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LABRADOR TECHNOLOGIES INC.
2005 ANNUAL REPORT
YEAR ENDED OCTOBER 31, 2005



LABRADOR TECHNOLOGIES INC.

YEAR ENDED OCTOBER 31, 2005

MANAGEMENT'S DISCUSSION & ANALYSIS

The following Management Discussion and Analysis ("MD&A") is prepared in accordance with National Instrument 51-102F1, and should be read in conjunction with the audited financial statements of Labrador Technologies Inc. ("LTI" or the "Company") for the years ended October 31, 2005 and October 31, 2004. Additional information with respect to LTI can be found on the Company's website at www.labradortechnologies.com or on SEDAR at www.sedar.com. The reporting and measurement currency is the Canadian dollar.

Certain statements in the MD&A constitute forward-looking statements that involve various risks and uncertainties. These risks and uncertainties include, but are not restricted to, the Company's continuing ability to promote and license its products, the Company's ability to attract and retain key employees, and the Company's ability to raise capital on acceptable terms when needed. These uncertainties may cause actual results to differ from information contained herein. There can be no assurance that such statements will prove to be accurate. Actual results and future events could differ materially from those anticipated in such statements. These forward-looking statements are based on the estimates and opinions of management on the dates they are made and are expressly qualified in their entirety by this notice.

This MD&A is dated as of February 28, 2006.

Overall Performance

Overview

LTI specializes in developing software applications (such as Labrador eTrieve™), as well as its Labrador® 'embeddable' software components, for distribution in the oil and gas industry, and other such industries with complex database environments. Since 1981, LTI has been developing Data-Flow Management™ (DFM) software for the oil and gas industry.

Three major events for LTI happened in Fiscal 2005: In July, the Company hired Tim Breitreutz as its Chief Technical Officer. On September 30th, LTI's Canadian Petro-LAB non-compete with Qbyte Services (now owned by P2 Energy Solutions) expired. On October 1st, LTI initiated development of Labrador® eTrieve™.

Labrador eTrieve™ is a secure, web-based, generic data retriever, which thrives in complex database environments, such as the oil and gas industry. Importantly, eTrieve™ offers its users the proven strengths of LTI's dynamic Labrador® query back-bone to access the most current data available, with all of the features of the Web 2.0 framework, popularized by Google's™ successes. As a web-based offering, eTrieve™ requires no installation, no CD updates, and no maintenance, while providing comprehensive search, reporting, and exporting – and employing Microsoft's impressive Virtual Earth satellite imagery mapping. eTrieve™ licensing is facilitated with a straight-forward "Click Wrap Agreement."

LTI has already achieved a major advancement with its eTrieve™ product – going well beyond conventional oil and gas web access – to provide wireless data retrieval for proven hand-held devices, such as BlackBerries™, Palm® Treos™, and Microsoft® Windows Mobile™ Smart Phones. Equally importantly for LTI, eTrieve™ puts an exceptionally friendly "face" on the Labrador technology, which is LTI's unique competitive advantage. As eTrieve™ is designed to be generic, it



positions LTI to sell Labrador® into other verticals, such as healthcare, pharmaceuticals, and insurance, all of which have complex database environments.

At October 31, 2005, the Company had cash of \$256,158, no long-term debt, and a working capital balance of \$249,006. Prior to the cash injection from its successful Private Placement completed on February 28th, 2006, the Company had cash of approximately \$5,800, and working capital of \$11,000.

In order to ensure continued operations, LTI had set out to raise additional capital through a private placement of up to 4,000,000 Units at \$0.10 per unit. Each unit consists of one common share and one-half share purchase warrant. As of the date of this MD&A, the company has received subscriptions for all 4,000,000 units, to provide \$400,000 in additional working capital; and \$200,000 of the \$400,000 has already been received. This additional working capital provides the Company with sufficient cash to discharge its obligations in the normal course of operations throughout fiscal 2006. As always, future operations will be dependent upon the successful ongoing development and marketing of the Company's newly, commercially released Labrador® eTrieve™ software service, as well as LTI's Labrador® DFM™ technology, and the corresponding generation of future cash flows and/or raising of additional capital.

Results of Operations

Revenue

Revenue has, historically, been classified into three categories: licensee fees earned from customers and distribution partners for the licensing of LTI's proprietary products; royalty income earned from royalty agreements with third parties; and, consulting fees earned for custom software development. Interest income arises from the investment of excess cash not required for short-term operations.

Revenue from the sale of licenses as well as revenue attributable to undelivered elements, including maintenance and other post-customer support services, is recognized ratably over the contract period. Revenue from consulting services is recognized when the services are performed and/or when earned.

Currently, the Company has no current ongoing sources of revenue, although it launched commercially its Labrador® eTrieve™ software service on February 22nd, 2006.

LTI's total revenue for the year ended October 31, 2005 was \$31,750 compared to \$12,982 for the year ended October 31, 2004, an increase of \$18,768. The revenue for the current year was comprised of \$28,840 of consulting fees and \$2,910 of interest income compared to the previous year when the revenue of \$12,982 was comprised entirely of interest income.

Financial Summary

	2005	2004	2003
Revenues			
License fees	\$ —	\$ —	\$ 3,420
Royalty income	—	—	879,375
Consulting fees	28,840	—	810
Interest income	2,910	12,982	—
	<u>\$ 31,750</u>	<u>\$ 12,982</u>	<u>\$ 883,605</u>
Expenses	670,409	1,221,569	1,867,987
Gain on sale of Petro-LAB	—	1,653,849	—
Net income (loss)	(638,659)	445,262	(984,382)
Net income (loss) per share	(0.07)	0.05	(0.12)
Outstanding shares	11,268,507	8,289,685	8,249,685



For a more detailed explanation of the Gain on sale of Petro-LAB, refer to note 6 of the notes to the year-end financial statements.

Expenses

General and administrative

This category of expenses is comprised primarily of office rent, office equipment rentals, administrative salaries, corporate expenses related to shareholder reporting, and professional fees. General and administrative expenses for the year ended October 31, 2005 were \$347,938 compared to \$598,372 for the year ended October 31, 2004 a decrease of \$250,434. The decrease is due to a reduction in administrative salaries of \$168,979, a reduction in legal fees of \$16,786, a reduction in office equipment rentals of \$13,260, a decrease in office rent of \$13,185, and minor variations in various other accounts.

Computer and related costs

Computer and related costs include programmers' salaries, software costs, and telecommunication costs. This category of expenses totaled \$186,809 for the year ended October 31, 2005 compared to \$401,353 for the year ended October 31, 2004, a decrease of \$214,544. The decrease is due to a reduction of programmers' salaries of \$212,931 and minor variations in various other accounts.

Sales and marketing

Sales and marketing expenses include expenses for sales and support salaries/consulting fees, and promotion/advertising. For the year ended October 31, 2005, sales and marketing expenses were \$94,684 compared to \$192,190 for the year ended October 31, 2004, a decrease of \$97,506. The decrease is due to a reduction in salaries/consulting fees of \$92,493 and minor variations in various other accounts.

Stock-based compensation

LTI issued 385,000 share options to various employees, officers and directors during the year ended October 31, 2005 and 60,000 share options to an employee for the year ended October 31, 2004. Accordingly, stock-based compensation expense of \$19,100 and \$6,700 were recorded for the respective years based on an estimate of the fair value of the options calculated using the Black-Scholes option-pricing model with the following parameters: no dividends; volatility of 60% per annum; a risk free rate of return of 5%; an expected life of 2 to 5 years; and, an exercise price of equal to the market value of the common stock on the date that the options were issued.

Depreciation

Depreciation expense for the year ended October 31, 2005 was \$21,878 compared to \$22,954 for the year ended October 31, 2004. The amount remained consistent as there were no significant additions or dispositions during the year.

Income taxes

The Company uses the asset and liability method of accounting for income taxes. Under this method, future income tax liabilities and future income tax assets are recorded based on temporary differences – the difference between the carrying amount of an asset and liability in the balance sheet and its tax basis using income tax rates enacted at the balance sheet date. The effect of changes in rates on future income tax liabilities and assets is recognized in the period that the change occurs. A valuation allowance is recorded against any future income tax assets if it is more likely than not that the asset will not be realized.

For the current period, LTI's current and future tax liability was \$nil.

Working capital

At October 31, 2005, LTI had cash of \$256,158, no debt, and working capital of \$249,006. The Company has no current sources of ongoing revenue and is relying on future sales to generate additional revenue. As a result, the Company's ability to maintain its operations in the future is dependent on its ability to generate sufficient revenue in the future to continue to fund its strategic business plan. Please refer to "Liquidity & Capital Resources" for current details on the success of LTI's January 24th private placement offering.



Financing and Investing

During the year ended October 31, 2005, the Company's cash position decreased by \$282,537. During the year, the Company raised \$275,000 from the issuance of 2,750,000 units in a private placement to qualified shareholders. Of the 2,750,000 units issued, 500,000 were issued to an Officer and Director of the Company, 250,000 were issued to a Director of the Company, and 100,000 were issued to an Officer of the Company. Please refer to "Liquidity & Capital Resources" for current details on the success of LTI's January 24th private placement offering.

Summary of Quarterly Results

Fiscal 2005	1-QTR	2-QTR	3-QTR	4-QTR
Revenue	30,987	173	590	—
License fees	—	—	—	—
Royalty income	—	—	—	—
Consulting fees	28,840	—	—	—
Interest income	2,147	173	590	—
Expenses	213,464	159,485	147,808	149,652
Net income (loss)	(182,477)	(159,312)	(147,218)	(149,652)
Net income (loss) per share	(0.02)	(0.02)	(0.02)	(0.01)
Outstanding shares	8,289,685	8,329,685	8,378,506	11,268,507

Fiscal 2004	1-QTR	2-QTR	3-QTR	4-QTR
Revenue	—	—	—	—
License fees	—	—	—	—
Royalty income	—	—	—	—
Consulting fees	—	—	—	—
Interest income	—	—	3,084	9,898
Expenses	337,554	343,462	284,413	256,140
Income (loss) before the following	(337,554)	(343,462)	(281,329)	(246,242)
Other income: gain on sale of Petro-LAB	1,653,849	—	—	—
Net income (loss)	1,316,295	(343,462)	(281,329)	(246,242)
Net income (loss) per share	0.16	(0.04)	(0.03)	(0.03)
Outstanding shares	8,249,685	8,249,685	8,289,685	8,289,685

Fiscal 2003	1-QTR	2-QTR	3-QTR	4-QTR
Revenue	383,497	81,313	220,670	198,125
License fees	—	—	—	3,420
Royalty income	382,687	81,313	220,670	194,705
Consulting fees	810	—	—	—
Interest income	—	—	—	—
Expenses	484,108	446,871	417,450	519,558
Net income (loss)	(100,611)	(365,558)	(196,780)	(321,433)
Net income (loss) per share	(0.01)	(0.04)	(0.02)	(0.04)
Outstanding shares	8,549,685	8,549,685	8,549,685	8,249,685

* The quarterly results have been restated for stock-based compensation where applicable.



Liquidity and Capital Resources

As at the date of the MD&A, February 28, 2006, the Company's cash position had been reduced to approximately \$5,800 with a corresponding working capital of \$11,000. In anticipation of same, the Company had undertaken to raise additional funds through the private placement of up to 4,000,000 units at \$0.10 per unit. As of the date of this MD&A, the Company has signed subscriptions for the full amount of the 4,000,000 units and has received \$200,000 of the \$400,000 of proceeds to the Company. The Company has no current sources of ongoing revenue and is relying on future sales to generate additional revenue. As a result, the Company's ability to maintain its operations in the future is dependent on its ability to generate sufficient cash in the future.

LTI has two contractual obligations: an operating lease for a vehicle supplied to an officer of the Company; and, an operating lease for office space. The vehicle lease is for a two-year term ending July 2006 and has a monthly cost of \$1,043 (including GST). The office space lease is for a one-year term ending August 2006 and has a monthly cost of \$8,440 (including GST). LTI has prepaid \$7,352 of the August 2006 lease cost.

Financial Instruments

At October 31, 2005, LTI had \$100,000 invested in a one year prime-linked cashable GIC with the Royal Bank of Canada with an interest rate of 2.0% per annum. The GIC was redeemed on January 9, 2006 with net interest to the Company of \$1,783.56. As a result, it is management's opinion that the Company is not exposed to any interest, currency or credit risks.

From time to time, LTI may invest excess cash in short-term low-risk interest bearing instruments such as Guaranteed Investment Certificates ("GIC"). It is management's opinion that the Company is not exposed to any interest, currency or credit risk arising from this particular financial instrument and that the fair value is equal to the carrying value.

Off-balance Sheet Arrangements

As of the date of this MD&A, LTI has no off-balance sheet arrangements.

Related Party Transactions

As of the date of this MD&A, the only related party transaction is the sale of shares to insiders through the private placement of 2,750,000 units of the Company.

Proposed Transactions

As of the date of this MD&A, the only proposed transaction is the private placement of 4,000,000 Units at \$0.10 per Unit, announced on January 24, 2006 and expected to close on or about February 28, 2006. Each Unit of the private placement consists of one common share and one-half share purchase warrant. One whole share purchase warrant entitles the holder to purchase one common share of the Company at \$0.20 per share for one year from the closing date of the private placement.

Changes in Accounting Policies

Effective November 1, 2002, the Company adopted the new Canadian accounting standard relating to stock-based compensation. Under this standard, the Company followed the settlement method of accounting for stock options granted to employees whereby the proceeds received on the exercise of options were included in capital stock and no compensation expense was recognized. For stock-based compensation to non-employees, the Company calculated a fair value using an option-pricing model, and recorded the expense to earnings over the term of the option.

In September 2003, the CICA issued an amendment to Section 3870 – Stock Based Compensation and Other Stock Based Payments. The amended section is effective for fiscal years beginning on or



after January 1, 2004. The amendment requires that all companies measure any stock based payments using the fair value method of accounting and recognize the compensation expense in the financial statements. The Company implemented this amendment beginning with the current financial year beginning November 1, 2004. As a result, the Company is required to restate the financial results from the previous year to comply with the amended policy for comparison purposes. As a result of this requirement, the Company's Deficit and Contributed Surplus at November 1 2004 was increased by \$24,620, and increased by \$17,920 as at November 1, 2003.

Subsequent Events

On January 24, 2006, the Corporation announced a private placement of 4,000,000 units of the Corporation at \$0.10 per unit to be closed on or before February 28, 2006. Each unit consists of one common share and one-half share purchase warrant. One whole share purchase warrant entitles the holder to purchase one common share of the Corporation at \$0.20 per share. The warrants expire one year from the closing date of the private placement. As at February 28, 2006 the Corporation had received signed subscription agreements for the entire private placement of 4,000,000 Units and had received \$200,000 of the \$400,000 of proceeds to the Company. Of the 4,000,000 units subscribed for, 500,000 units were from an Officer and Director of the Company and 500,000 units were from a Director of the Company.

Outstanding Share Data

On October 28, 2003, LTI cancelled 300,000 shares issued to a previous employee. The shares were pledged as collateral for an indebtedness and were repossessed and cancelled in settlement of the indebtedness. After the cancellation, LTI had 8,249,685 shares outstanding.

On March 26, 2004, LTI issued 40,000 shares upon the exercise of stock options for the amount of \$6,400. After the issue of shares, LTI had 8,289,685 shares outstanding.

On March 22, 2005, LTI issued 40,000 shares upon the exercise of stock options for the amount of \$4,800. After the issue of shares, LTI had 8,329,685 shares outstanding.

On June 8, 2005, LTI issued 100,000 share options to an employee of the Company.

On June 30, 2005, LTI issued 22,154 shares to an employee of the Company in lieu of salary. After the issue of shares, LTI had 8,351,839 shares outstanding.

On July 31, 2005, LTI issued 26,667 shares to an employee of the Company in lieu of salary. After the issue of shares, LTI had 8,378,506 shares outstanding.

On August 17, 2005, LTI issued 2,750,000 shares in a private placement. After the issue of shares, LTI had 11,128,506 shares outstanding.

On August 31, 2005 LTI issued 26,667 shares to an employee in lieu of salary and 20,000 shares to a consultant in lieu of consulting fees. After the issue of shares, LTI had 11,175,173 shares outstanding.

On September 31, 2005 LTI issued 26,667 shares to an employee in lieu of salary and 20,000 shares to a consultant in lieu of consulting fees. After the issue of shares, LTI had 11,221,840 shares outstanding.

On October 31, 2005 LTI issued 26,667 shares to an employee in lieu of salary and 20,000 shares to a consultant in lieu of consulting fees. After the issue of shares, LTI had 11,268,507 shares outstanding.

On November 30, 2005 LTI issued 26,667 shares to an employee in lieu of salary and 20,000 shares to a consultant in lieu of consulting fees. After the issue of shares, LTI had 11,315,174 shares outstanding. As at



On December 31, 2005 LTI issued 66,667 shares to an employee in lieu of salary and 20,000 shares to a consultant in lieu of consulting fees. After the issue of shares, LTI had 11,401,841 shares outstanding.

On January 31, 2006 LTI issued 66,667 shares to an employee in lieu of salary and 20,000 shares to a consultant in lieu of consulting fees. After the issue of shares, LTI had 11,488,508 shares outstanding.

As of February 28, 2006, LTI had 11,488,508 common shares and 720,000 options to acquire common shares outstanding.

Subsequent Events

On January 24, 2006, the Corporation announced a private placement of 4,000,000 Units of the Corporation at \$0.10 per Unit to be closed on or before February 28, 2006. Each Unit consists of one common share and one-half share purchase warrant. One whole share purchase warrant entitles the holder to purchase one common share of the Corporation at \$0.20 per share. The warrants expire one year from the closing date of the private placement. As at February 28, 2006 the Corporation had received subscription agreements for the entire private placement of 4,000,000 Units.

H. Ronald Sterne

Darryl K. Stackhouse

(x "signed")

(x "signed")

President & Chief Executive Officer
Labrador Technologies Inc.

Chief Financial Officer
Labrador Technologies Inc.

kpmg

Financial Statements of

LABRADOR TECHNOLOGIES INC.

Years ended October 31, 2005 and 2004



KPMG LLP
Chartered Accountants
1200-205 5 Avenue SW
Calgary AB T2P 4B9

Telephone (403) 691-8000
Telefax (403) 691-8008
www.kpmg.ca

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the balance sheets of Labrador Technologies Inc. as at October 31, 2005 and 2004 and the statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Corporation as at October 31, 2005 and 2004 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants

Calgary, Canada
February 28, 2006

LABRADOR TECHNOLOGIES INC.

Balance Sheets

October 31, 2005 and 2004

	2005	2004
		(Restated – note 3)
Assets		
Current assets:		
Cash and cash equivalents	\$ 256,158	\$ 538,695
Accounts receivable	–	7,000
Prepaid expenses	7,352	32,949
	263,510	578,644
Property and equipment (note 4)	44,304	53,612
	\$ 307,814	\$ 632,256
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 14,504	\$ 21,511
Shareholders' equity:		
Common shares (note 5)	5,179,908	4,909,284
Share purchase warrants (note 5)	31,500	–
Contributed surplus (notes 3 and 5)	227,814	208,714
Deficit	(5,145,912)	(4,507,253)
	293,310	610,745
Going concern (note 1)		
Commitments (note 9)		
Subsequent events (notes 1, 5 and 11)		
	\$ 307,814	\$ 632,256

See accompanying notes to financial statements.

On behalf of the Board:

“signed”
H. Ronald Sterne
Director

“signed”
Jeffrey A. Howe
Director

LABRADOR TECHNOLOGIES INC.

Statements of Operations and Deficit

Years ended October 31, 2005 and 2004

	2005	2004 (Restated - note 3)
Revenues:		
Consulting fees	\$ 28,840	\$ —
Interest income	2,910	12,982
	31,750	12,982
Expenses:		
General and administration	347,938	598,372
Computer and related costs	186,809	401,353
Sales and marketing	94,684	192,190
Depreciation	21,878	22,954
Stock-based compensation (notes 3 and 5)	19,100	6,700
	670,409	1,221,569
Loss before the following	(638,659)	(1,208,587)
Other income:		
Gain on the sale of Petro-LAB™ (note 6)	—	1,653,849
Net income (loss)	(638,659)	445,262
Deficit, at beginning of year, as previously reported	(4,482,633)	(4,934,595)
Change in accounting policy (note 3)	(24,620)	(17,920)
As restated	(4,507,253)	(4,952,515)
Deficit, at end of year	<u>\$(5,145,912)</u>	<u>\$(4,507,253)</u>
Net income (loss) per share (note 5):		
Basic and diluted	\$ (0.07)	\$ 0.05

See accompanying notes to financial statements.

LABRADOR TECHNOLOGIES INC.

Statements of Cash Flows

Years ended October 31, 2005 and 2004

	2005	2004
		(Restated - note 3)
Cash provided by (used in):		
Operating activities:		
Net income (loss)	\$ (638,659)	\$ 445,262
Items not involving cash:		
Gain on sale of Petro-LAB	—	(1,653,849)
Depreciation	21,878	22,954
Stock-based compensation	19,100	6,700
Shares for services performed	22,324	—
	(575,357)	(1,178,933)
Changes in non-cash working capital (note 8)	25,590	46,421
	(549,767)	(1,132,512)
Investing activities:		
Property and equipment	(12,570)	(15,656)
Proceeds on the sale of Petro-LAB™	—	1,591,038
	(12,570)	1,575,382
Financing activities:		
Proceeds from the sale of shares and warrants	275,000	—
Proceeds from the exercise of options	4,800	6,400
	279,800	6,400
Increase (decrease) in cash and cash equivalents	(282,537)	449,270
Cash and cash equivalents, beginning of year	538,695	89,425
Cash and cash equivalents, end of year	\$ 256,158	\$ 538,695

See accompanying notes to financial statements.

LABRADOR TECHNOLOGIES INC.

Notes to Financial Statements

Years ended October 31, 2005 and 2004

Labrador Technologies Inc. (the "Corporation") is engaged in the research and development and marketing of data retrieval technology for customers.

1. Going concern:

These financial statements have been prepared on the basis of accounting principles applicable to a going concern, which assume that the Corporation will continue in operation throughout fiscal 2006 and will be able to realize its assets and discharge its obligations in the normal course of operations.

The Corporation's ability to maintain its current level of operations is dependent on its ability to generate sufficient cash to fund its strategic business plan. To date, the Corporation has no ongoing source of revenue. At October 31, 2005 the Corporation had cash of \$256,158, no long-term debt, an accumulated deficit of \$5,145,912 and a working capital balance of \$249,006. During the year ended October 31, 2005 the Corporation incurred a net loss totaling \$638,659 and utilized funds from operations totaling \$575,357. At February 28, 2006, the Corporation's cash position is estimated to be approximately \$5,800 with a corresponding working capital balance of approximately \$11,000. On January 24, 2006 the Corporation announced a private placement of up to 4,000,000 Units at \$0.10 per Unit for proceeds of \$400,000. Each Unit consists of one common share and one-half share purchase warrant with each whole warrant exercisable at a price of \$0.20 per common share, for a period of 12 months following the closing date of the private placement. As at February 28, 2006, the Corporation had received signed subscriptions for the entire private placement of 4,000,000 Units and had received \$200,000 of the \$400,000 of proceeds to the Corporation from the private placement. Based on the Corporation's current level of expenditures, the Corporation estimates that it has enough cash to continue the current operations throughout fiscal 2006. Management and the Board of Directors continue to review alternatives to develop ongoing sources of revenue.

While management believes that the Corporation has sufficient cash to discharge its obligations in the normal course of operations through this fiscal year, future operations will regardless be dependent upon the successful ongoing development and marketing of the Corporation's data retrieval technology and the corresponding generation of future cash flows. Management believes the going concern assumption is appropriate for these financial statements. If the going concern assumption were not appropriate for these financial statements, then adjustments might be necessary to the carrying value of assets and liabilities, reported revenues and expenses and the balance sheet classifications used.

2. Significant accounting policies:

The financial statements of the Corporation have been prepared by management in accordance with Canadian generally accepted accounting principles. In the preparation of these financial statements, management has made estimates and assumptions that affect the recorded amounts of certain of the Corporation's assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities. While it is the opinion of management that these financial statements have been properly prepared within reasonable limits of materiality and within the framework of the significant accounting policies summarized below, actual results could differ from the estimates made.

(a) Revenue recognition:

Revenue from the sale of licenses as well as revenue attributable to undelivered elements, including maintenance and other post-customer support services, is recognized ratably over the contract period. Revenue from consulting services is recognized when the services are performed and/or when earned.

(b) Property and equipment:

Property and equipment are recorded at cost upon acquisition. Depreciation is provided annually over the estimated useful lives of the assets as follows:

Asset	Basis	Rate
Computer equipment	Declining balance	30%
Furniture and equipment	Declining balance	20%
Purchased computer software	Declining balance	50%
Leasehold improvements	Straight line	2 years

(c) Per share amounts:

Basic net income (loss) per share is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted per share amounts reflect the potential dilution that could occur if securities or other contracts to issue common shares were exercised or converted to common shares. The treasury stock method is used to determine the dilutive effect of stock options, warrants and other dilutive instruments.

(d) Income taxes:

The Corporation uses the asset and liability method of accounting for income taxes (see note 7). Under this method, future income tax liabilities and future income tax assets are recorded based on temporary differences – the difference between the carrying amount of an asset and liability in the balance sheet and its tax basis using income tax rates enacted at the balance sheet date. The effect of changes in rates on future income tax liabilities and assets is recognized in the period that the change occurs. A valuation allowance is recorded against any future income tax assets if it is more likely than not that the asset will not be realized.

3. Change in accounting policies – stock-based compensation:

Effective November 1, 2004, the Corporation retroactively adopted the amended standard with respect to stock-based compensation, which requires the use of the fair value method for valuing all stock options granted whether they be to employees, directors or non-employees. As a result of adopting this amended standard, the Corporation recognized an expense for all options granted from November 1, 2002. As such, stock-based compensation expense totalling \$6,700 was recorded for 2004 and \$17,920 was recorded for prior years. The deficit and contributed surplus were increased by \$24,620 as at November 1, 2004 and increased by \$17,920 as at November 1, 2003.

4. Property and equipment:

2005	Cost	Accumulated depreciation	Net book value
Computer equipment	\$ 474,228	\$ 448,640	\$ 25,588
Furniture and equipment	182,092	170,733	11,359
Purchased computer software	300,114	292,757	7,357
Leasehold improvements	80,306	80,306	–
	<u>\$ 1,036,740</u>	<u>\$ 992,436</u>	<u>\$ 44,304</u>
2004			
Computer equipment	\$ 463,690	\$ 437,673	\$ 26,017
Furniture and equipment	182,092	167,894	14,198
Purchased computer software	298,082	286,415	11,667
Leasehold improvements	80,306	78,576	1,730
	<u>\$ 1,024,170</u>	<u>\$ 970,558</u>	<u>\$ 53,612</u>

5. Share capital:

(a) Authorized:

Unlimited preferred shares, Series A and Series B; and

Unlimited common shares.

(b) Common shares issued:

Common shares	2005		2004	
	Number of shares	Amount	Number of shares	Amount
Balance, beginning of year	8,289,685	\$ 4,909,284	8,249,685	\$ 4,902,884
Exercise of options	40,000	4,800	40,000	6,400
Sale of units	2,750,000	243,500	—	—
Shares for services performed	188,822	22,324	—	—
Balance, end of year	11,268,507	\$ 5,179,908	8,289,685	\$ 4,909,284

During the year ended October 31, 2005, the Corporation completed a private placement of 2,750,000 units at a price of \$0.10 per unit. Each unit consists of one common share and one-half share purchase warrant. Of the 2,750,000 units issued under the private placement, 500,000 units were issued to an Officer and a Director of the Corporation, 250,000 units were issued to a Director of the Corporation and 100,000 units were issued to an Officer of the Corporation. Of the proceeds raised totaling \$275,000, \$243,500 was allocated to common share capital and \$31,500 was allocated to share purchase warrants.

From October 31, 2005 to February 28, 2006, an additional 220,001 common shares for services performed have been issued to an employee and to a consultant of the Corporation at prices ranging from \$0.06 to \$0.15 per share. Based on the existing one year service agreements, the Corporation will continue to issue 106,667 common shares for services performed every month, until the contracts expire, or are renegotiated.

5. Share capital (continued):

(c) Share purchase warrants issued:

Common shares	2005		2004	
	Number of shares	Amount	Number of shares	Amount
Balance, beginning of year	–	\$ –	–	\$ –
Sale of units	1,375,000	31,500	–	–
Balance, end of year	1,375,000	\$ 31,500	–	\$ –

One whole share purchase warrant entitles the holder to purchase one common share of the Corporation at \$0.20 per share. The warrants expire one year from the closing date of the private placement. The value of these warrants was estimated using the Black-Scholes options-pricing model using the assumptions described in note 5(e) resulting in a weighted average warrant value of approximately \$0.02 per warrant..

(d) Stock option plan:

The Corporation has a stock option plan for its directors, officers and employees. Details of the stock options outstanding under this plan were as follows:

	Number	Exercise price	Weighted average exercise price
Outstanding at October 31, 2003	744,969	\$ 0.12 – 0.35	\$ 0.28
Granted	60,000	0.20	0.20
Exercised	(40,000)	0.16	0.16
Cancelled	(234,969)	0.16 – 0.20	0.19
Outstanding at October 31, 2004	530,000	0.12 – 0.35	0.32
Granted	385,000	0.10 - 0.12	0.11
Expired	(40,000)	0.16	0.16
Exercised	(40,000)	0.12	0.12
Cancelled	(115,000)	0.12 – 0.35	0.29
Outstanding at October 31, 2005	720,000	\$ 0.10 – 0.35	\$ 0.23

5. Share capital (continued):

(d) Stock option plan (continued):

Exercise price	Exercisable and outstanding at October 31, 2005	Weighted
		average remaining contractual life (months)
\$ 0.10	100,000	55
0.12	215,000	13
0.12	40,000	31
0.35	325,000	14
0.35	40,000	17
	720,000	21

(e) Stock-based compensation:

During the year, 385,000 (2004 – 60,000) share options were granted to employees, officer and directors of the Corporation. All of the 385,000 share options vested immediately. Accordingly, stock-based compensation expense has been recorded for the year based on an estimate of the fair value of the options.

The fair value of stock options granted during the years ended October 31 were estimated using the Black-Scholes option-pricing model with the following assumptions:

	2005	2004
Dividend yield	0%	0%
Expected volatility	60%	60%
Risk free rate of return	5%	5%
Expected option life	2 – 5 years	5 years
Weighted average option value	\$ 0.05	\$ 0.11

(f) Contributed surplus:

	2005	2004
Beginning of year	\$ 208,714	\$ 202,014
Stock-based compensation	19,100	6,700
End of year	\$ 227,814	\$ 208,714

5. Share capital (continued):

(g) Per share amounts:

The weighted average number of common shares outstanding during the year ended October 31, 2005 was 8,993,557 (2004 – 8,273,018).

There is no dilutive effect from the options and warrants for the year ended October 31, 2005 (2004 – nil).

6. Gain on sale of Petro-LAB™:

On December 18, 2003 the Corporation entered into an agreement to terminate its royalty agreement with the purchaser of the Petro-LAB™ software resulting in the Corporation receiving a final cash payment, including adjustments, of approximately \$1,591,000 and the settlement of accounts payable and accrued liabilities totaling approximately \$63,000. As a result, a total gain on termination of the agreement and royalty payments of approximately \$1,654,000 was recorded in fiscal 2004. As such, the Corporation will receive no further royalty payments from the purchaser of the Petro-LAB™ software.

7. Income taxes:

Total income taxes are different from the amount computed by applying the combined expected Canadian Federal and Provincial tax rate of 34% (2004 – 35%) to income before income taxes and other items. The reasons for the difference are as follows:

	2005	2004
Computed expected tax (recovery)	\$ (215,000)	\$ 153,000
Add (deduct) the following:		
Non-deductible expenses	12,000	9,000
Net increase in valuation allowance	131,000	(162,000)
Impact of future tax rate on future tax assets	72,000	–
	\$ –	\$ –

7. Income taxes (continued):

The components of the future income tax assets and liabilities at October 31, 2005 is as follows:

	2005	2004
Future income tax assets:		
Non-capital losses	\$ 1,568,000	\$ 1,438,000
Capital assets	41,000	40,000
	1,609,000	1,478,000
Less valuation allowance	(1,609,000)	(1,478,000)
Net future income tax asset (liability)	\$ -	\$ -

As at October 31, 2005, the Corporation has investment tax credit carry-forwards of approximately \$363,000 (2004 - \$363,000) that may be used to offset federal taxes payable in future years. These investment tax credits expire in the years 2007 to 2010. As at October 31, 2005, the Corporation has federal non-capital losses totalling approximately \$4,550,000, and Alberta non-capital losses totalling approximately \$4,885,000, which expire in the years 2007 to 2015. The potential income tax benefit arising from these amounts has not been reflected in these financial statements.

8. Supplemental cash flow disclosure:

Changes in non-cash working capital are as follows:

	2005	2004
Accounts receivable	\$ 7,000	\$ 112,684
Prepaid expenses	25,597	2,647
Accounts payable and accrued liabilities	(7,007)	(68,910)
	\$ 25,590	\$ 46,421

9. Commitments:

The Corporation has leases on its premises and certain computer and office equipment, which expire through 2006. Minimum annual payments under the leases are approximately as follows:

2006	\$ 84,000
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10. Fair values:

As at October 31, 2005 and 2004, the fair values of the Corporation's monetary assets and liabilities approximated their carrying values.

11. Subsequent event:

On January 24, 2006, the Corporation announced a private placement of 4,000,000 Units of the Corporation at \$0.10 per Unit to be closed on or before February 28, 2006. Each Unit consists of one common share and one-half share purchase warrant. One whole share purchase warrant entitles the holder to purchase one common share of the Corporation at \$0.20 per share. The warrants expire one year from the closing date of the private placement. As at February 28, 2006, the Corporation had received signed subscriptions for the entire private placement of 4,000,000 Units and had received \$200,000 of the \$400,000 of proceeds to the Corporation from the private placement. Of the subscription agreements signed, 1,000,000 Units were with directors and/or officers of the Corporation.