

ACMAT CORPORATION AND SUBSIDIARIES
MARCH 31, 2006

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ACMAT CORPORATION AND SUBSIDIARIES
Consolidated Balance Sheets

<u>Assets</u>	March 31, <u>2006</u> (Unaudited)	December 31, <u>2005</u>
Investments:		
Fixed maturities-available for sale at fair value (Cost of \$78,459,542 in 2006 and \$80,003,030 in 2005)	\$77,493,270	79,436,415
Equity securities, at fair value (Cost of \$10,824,759 in 2006 and \$10,074,759 in 2005)	10,775,678	10,086,263
Short-term investments, at cost which approximates fair value	<u>9,364,170</u>	<u>9,281,841</u>
Total investments	97,633,118	98,804,519
Cash and cash equivalents	10,910,363	14,729,289
Accrued interest receivable	505,368	514,629
Receivables, net of allowance for doubtful accounts of \$302,606 in 2006 and 2005	2,138,714	1,718,382
Reinsurance recoverable:		
Unpaid losses	4,037,301	3,896,869
Paid losses	164,118	164,118
Prepaid expenses	158,886	171,559
Deferred income taxes	282,586	370,888
Property & equipment, net	10,852,477	10,874,334
Deferred policy acquisition costs	1,200,467	1,219,209
Other assets	1,073,420	1,294,130
Intangibles	<u>1,920,360</u>	<u>1,920,360</u>
	<u>\$130,877,178</u>	<u>135,678,286</u>
<u>Liabilities & Stockholders' Equity</u>		
Accounts payable	\$ 1,791,012	2,861,329
Reserves for losses and loss adjustment expenses	23,827,728	23,102,777
Unearned premiums	4,836,399	4,998,721
Collateral held	33,754,051	36,508,599
Income tax payable	492,466	282,595
Accrued liabilities	1,481,867	3,051,273
Long-term debt	<u>13,229,368</u>	<u>13,883,988</u>
Total liabilities	79,412,891	84,689,282
Stockholders' Equity:		
Common Stock (No par value; 3,500,000 shares authorized; 510,335 and 510,585 shares issued and outstanding)	510,335	510,585
Class A Stock (No par value; 10,000,000 shares authorized; 1,697,581 and 1,699,848 shares issued and outstanding)	1,697,581	1,699,848
Retained earnings	50,062,923	49,220,834
Accumulated other comprehensive loss	<u>(806,552)</u>	<u>(442,263)</u>
Total stockholders' equity	<u>51,464,287</u>	<u>50,989,004</u>
	<u>\$130,877,178</u>	<u>135,678,286</u>

See Notes to Unaudited Consolidated Financial Statements.

ACMAT CORPORATION AND SUBSIDIARIES
Consolidated Statements of Earnings (Unaudited)
Three Months Ended March 31, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Contract revenues	\$1,713,761	1,405,986
Earned premiums	2,698,805	3,441,737
Investment income, net	1,227,786	951,531
Net realized capital gains (losses)	887	(8,706)
Other income	<u>80,160</u>	<u>162,649</u>
	<u>5,721,399</u>	<u>5,953,197</u>
Cost of contract revenues	1,653,131	1,268,767
Losses and loss adjustment expenses	714,526	1,276,128
Amortization of policy acquisition costs	608,688	739,563
General and administrative expenses	1,197,163	1,256,423
Interest expense	<u>215,006</u>	<u>232,657</u>
	<u>4,388,514</u>	<u>4,773,538</u>
Earnings before income taxes	1,332,885	1,179,659
Income taxes	<u>451,912</u>	<u>407,603</u>
Net earnings	<u>\$880,973</u>	<u>772,056</u>
Basic Earnings Per Share	\$.40	.34
Diluted Earnings Per Share	\$.38	.33

See Notes to Unaudited Consolidated Financial Statements.

ACMAT CORPORATION AND SUBSIDIARIES
Consolidated Statements of Stockholders' Equity (Unaudited)
March 31, 2006 and 2005

	Common Stock par value	Class A Stock par value	Retained earnings	Accumulated other comprehensive income (loss)	Total stockholders' equity
Balance as of December 31, 2004	\$540,329	1,738,478	41,676,900	108,002	44,063,709
Comprehensive income:					
Net unrealized losses on debt and equity securities, net of reclassification	-	-	-	(644,735)	(644,735)
Net unrealized loss on derivatives qualifying as cash flow hedges	-	-	-	(90,519)	(90,519)
Net earnings	-	-	772,056	-	<u>772,056</u>
Total comprehensive income					36,802
Acquisition and retirement of 980 shares of Common Stock	(980)	-	(8,388)	-	(9,368)
Acquisition and retirement of 19,000 shares of Class A Stock	<u>-</u>	<u>(19,000)</u>	<u>(224,390)</u>	<u>-</u>	<u>(243,390)</u>
Balance as of March 31, 2005	<u>\$539,349</u>	<u>1,719,478</u>	<u>42,216,178</u>	<u>(627,252)</u>	<u>43,847,753</u>
Balance as of December 31, 2005	\$510,585	1,699,848	49,220,834	(442,263)	50,989,004
Comprehensive income:					
Net unrealized gains on debt and equity securities	-	-	-	(325,412)	(325,412)
Net unrealized loss on derivatives qualifying as cash flow hedges	-	-	-	(38,877)	(38,877)
Net earnings	-	-	880,973	-	<u>880,973</u>
Total comprehensive income					516,684
Acquisition and retirement of 250 shares of Common Stock	(250)	-	(3,750)	-	(4,000)
Acquisition and retirement of 2,267 shares of Class A Stock	<u>-</u>	<u>(2,267)</u>	<u>(35,134)</u>	<u>-</u>	<u>(37,401)</u>
Balance as of March 31, 2006	<u>\$510,335</u>	<u>1,697,581</u>	<u>50,062,923</u>	<u>(806,552)</u>	<u>51,464,287</u>

See Notes to Unaudited Consolidated Financial Statements.

ACMAT CORPORATION AND SUBSIDIARIES
Consolidated Statements of Cash Flows (Unaudited)
Three Months Ended March 31, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Cash flows from operating activities:		
Net earnings	\$880,973	772,056
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	132,084	140,588
Stock option expense	57,073	--
Net realized capital (gains) losses	(887)	8,706
Deferred income taxes	88,302	(22,525)
Changes in:		
Accrued interest receivable	9,261	(71,657)
Reinsurance recoverable	(140,432)	(169,762)
Receivables, net	(420,332)	930,607
Deferred policy acquisition costs	18,742	346,999
Prepaid expenses and other assets	233,383	3,221,769
Accounts payable and accrued liabilities	(2,600,846)	(812,409)
Cash collateral held	(2,754,548)	546,660
Reserves for losses and loss adjustment expenses	724,951	509,469
Income taxes, net	209,871	389,907
Unearned premiums	<u>(162,322)</u>	<u>(1,286,576)</u>
Net cash provided by (used for) operating activities	<u>(3,724,727)</u>	<u>4,503,832</u>
Cash flows from investing activities:		
Proceeds from investments sold or matured:		
Fixed maturities-matured	3,513,870	3,910,190
Purchases of:		
Fixed maturities	(1,987,324)	(11,591,797)
Equity securities	(750,000)	(1,000,000)
Short-term investments, (purchases) sales, net	(82,329)	6,121,164
Capital expenditures	<u>(92,395)</u>	<u>(65,148)</u>
Net cash (used for) cash provided by investing activities	<u>601,822</u>	<u>(2,625,591)</u>
Cash flows from financing activities:		
Repayments on long-term debt	(654,620)	(624,258)
Payments for acquisition & retirement of stock	<u>(41,401)</u>	<u>(252,758)</u>
Net cash used for financing activities	<u>(696,021)</u>	<u>(877,016)</u>
Net change in cash and cash equivalents	(3,818,926)	1,001,225
Cash and cash equivalents at beginning of period	<u>14,729,289</u>	<u>28,774,539</u>
Cash and cash equivalents at end of period	<u>\$10,910,363</u>	<u>29,775,764</u>

See Notes to Unaudited Consolidated Financial Statements.

ACMAT CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(1) Financial Statements

The consolidated financial statements include the accounts of ACMAT Corporation ("ACMAT" or the "Company") and its subsidiaries. The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and are unaudited.

The interim financial information contained in this report has been prepared from the books and records of the Company and its subsidiaries and reflects, in the opinion of the management of the Company, all adjustments (consisting of normal and recurring accruals) necessary to fairly present results of operations for the periods indicated. All significant intercompany accounts and transactions have been eliminated in consolidation.

These statements should be read in conjunction with the financial statements and notes thereto included in the Company's annual report for the year ended December 31, 2005.

(2) Earnings Per Share

The following is a reconciliation of the numerators and denominators of the basic and diluted earnings per share ("EPS") computations for the three-month periods ended March 31, 2006 and 2005:

<u>2006:</u>	<u>Earnings</u>	<u>Average Shares Outstanding</u>	<u>Per-Share Amount</u>
Basic EPS:			
Earnings available to stockholders	\$880,973	2,208,583	\$.40
Effect of Dilutive Securities:			
Stock options	-----	<u>101,349</u>	
Diluted EPS:			
Earnings available to stockholders	<u>\$880,973</u>	<u>2,309,932</u>	<u>\$.38</u>
<u>2005</u>			
Basic EPS:			
Earnings available to stockholders	\$772,056	2,267,484	\$.34
Effect of Dilutive Securities:			
Stock options	-----	<u>50,837</u>	
Diluted EPS:			
Earnings available to stockholders	<u>\$772,056</u>	<u>2,318,321</u>	<u>\$.33</u>

(3) Supplemental Cash Flow Information

Income tax paid during the three months ended March 31, 2006 and 2005 was \$153,739 and \$40,151, respectively. Interest paid for the three months ended March 31, 2006 and 2005 was \$211,802 and \$229,381, respectively.

(4) Comprehensive Income

The following table summarizes reclassification adjustments for other comprehensive income (loss) and the related tax effects for the three months ended March 31, 2006 and 2005:

	<u>2006</u>	<u>2005</u>
Unrealized gains (losses) on investments:		
Unrealized holding gain (loss) arising during period, net of income tax	\$(324,827)	\$(636,029)
Less reclassification adjustment for gains (losses) included in net earnings, net of income tax expense of \$302 in 2006	(585)	(8,706)
Unrealized loss on derivatives qualifying as cash flow hedges	<u>(38,877)</u>	<u>(90,519)</u>
Other comprehensive income (loss)	<u>\$(364,289)</u>	<u>\$(735,254)</u>

(5) Stock-Based Compensation

The Company periodically grants non-qualified stock options giving such individuals the right to purchase restricted shares of the Company's Common Stock and Class A Stock. The majority of the options outstanding to officers generally vest evenly over a five to ten years. The Company uses a variation of the Black-Scholes option pricing model to value stock options.

Compensation expense of \$57,073 is reflected in net earnings for the first quarter of 2006. The Company applied the recognition and measurement principles of SFAS 123R, Share Based Payment in the first quarter of 2006.

As of March 31, 2006 there were 409,000 stock options outstanding of which 160,465 were not yet vested. The compensation costs related to non-vested share compensation arrangements granted but not yet recognized was approximately \$400,000 as of March 31, 2006. The Company expects to recognize that cost over a weighted average period of 4.1 years.

The pro forma fair value of stock-based compensation in the Company's Class A Shares for the quarter ended March 31, 2005 is as follows:

Net earnings as reported	<u>2005</u> \$772,056
Add: Stock-based employee compensation reported in net earnings, net of related tax effects	---
Deduct: Stock-based compensation expense determined under fair value based method, net of related tax effects	<u>(28,327)</u>
Net earnings, pro forma	<u>\$743,729</u>
Earnings per share	
Basic and diluted – as reported	\$.34/.33
Basic and diluted – pro forma	\$.33/.32

The significant assumptions used during the year in estimating the fair value on the date of the grant for original options and reload options granted in 2005 were as follows:

	<u>2005</u>
Expected life of stock options, in years	6
Expected volatility of ACMAT stock	30%
Risk-free interest rate	4.0
Expected annual dividend yield	---
Expected annual forfeiture rate	---

No options were granted in 2006.

(6) Investments

The Company's portfolio is comprised primarily of fixed maturity securities rated AA or better by Standard and Poor's and includes mostly U.S. Treasuries and tax-free municipal securities.

The Company makes investments in collateralized mortgage obligations (CMOs). CMOs typically have high credit quality, offer good liquidity, and provide a significant advantage in yield and total return compared to U.S. Treasury securities. The Company's investment strategy is to purchase CMO tranches which offer the most favorable return given the risks involved. One significant risk evaluated is prepayment sensitivity. This drives the investment process to generally favor prepayment protected CMO tranches including planned amortization classes and last cash flow tranches. The Company does invest in other types of CMO tranches if a careful assessment indicates a favorable risk/return tradeoff. The Company does not purchase residual interests in CMOs.

An investment in debt or equity security is impaired if its fair value falls below its book value and the decline is considered to be other-than temporary. Factors considered in determining whether a decline is other-than-temporary include the length of time and the extent to which fair value has been below cost, the financial condition and the near-term prospects of the issuer; and the Company's ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery. Additionally, for certain securitized financial assets with contractual cash flows (including asset backed securities), EITF 99-20 requires the Company to periodically update its best estimate of cash flows over the life of the security. If management determines that the fair value of its securitized financial asset is less than its carrying amount and there has been a decrease in the present value of the estimated cash flows since the last revised estimate, considering both timing and amount, then an other-than-temporary impairment charge is recognized. A debt security is impaired if it is probable that the Company will not be able to collect all amounts due under the security's contractual terms. Equity investments are impaired when it becomes apparent that the Company will not recover its cost over the expected holding period and consideration is given to the financial condition of the issue. Further, for securities expected to be sold, an other-than-temporary impairment charge is recognized if the Company does not expect the fair value of a security to recover the cost prior to the expected date of sale.

The Company's process for reviewing invested assets for impairments during any quarter includes the following:

- Identification and evaluation of investments which have possible indications of impairment;
- Analysis of investments with gross unrealized investment losses that have fair value less than 80% of amortized cost during successive quarterly periods over a rolling one-year period;
- Management review of for other-than-temporary impairments based on the investee's current financial condition, liquidity, near term recovery prospects and other factors, as well as consideration of other investments that were not recommended for other-than-temporary impairments;
- Consideration of evidential matter, including an evaluation of factors or triggers that would or could cause individual investments to qualify as having other-than-temporary impairment and those that would not support other-than-temporary impairments;
- Determination of the status of each analyzed investment as other-than-temporary or not.

The gross unrealized investment losses and related fair value for fixed maturities and equity securities at March 31, 2006 and 2005 were as follows:

	<u>Less than 12 months</u>		<u>12 months or longer</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Gross Unrealized Loss</u>	<u>Fair Value</u>	<u>Gross Unrealized Loss</u>	<u>Fair Value</u>	<u>Gross Unrealized Loss</u>
<u>2006:</u>						
Fixed maturities:						
States, municipalities and political subdivisions	---	---	723,315	24,461	723,315	24,461
United States government and government agencies	3,897,148	75,434	4,962,013	135,625	8,859,161	211,059
Mortgage-backed securities	36,459,384	374,298	4,002,555	91,393	40,461,939	465,691
Industrial and miscellaneous	<u>2,019,410</u>	<u>14,872</u>	<u>9,687,489</u>	<u>329,007</u>	<u>11,706,899</u>	<u>343,879</u>
Total fixed maturities	42,375,942	464,604	19,375,372	580,486	61,751,314	1,045,090
Equity securities – common stocks: ---						
Equity securities – redeemable preferred:	1,723,300	26,700	2,842,600	168,800	4,565,900	195,500
Equity securities – perpetual preferred:	---	---	<u>958,000</u>	<u>42,000</u>	<u>958,000</u>	<u>42,000</u>
Total equity	1,723,300	26,700	3,800,600	210,800	5,523,900	237,500
Total temporarily impaired securities	<u>44,099,242</u>	<u>491,304</u>	<u>23,175,972</u>	<u>791,286</u>	<u>67,275,214</u>	<u>1,282,590</u>
<u>2005:</u>						
Fixed maturities:						
States, municipalities and political subdivisions	\$ 207,333	2,214	528,160	15,385	735,493	17,599
United States government and government agencies	7,287,986	116,051	6,302,975	115,594	13,590,961	231,645
Mortgage-backed securities	9,780,081	230,077	3,430,687	30,581	13,210,768	260,658
Industrial and miscellaneous	<u>5,942,900</u>	<u>72,480</u>	<u>5,588,018</u>	<u>211,982</u>	<u>11,530,918</u>	<u>284,462</u>
Total fixed maturities	23,218,300	420,822	15,849,840	373,542	39,068,140	794,364
Equity securities – common stocks:	159,188	25,812	--	--	159,188	25,812
Equity securities – redeemable preferred:	999,920	80	3,735,930	226,570	4,735,850	226,650
Equity securities – perpetual preferred:	---	---	<u>2,549,520</u>	<u>50,480</u>	<u>2,549,520</u>	<u>50,480</u>
Total equity	1,159,108	25,892	6,285,450	277,050	7,444,558	302,942
Total temporarily impaired securities	<u>\$24,377,408</u>	<u>446,714</u>	<u>22,135,290</u>	<u>650,592</u>	<u>46,512,698</u>	<u>1,097,306</u>

Management has determined that the above unrealized losses were temporary

(7) Segment Reporting

The Company had three reportable operating segments: ACMAT Contracting, ACSTAR Bonding and United Coastal Liability Insurance. The Company's reportable segments are primarily the three main legal entities of the Company which offer different products and services. The accounting policies of the segments are the same as those described in the summary of significant accounting policies.

On November 22, 2005, the Company and ACSTAR completed the sale of their shares in United Coastal to Rockhill Holding Company. United Coastal was wholly-owned by ACMAT and ACSTAR.

The Bonding operating segment provides surety bonds written for prime, specialty trade, environmental, asbestos and lead abatement contractors and miscellaneous obligations. ACSTAR also offers commercial and other miscellaneous surety such as workers' compensation bonds, supply bonds, subdivision bonds and license and permit bonds.

ACMAT Contracting provides construction contracting services to commercial and governmental customers. ACMAT Contracting also provides underwriting services to its insurance subsidiaries. In addition, ACMAT Contracting owns a commercial office building in New Britain Connecticut and leases office space to its subsidiaries as well as to third parties.

The United Coastal Liability Insurance operating segment offered specific lines of liability insurance as an approved non-admitted excess and surplus lines insurer in forty-seven states, Puerto Rico, the Virgin Islands and the District of Columbia. United Coastal offered claims made and occurrence policies for specific specialty lines of liability insurance through certain excess and surplus lines brokers who are licensed and regulated by the state insurance department(s) in the state(s) in which they operate. United Coastal offered general liability insurance for a wide range of commercial risks and provides general, asbestos, lead, pollution and professional liability insurance nationwide to specialty trade contractors, environmental contractors, property owner, storage and treatment facilities and professionals. United Coastal also offered products liability insurance to manufacturers and distributors.

The Company evaluates performance based on earnings before income taxes and excluding interest expense. The Company accounts for intersegment revenue and expenses as if the products/services were to third parties. Information relating to the three segments for the three-month periods ended March 31, 2006 and 2005 is summarized as follows:

	<u>2006</u>	<u>2005</u>
Revenues:		
ACSTAR Bonding	\$3,642,361	2,454,088
United Coastal Liability Insurance	--	1,821,342
ACMAT Contracting	<u>2,411,265</u>	<u>2,210,737</u>
	<u>\$6,053,626</u>	<u>6,486,167</u>
Operating Earnings (Loss):		
ACSTAR Bonding	\$1,786,681	1,156,785
United Coastal Liability Insurance	--	294,994
ACMAT Contracting	<u>(238,790)</u>	<u>(39,463)</u>
	<u>\$1,547,891</u>	<u>1,412,316</u>
Depreciation and Amortization:		
ACSTAR Bonding	\$ 4,609	21,523
United Coastal Liability Insurance	---	4,939
ACMAT Contracting	<u>127,475</u>	<u>114,126</u>
	<u>\$132,084</u>	<u>140,588</u>
Identifiable Assets:		<u>December 31, 2005</u>
ACSTAR Bonding	\$ 98,397,436	101,794,119
ACMAT Contracting	<u>32,479,742</u>	<u>33,884,167</u>
	<u>\$130,877,178</u>	<u>135,678,286</u>

The components of revenue for each segment for the three-month periods ended March 31, 2006 and 2005 are as follows:

	<u>2006</u>	<u>2005</u>
ACSTAR Bonding:		
Premiums	\$2,698,805	1,972,283
Investment income, net	941,853	538,635
Capital gains (losses)	887	(8,706)
Other income (expense)	<u>816</u>	<u>48,124</u>
	<u>\$3,642,361</u>	<u>2,454,088</u>
United Coastal Liability Insurance:		
Premiums	\$ --	1,469,454
Investment income, net	--	342,205
Capital gains	--	--
Other	<u>--</u>	<u>9,683</u>
	<u>\$ --</u>	<u>1,821,342</u>
ACMAT Contracting:		
Contract revenues	\$1,713,761	1,405,986
Investment income, net	203,428	9,581
Intersegment revenue:		
Rental income	79,149	242,550
Underwriting services and agency commissions	335,583	453,934
Other	<u>79,344</u>	<u>98,686</u>
	<u>\$2,411,265</u>	<u>2,210,737</u>

The following is a reconciliation of segment totals for revenue and operating income to corresponding amounts in the Company's statement of earnings:

Revenue:	<u>2006</u>	<u>2005</u>
Total revenue for reportable segments	\$6,053,626	6,486,167
Intersegment eliminations	<u>(332,227)</u>	<u>(532,970)</u>
	<u>\$5,721,399</u>	<u>5,953,197</u>

The adjustments and eliminations required to arrive at consolidated amounts shown above consist principally of the elimination of the intersegment revenues related to the performance of certain services and rental charges. Identifiable assets are those assets that are used by each segment's operations.

Operating Earnings:	<u>2006</u>	<u>2005</u>
Total operating earnings for reportable segments	\$1,547,891	1,412,316
Interest expense	<u>(215,006)</u>	<u>(232,657)</u>
	<u>\$1,332,885</u>	<u>1,179,659</u>

Operating earnings for ACMAT contracting are operating revenues less cost of contract revenues and identifiable selling, general and administrative expenses. Operating earnings for the bonding and liability insurance segments are revenues less losses and loss adjustment expenses, amortization of policy acquisition costs and identifiable general and administrative expenses.