimated on the date of grant using the Black-Scholes fair value option-pricing model using the following assumptions:

# **Aecon Group Inc.**

## Notes to Consolidated Financial Statements

**June 30, 2006 and 2005**

---

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

	<u><b>2006</b></u>
Dividend yield	0%
Expected volatility	32%
Risk free interest rate	4%
Weighted average expected life (years)	3.25

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 250,000 options that were previously issued and remain outstanding under this plan. Details of common shares issued upon the exercise of options under the 1998 Stock Option 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, 2006 and 2005

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

	2006		2005	
	Shares	Weighted average exercise price	Shares	Weighted average exercise price
Options outstanding - January 1	525,000	\$ 4.58	1,181,000	\$ 4.05
Exercised	(275,000)	3.60	(276,000)	3.67
Options outstanding - March 31	250,000	5.66	905,000	4.19
Exercised	-	-	(275,000)	3.60
Options outstanding – June 30	250,000	\$ 5.66	630,000	\$ 4.42
Options exercisable at end of period	150,000	\$ 5.26	446,666	\$ 3.69

Options were exercised under the 1998 Stock Option Plan during the three months ended June 30, 2005 for 275,000 shares for which share capital was increased by \$990. For the six months ended June 30, 2006, 275,000 options were exercised (2005 – 551,000) for which share capital was increased by \$990 (2005 - \$2,004). Options currently outstanding have the following exercise prices and expiry dates:

Options granted in	Number of shares	Exercise price	Expiry date
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.

During the three months ended June 30, 2006, compensation expense of \$16 (2005 - \$39), and contributed surplus was increased by the same amount, on account of options granted under the 1998 Stock Option Plan. During the six months ended June 30, 2006, compensation expense of \$33 (2005 - \$79) was recognized and contributed surplus was increased by the same amount, on account of options granted under the 1998 Stock Option Plan.

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 1,584,963 (June 30, 2006 - 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.

# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2006 and 2005

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

### Three months ended June 30

	<b>2006</b>		
	<b>(Loss) income (numerator)</b>	<b>Shares (denominator)</b>	<b>Per share</b>
<b>Net loss per share</b>			
Net loss for the period	\$ (988)	36,664,586	\$ (0.03)
Effect of dilutive securities (i):			
Options	-	1,408,940	-
	<u>\$ (988)</u>	<u>38,073,526</u>	<u>\$ (0.03)</u>
			<b>2005</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 debentures 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>

# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2006 and 2005

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

### Six months ended June 30

	<b>2006</b>		
	<b>(loss) income (numerator)</b>	<b>Shares (denominator)</b>	<b>Per share</b>
<b>Net loss per share</b>			
Net loss for the period	\$ (11,935)	33,755,034	\$ (0.35)
Effect of dilutive securities (i):			
Options	-	1,427,241	-
Convertible secured subordinated debentures bearing interest at prime rate plus 1.0% maturing on June 30, 2006	77	889,875	-
	<u>\$ (11,858)</u>	<u>36,072,150</u>	<u>\$ (0.35)</u>
<b>2005</b>			
<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 debentures bearing interest at prime rate plus 1.0% maturing on June 30, 2006	165	2,147,568	-
	<u>\$ (6,555)</u>	<u>33,031,797</u>	<u>\$ (0.23)</u>
<b>2005</b>			
<b>Loss per share before extraordinary items</b>			
Loss before extraordinary items	\$ (10,164)	29,292,929	\$ (0.35)
Effect of dilutive securities (i):			
Options	-	1,591,300	-
Convertible secured subordinated debentures bearing interest at prime rate plus 1.0% maturing on June 30, 2006	165	2,147,568	-
	<u>\$ (9,999)</u>	<u>33,031,797</u>	<u>\$ (0.35)</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.

# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2006 and 2005

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

In the three months ended June 30, 2005, basic and diluted earnings per share from extraordinary items amounted to \$nil, while for the six months ended June 30, 2005, basic and diluted earnings per share from extraordinary items amounted to \$0.12. There were no extraordinary items in the first or second quarter of 2006.

### 8. Cash flow information

Change in other balances relating to operations:

	<u>Three months to June 30</u>		<u>Six months to June 30</u>	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
(Increase) decrease in:				
Accounts receivable	\$ (41,861)	\$ (53,913)	\$ (5,562)	\$ (14,350)
Holdbacks receivable	3,243	(8,675)	4,616	1,873
Deferred contract costs and unbilled revenue	(7,289)	(20,387)	(860)	(13,447)
Inventories	(1,295)	(204)	(2,032)	567
Prepaid expenses	(3,081)	522	(5,795)	(972)
Increase (decrease) in:				
Accounts payable and accrued liabilities	20,503	44,433	(13,371)	10,495
Holdbacks payable	(5,539)	1,843	(3,252)	(5,616)
Deferred revenue	7,235	(534)	8,246	(17,410)
Income taxes payable	(1,356)	(1,939)	(1,463)	(1,126)
	<u>\$ (29,440)</u>	<u>\$ (38,854)</u>	<u>\$ (19,473)</u>	<u>\$ (39,986)</u>

Other supplementary information:

	<u>Three months to June 30</u>		<u>Six months to June 30</u>	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Cash interest paid	\$ 1,837	\$ 1,982	\$ 4,171	\$ 2,695
Cash income taxes paid	\$ 1,597	\$ 149	\$ 2,409	\$ 2,515

Property, plant and equipment acquired and financed by means of capital leases during the three months ended June 30, 2006 amounted to \$371 (2005 - \$1,963) and \$1,137 (2005 - \$2,308) for the six months ended June 30, 2006.

Investing and financing activities not requiring an immediate use of cash in the three and six months ended June 30, 2006 included the acquisition of the concession rights to operate the existing Quito Airport and the related increase in concession related deferred revenue, both in the amount of \$64,000 (see note 2 (b)).

In June 2006, the Company was reimbursed by Quiport JV for deferred development costs. The resulting decrease in other assets of \$15,236 (i.e. decrease in deferred development costs) and increase in concession rights to operate the New Quito Airport are treated as non-cash items and not reported in the statements of cash flows.



# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2006 and 2005

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

In March 2006, the Company's largest shareholder exercised its option to convert convertible debt with a face value of \$7,731 into 2,147,566 common shares at a conversion price of \$3.60 per share. In addition, share capital was increased by \$836 representing the equity portion of the convertible debentures that was previously classified as a separate component of shareholders' equity (notes 5 and 7).

As described in note 3, the shareholders of Derech Eretz purchased certain options held by project lenders. The Company's pro rata share of the purchase price was \$1,460 (US\$ 1,250) and was financed by a loan from the other shareholders in Derech Eretz.

### 9. Employee future benefit expenses

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

	Three months ended June 30		Six months ended June 30	
	2006	2005	2006	2005
Defined benefit plan expense:				
Company sponsored pension plans	\$ 477	\$ 481	\$ 889	\$ 886
Defined contribution plan expense:				
Company sponsored pension plans	486	490	931	840
Multi-employer pension plans	5,478	6,159	8,918	9,699
Total employee future benefit expenses	\$ 6,441	\$ 7,130	\$ 10,738	\$ 11,425

### 10. Segmented information and business concentration

The Company operates in four principal segments within the construction industry - Infrastructure, Buildings, Industrial and Concessions. Prior to this quarter, the Company reported its concession operations (principally its investment in the Cross Israel highway) within its Infrastructure segment. However, with the achievement of financial close of a concession agreement to own and operate the existing and new airports in Quito, Ecuador, concession ownership and operations became a significant portion of the Company's overall operations. 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.

#### *Infrastructure*

This segment includes all aspects of the construction of both public and private infrastructure, including roads and highways, principally within the Province of Ontario, as well as toll highways, dams, tunnels, bridges, airports, marine facilities, transit systems and hydro-electric power projects, domestically and internationally. This segment includes the mining, manufacture, and supply of asphalt and aggregate products, and the construction and/or installation of utility distribution systems for natural gas, telecommunications and electrical

# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2006 and 2005

---

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

networks, as well as water and sewer mains, traffic signals and highway lighting, also principally within the Province of Ontario. Services provided in the Infrastructure segment include construction of large civil infrastructure projects in Canada and, on a selective basis, internationally.

### *Buildings*

This segment specializes in the construction and renovation of commercial, institutional and multi-family residential buildings, including retail complexes, office buildings, airport terminals, entertainment facilities, schools, embassies, hospitals, and high rise condominium buildings among others. Work in this segment is concentrated primarily in Canada and the north-western United States. Services include general contracting and fee for service construction management, as well as building renovation and facilities management.

### *Industrial*

This segment encompasses all of the Company's industrial construction and manufacturing activities including in-plant construction and module assembly in the manufacturing, energy, petrochemical, steel and automotive sectors. Activities in this sector also include the construction of alternative, fossil fuel, cogeneration power plants and in-plant construction of nuclear power plants as well as the fabrication of small and large diameter specialty pipe and the design and manufacture of once-through heat recovery steam generators for industrial and power plant applications. Although activity in this segment is concentrated primarily in Canada, with selected projects in the United States and Europe, the Company sells and installs once-through steam generators throughout the world through its Innovative Steam Technologies division.

### *Concessions*

This segment includes the development, operation and financing of infrastructure projects by way of build-operate-transfer, build-own-operate-transfer or public-private partnership contract structures. This segment focuses primarily on the operations, management, maintenance and enhancement of investments held by the Company in infrastructure concessions - currently these comprise investments in the Cross Israel Toll Highway and Quito International Airport Project concession companies. This segment includes the operations of Highway 104 in Atlantic Canada. This segment also has a development function whereby it monitors and, where appropriate, brings the diverse capabilities and strengths within the Company and its strategic partners to the development of domestic and international public-private partnership concession projects in which the Company may play a role as an investor, constructor and/or operator.

# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2006 and 2005

(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>2006</b>
	<b>Infrastructure</b>	<b>Buildings</b>	<b>Industrial</b>	<b>Concessions</b>	<b>Corporate and Other</b>	<b>Total</b>	
Revenues	\$ 108,408	\$ 80,145	\$ 67,755	\$ 5,009	\$ (2,578)	\$ 258,739	
EBITDA (i)	\$ 3,213	\$ 1,273	\$ 2,552	\$ (1,212)	\$ (2,995)	\$ 2,831	
Depreciation and amortization	1,177	85	466	2	226	1,956	
Segment operating profit (loss) (ii)	\$ 2,036	\$ 1,188	\$ 2,086	\$ (1,214)	\$ (3,221)	\$ 875	
Interest and income taxes						(1,863)	
Net loss						\$ (988)	
Total assets	\$ 216,045	\$ 85,048	\$ 84,109	\$ 180,516	\$ 43,126	\$ 608,844	
Intangible assets and goodwill	\$ 2,743	\$ 2,547	\$ 3,750	\$ 80,323	\$ -	\$ 89,363	
Capital expenditures	\$ 219	\$ 14	\$ 29	\$ -	\$ 105	\$ 367	
Cash flow from (used in) operations	\$ 3,811	\$ 1,273	\$ 2,637	\$ (1,212)	\$ (4,099)	\$ 2,410	

# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2006 and 2005

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

							<b>2005</b>
	<b>Infrastructure</b>	<b>Buildings</b>	<b>Industrial</b>	<b>Concessions</b>	<b>Corporate and Other</b>	<b>Total</b>	
Revenues	\$ 103,676	\$ 108,191	\$ 68,690	\$ 3,682	\$ (1,261)	\$ 282,978	
EBITDA (i)	\$ 5,805	\$ 514	\$ 2,831	\$ 69	\$ (2,784)	\$ 6,435	
Depreciation and amortization	1,156	101	493	-	218	1,968	
Segment operating profit (loss)	\$ 4,649	\$ 413	\$ 2,338	\$ 69	\$ (3,002)	\$ 4,467	
Interest and income taxes						(2,797)	
Net income						\$ 1,670	
Total assets	\$ 191,108	\$ 111,653	\$ 67,852	\$ 56,475	\$ 47,609	\$ 474,697	
Intangible assets and goodwill	\$ 2,676	\$ 1,923	\$ 3,750	\$ -	\$ -	\$ 8,349	
Capital expenditures	\$ 305	\$ 41	\$ 397	\$ -	\$ 157	\$ 900	
Cash flow from (used in) operations	\$ 5,215	\$ 514	\$ 2,831	\$ 69	\$ (4,265)	\$ 4,364	

# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2006 and 2005

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

As at June 30 and the six months then ended

	<b>2006</b>					
	<b>Infrastructure</b>	<b>Buildings</b>	<b>Industrial</b>	<b>Concessions</b>	<b>Corporate and Other</b>	<b>Total</b>
Revenues	\$ 164,305	\$ 167,488	\$ 120,753	\$ 10,608	\$ (3,840)	\$ 459,314
EBITDA (i)	\$ (271)	\$ 867	\$ 3,469	\$ (1,903)	\$ (5,923)	\$ (3,761)
Depreciation and amortization	2,213	198	931	3	451	3,796
Segment operating profit (loss) (ii)	\$ (2,484)	\$ 669	\$ 2,538	\$ (1,906)	\$ (6,374)	\$ (7,557)
Interest and income taxes						(4,378)
Net loss						\$ (11,935)
Capital expenditures	\$ 356	\$ 90	\$ 271	\$ -	\$ 179	\$ 896
Cash flow from (used in) operations	\$ 236	\$ 867	\$ 3,554	\$ (1,903)	\$ (8,626)	\$ (5,872)

# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2006 and 2005

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

	<b>2005</b>					
	<b>Infrastructure</b>	<b>Buildings</b>	<b>Industrial</b>	<b>Concessions</b>	<b>Corporate and Other</b>	<b>Total</b>
Revenues	\$ 159,001	\$ 185,342	\$ 107,714	\$ 5,992	\$ (2,199)	\$ 455,850
EBITDA (i)	\$ 3,433	\$ 859	\$ 910	\$ (1,163)	\$ (5,106)	\$ (1,067)
Depreciation and amortization	2,155	213	933	-	433	3,734
Segment operating profit (loss)	\$ 1,278	\$ 646	\$ (23)	\$ (1,163)	\$ (5,539)	(4,801)
Interest and income taxes						(5,363)
Loss before extraordinary item						\$ (10,164)
Extraordinary gain						\$ 4,122
Income taxes on extraordinary gain						(678)
Extraordinary gain, net of income taxes						\$ 3,444
Net loss						\$ (6,720)
Capital expenditures	\$ 757	\$ 114	\$ 560	\$ -	\$ 286	\$ 1,717
Cash flow from (used in) operations	\$ 2,550	\$ 859	\$ 962	\$ (1,163)	\$ (8,365)	\$ (5,157)

- 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 (used in) 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.
- ii. Included in the segment operating profit (loss) of the Industrial segment is income from investments accounted for by the equity method of \$406.

# **Aecon Group Inc.**

## Notes to Consolidated Financial Statements

**June 30, 2006 and 2005**

---

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

### **11. Quiport Joint Venture - additional information**

In accordance with the recommendations of the Canadian Institute of Chartered Accountants, the Company's investment in the Quiport JV is currently accounted for by the proportionate consolidated method, whereby the consolidated financial statements reflect, line by line, the pro-rata share of each of the assets, liabilities, revenues and expenses of Quiport JV. Given the significant effect of Quiport JV on the Company's consolidated financial statements and to provide additional information about the Quiport JV operations and assets which act as security for the debt described in note 2 (e), the Company provides the following consolidating worksheets as additional information about its accounts, thereby enabling the reader to have a greater understanding of the Company's underlying assets, earnings base and financial resources.

# Aecon Group Inc.

## Notes to Consolidated Financial Statements June 30, 2006 and 2005

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

### Consolidating Balance Sheets

	At June 30, 2006			
	Consolidated Balance Sheet excluding Quiport JV	Quiport JV	Elimination	Consolidated Balance Sheet
<b>Assets</b>				
<b>Current assets</b>				
Cash and cash equivalents	\$ 13,667	\$ 35,675	\$ -	\$ 49,342
Other current assets	316,916	7,898	-	324,814
	330,583	43,573	-	374,156
Property, plant and equipment	53,886	-	-	53,886
Future income tax assets	20,100	-	-	20,100
Concession rights	-	80,145	-	80,145
Long-term investment	42,733	-	-	42,733
Other assets	36,069	1,755	-	37,824
Due from Quiport JV	14,728	-	(14,728)	-
Investment in Quiport JV	508	-	(508)	-
	\$ 498,607	\$ 125,473	\$ (15,236)	\$ 608,844
<b>Liabilities</b>				
Current liabilities	\$ 263,047	\$ 2,248	\$ -	\$ 265,295
Long-term debt	27,778	39,254	-	67,032
Due to Aecon	-	14,728	(14,728)	-
Other liabilities	2,922	-	-	2,922
Other income tax liabilities	13,814	-	-	13,814
Concession related deferred revenue	-	68,735	-	68,735
Convertible debentures	59,574	-	-	59,574
	367,135	124,965	(14,728)	477,372
<b>Shareholders' Equity</b>				
Capital stock	133,247	508	(508)	133,247
Contributed Surplus	996	-	-	996
Convertible debentures	4,146	-	-	4,146
Deficit	(6,917)	-	-	(6,917)
	131,472	508	(508)	131,472
	\$ 498,607	\$ 125,473	\$ (15,236)	\$ 608,844



# Aecon Group Inc.

## Notes to Consolidated Financial Statements June 30, 2006 and 2005

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

### Consolidating Statements of Cash Flows

	For the six months ended June 30, 2006			
	Consolidated Cash Flows excluding Quiport JV	Quiport JV	Elimination	Consolidated Cash Flows
<b>Cash provided by (used in):</b>				
Operating activities	\$ (19,695)	\$ (5,650)	\$ -	\$ (25,345)
Investing activities	(6,604)	(17,900)	15,236	(9,268)
Financing activities	13,250	59,225	(15,236)	57,239
<b>(Decrease) increase in cash and cash equivalents</b>	<b>(13,049)</b>	<b>35,675</b>	<b>-</b>	<b>22,626</b>
<b>Effects of foreign exchange on cash balances</b>	<b>(286)</b>	<b>-</b>	<b>-</b>	<b>(286)</b>
<b>Cash and cash equivalents - beginning of period</b>	<b>27,002</b>	<b>-</b>	<b>-</b>	<b>27,002</b>
<b>Cash and cash equivalents - end of period</b>	<b>\$ 13,667</b>	<b>\$ 35,675</b>	<b>\$ -</b>	<b>\$ 49,342</b>

## 12. 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
------	----------

### 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, 2006 and 2005

---

(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 12% 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. In the second quarter of 2006, the Company paid \$192 (second quarter of 2005 - \$192) with respect to the short-term note payable of \$384 recorded in connection with that acquisition.

### 13. 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, which is the consideration agreed to by the parties.

- (a) Hochtief, the parent of Hochtief Canada Inc. ("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 \$126 during the six months ended June 30, 2006 (2005 - \$137) in connection with these guarantees.
- (b) The Company is in a joint venture with Hochtief on the Eastmain hydro-electric powerhouse project in Quebec.
- (c) On January 13, 2006, the Company repaid a short-term unsecured loan of \$2,500 from Hochtief. The loan was provided to support a portion of the Company's working capital contribution requirements to the Eastmain joint venture, the hydro-electric powerhouse project in northern Quebec. Interest due was calculated on the amount outstanding at prime rate plus 1.5%. During the six months ended June 30, 2006, the Company paid interest of \$39 in relation to this loan.
- (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. 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.
- (e) During the six months ended June 30, 2006, the Company paid interest of \$97 (2005 - \$201) to HCI on the convertible subordinated debentures described in note 5.
- (f) During the six months ended June 30, 2006, the Company received \$21 from Hochtief PPP Solutions GmbH with respect to bid costs, pursuant to an arrangement in place for the sharing of such costs.
- (g) To the best of the Company's knowledge from information available to it and from public records, \$800 of the Company's \$32,500 convertible debentures issued on March 17, 2005 is held by officers and directors of the Company or parties related thereto.

# Aecon Group Inc.

## Notes to Consolidated Financial Statements

June 30, 2006 and 2005

---

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

- (h) During the three months ended June 30, 2006, the Company paid professional fees in the amount of \$53 (2005 - \$24), and \$53 during the six months ended June 30, 2006 (2005 - \$50) to a consulting company in which a director of the Company is a partner.

### 14. Commitments and contingencies

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 \$27,964 (original request for payment from SJVN) 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 claims for liquidated damages are unwarranted and without legal merit. The joint venture also believes that even in the unlikely situation that it might be found responsible (through arbitration hearings that are currently in progress) for some part of the delay, this did not result in any damages to SJVN then, as a matter of law, liquidated damages cannot be enforced. The joint venture's conclusion regarding the impermissibility of SJVN to enforce liquidated damages is supported by two independent legal opinions. The joint venture had previously submitted for arbitration claims of approximately \$111,664 against SJVN, the most significant of which is to cover the joint venture's cost of delays related to these same matters. This is in addition to \$8,773, which was previously received by the joint venture and is included in the joint venture's profit estimate for this project. These submissions have been subsequently revised to an amount of \$88,476 as a result of findings during the course of the arbitration proceeding. 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 revenues from claims only when resolved, has any amount been recognized for potential recoveries under the claims.

It should be noted that all amounts quoted in the preceding paragraph are based on foreign currency amounts which have been translated to Canadian dollars at exchange rates effective on June 30, 2006.

With respect to commitments and contingencies relating to the Company's investment in Quito International Airport project, see note 2.

### 15. Comparative figures

Certain comparative figures have been reclassified to conform to the presentation adopted in the three months and six months ended June 30, 2006.









***AECON***

**Aecon Group Inc.**

20 Carlson Court, Suite 800

Toronto, Ontario

Canada M9W 7K6

Telephone 416-293-7004

Facsimile 416-293-0271

[aecon@aecon.com](mailto:aecon@aecon.com)

[www.aecon.com](http://www.aecon.com)