

**LABRADOR TECHNOLOGIES INC.**

**2006 ANNUAL REPORT**

**YEAR ENDED OCTOBER 31, 2006**

# **LABRADOR TECHNOLOGIES INC.**

**YEAR ENDED OCTOBER 31, 2006**

## **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 "Corporation") for the years ended October 31, 2006 and 2005. Additional information with respect to LTI can be found on the Corporation's website at [www.labradortechnologies.com](http://www.labradortechnologies.com) or on SEDAR at [www.sedar.com](http://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 Corporation's continuing ability to promote and license its products, the Corporation's ability to attract and retain key employees, and the Corporation'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 14th, 2007.

### **Overall Performance**

#### **CEO's REPORT TO SHAREHOLDERS**

##### **Words Versus Revenue**

In an effort to keep our shareholders apprised of ongoing developments, management has provided a detailed account of ongoing developments, as best exemplified by the CEO's 3<sup>rd</sup> Quarter Report to Shareholders. However, as a technology company, much of the previous content references management's business philosophy, technical aspirations and milestones, but management is well aware that words will not get the job done – only revenue can re-establish the Corporation firmly on the corporate landscape.

##### **Our 27<sup>th</sup> Year**

In this our 27<sup>th</sup> year, Labrador® eTrierer™ is our fifth major product. Before it, PHD®, IDEA™, Petro-LAB™, and the Labrador® Tools™ have all had varying degrees of success. Not only are we able to draw upon the experience gained from these previous successes, but also the infrastructure from the re-engineered Labrador Tools is being integrated into eTrierer to make it, in management's view, by far the best product in the Corporation's history. LTI has adopted the web's new platform at a time when the internet has finally proven itself worthy of the biggest companies in the world.

## **Calgary**

Calgary is Canada's most booming economy, and is, probably, No. 1 in North America. Many stories have been written about the labour shortage, and the difficulties that companies are having hiring able personnel. In this regard, in the past year, the Company had doubled its staff from four to eight, and still managed to keep the burn-rate under control. The attraction to LTI is multi-faceted, including Labrador®, as above, the quality of a team-oriented working environment, and a proven, yet leading-edge development environment, which provides the Corporation with a competitive advantage.

## **eTrieve and Commonsense**

The going has been slower than expected to release eTrieve into Calgary's marketplace. As a result, LTI has been reluctant to aggressively market eTrieve until the research that is being routinely undertaken proves that eTrieve has enough "meat on its bones", such that oil & gas related companies can use it to make informed decisions. One shareholder remarked in a recent e-mail..."I would start with getting a customer, and go from there." The Corporation acknowledges the validity of this commonsensical feedback, and will continue to execute its game-plan accordingly.

## **Experience and Resolve**

Having the foregoing top-of-mind, the Corporation has raised additional capital, as evidenced in closing the first tranche of its existing Private Placement at 45 cents a share. Our recent release of eTrieve, allowing users to "toggle" back and forth between Google® Map and Microsoft®'s Virtual Earth, to glean the best satellite imagery available, is part of a dedicated process to get it "right" before asking the market to put up hard dollars for proven technology. Stocks, based on technology are back, for a renewed re-evaluation, as other corrections take place in corporate valuations. Management will do whatever is necessary, including take whatever time is required, to ensure that Labrador eTrieve is ready and able to establish itself as a force in the market-place. Twenty-six previous years of experience provide us with valuable insight.

## **Results of Operations**

At October 31, 2006, the Corporation had cash of \$347,536, no long-term debt, and a working capital balance of \$342,054.

During the year ended on October 31, 2006, the Corporation completed two private placements for proceeds of \$635,050. In addition, warrants exercised during the year generated an additional \$230,000. In fiscal 2007, in addition to any capital raised from any new financings, there are 2,000,000 share purchase warrants exercisable at \$0.20 expiring on March 2, 2007 and 335,785 share purchase warrants exercisable at \$0.45 expiring on August 2, 2007. Each share purchase warrant is exercisable into one common share. Future operations will be dependent upon the successful ongoing development and marketing of the Corporation's data retrieval technology, and the corresponding generation of future cash flows and/or raising of additional capital.

## **Revenue**

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

LTI had interest income of \$3,238 compared to \$2,910 for 2005. In 2005, the Corporation earned \$28,840 in consulting revenue.

## Financial Summary

	2006	2005	2004
Revenues			
Consulting fees	—	28,840	—
Interest income	3,238	2,910	12,982
	<u>\$ 3,238</u>	<u>\$ 31,750</u>	<u>\$ 12,982</u>
Expenses	931,570	670,409	1,221,569
Gain on sale of Petro-LAB	—	—	1,653,849
Net income (loss)	(928,332)	(638,659)	445,262
Net income (loss) per share	(0.06)	(0.07)	0.05
Outstanding shares	17,863,347	11,268,507	8,289,685

For a more detailed explanation of the Gain on sale of Petro-LAB, refer to note 6 of the 2005 year-end financial statements.

### Expenses

#### General and administration

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 administration expenses for the current year were \$492,713 compared to \$347,938 for 2005, an increase of \$144,775. The difference is primarily attributed to increases in administrative salaries of \$108,865, travel and promotion of \$9,666, office miscellaneous expenses of \$5,001, and office rent of \$5,798.

#### Computer and related costs

Computer and related costs include programmers' salaries, software costs, and telecommunication costs. This category of expenses totaled \$288,705 for the year compared to \$186,809 for 2005, an increase of \$101,896. The increase is due primarily to the addition of personnel and corresponding salaries/consulting fees.

#### Sales and marketing

Sales and marketing expenses include expenses for sales and support salaries/consulting fees, and promotion/advertising. For the year, sales and marketing expenses were \$87,366 compared to \$94,684 for 2005, a decrease of \$7,318. The decrease is due to a reduction in salaries/consulting fees of \$32,018, offset by an increase in miscellaneous expenses of \$15,449 and variations in various other accounts.

#### Stock-based compensation

LTI issued 950,000 share options to various employees, officers and directors during the year compared to 385,000 share options issued in 2005. Stock-based compensation expense of \$44,700 and \$19,100 was recorded for 2006 and 2005, respectively, based on an estimate of the fair value of the options calculated using the Black-Scholes option-pricing model.

#### Depreciation

Depreciation expense for the year was \$18,087 compared to \$21,878 for 2005. The amount remained consistent as there were no significant additions or dispositions during the year.

#### Working capital

At year end, LTI had cash of \$347,536, no debt, and working capital of \$342,054. The Corporation has no current sources of ongoing revenue and is relying on future sales to generate additional revenue. As a result, the Corporation's ability to maintain its operations in the future is dependent on its ability to generate sufficient revenue, and/or raise sufficient capital, in the future to continue to fund its strategic business plan.

Please refer to "Subsequent Events" for current details on LTI's February 5, 2007 private placement announcement.

### Financing and Investing

During the year, the Corporation's cash position increased by \$91,378 from the previous year end. The Corporation completed two private placements in 2006 for proceeds of \$635,050 and warrants exercised during the year generated an additional \$230,000. In fiscal 2007, in addition to any capital raised from any new financings, there are 2,000,000 share purchase warrants exercisable at \$0.20 expiring on March 2, 2007 and 335,785 share purchase warrants exercisable at \$0.45 expiring on August 2, 2007. Each share purchase warrant is exercisable into one common share. Please refer to the 'Subsequent Events' for details on the closing of the private placement announced on the 5<sup>th</sup> of February, 2007.

### Summary of Quarterly Results

Fiscal 2006	1-QTR	2-QTR	3-QTR	4-QTR
Revenue	1,784	—	—	1,454
Interest income	1,784	—	—	1,454
Expenses	190,768	292,541	243,308	204,953
Net loss	(188,984)	(292,541)	(243,308)	(203,499)
Net loss per share	(0.02)	(0.02)	(0.02)	(0.01)
Outstanding shares	11,488,508	15,794,678	16,594,016	17,863,347

Fiscal 2005	1-QTR	2-QTR	3-QTR	4-QTR
Revenue	30,987	173	590	—
Consulting fees	28,840	—	—	—
Interest income	2,147	173	590	—
Expenses	213,464	159,485	147,808	149,652
Net loss	(182,477)	(159,312)	(147,218)	(149,652)
Net 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

### Liquidity and Capital Resources

As at the date of the MD&A, LTI had cash of \$258,806, no debt and working capital of \$253,324. In addition to any capital raised from any new financings, there are 2,000,000 share purchase warrants exercisable at \$0.20 expiring on March 2, 2007 and 335,785 share purchase warrants exercisable at \$0.45 expiring on August 2, 2007. The Corporation has no current sources of ongoing revenue and is relying on future sales to generate additional revenue. As a result, the Corporation's ability to maintain its operations in the future is dependent on its ability to generate sufficient cash in the future.

As at the date of the MD&A, LTI has two contractual obligations: an operating lease for office space and, subsequent to October 31, 2006, a lease for a vehicle supplied to an officer of the Corporation. The office space lease is for a three-year term ending August 2009 and has a monthly cost of \$8,560. LTI has prepaid \$7,352 of the August 2009 lease cost. The vehicle lease is for a three-year term ending January 2010 and has a monthly cost of \$491.

### Financial Instruments

As of October 31, 2006, LTI had \$100,000 on deposit in a one year cashable GIC with the Royal Bank of Canada with an interest rate at prime. It is management's opinion that the Corporation 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.

## **Related Party Transactions**

Of the 1,150,000 warrants exercised, 375,000 units were exercised by directors and/or officers of the Corporation. During the year ended October 31, 2006, \$20,000 in consulting fees were paid to a director of the Corporation. This was measured at the exchange amount.

## **Outstanding Share Data**

As of August 31, 2006 LTI had 17,760,406 common shares, 2,335,785 warrants and 1,480,000 options to acquire common shares outstanding.

On September 30, 2006 LTI issued 2,941 shares to an employee in lieu of salary. After the issue of shares, LTI had 17,763,347 shares outstanding.

On October 2, 2006 LTI issued 100,000 shares upon the exercise of stock options for the amount of \$10,000. After the issue of shares, LTI had 17,863,347 shares outstanding.

As of October 31, 2006 LTI had 17,863,347 common shares, 2,335,785 warrants and 1,380,000 options to acquire common shares outstanding.

On November 1, 2006 LTI issued 2,703 shares to an employee in lieu of salary. After the issue of shares, LTI had 17,866,050 shares outstanding.

As of February 14, 2007 LTI had 18,207,837 common shares, 2,447,785 warrants and 1,275,000 options to acquire common shares outstanding.

## **Subsequent Events**

On February 5, 2007, the Corporation announced a private placement for between 222,222 and 1,666,667 units at a price of \$0.45 per unit. 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 \$0.55 per share and expires one year from the date of the private placement. As at February 14, 2007, the Corporation had received signed subscription agreements for 224,000 units and had received \$100,000 in proceeds.

## **Disclosure Controls and Procedures**

Management, including the Chief Executive Officer and the Chief Financial Officer, have evaluated the effectiveness of the Corporation's disclosure controls and procedures as of the end of the year covered by the annual filings and has concluded that the disclosure controls are effective in ensuring that all material information required to be filed has been made known to them in a timely fashion. The required information was effectively recorded, processed, summarized and reported within the time period necessary to prepare the annual filings. The disclosure controls and procedures are effective in ensuring that information required to be disclosed pursuant to applicable securities laws are accumulated and communicated to management, including the Chief Executive Officer and the Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

## **Internal Controls Over Financial Reporting**

Management, including the CEO and CFO of the Corporation, are responsible for designing internal controls over financial reporting or causing them to be designed under their supervision in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. We have assessed the design of our internal control

over financial reporting and during this process we identified certain weaknesses in internal controls over financial reporting which are as follows:

- a) due to the limited number of staff at the Corporation, it is not feasible to achieve complete segregation of incompatible duties;
- b) due to the limited number of staff, the Corporation does not have a sufficient number of finance personnel with all the technical accounting knowledge to address all complex and non-routine accounting transactions that may arise; and
- c) the Corporation did not have a whistle blower policy in place during the period.

Management and the board of directors works to mitigate the risk that results from these weaknesses as follows:

- a) increased oversight and diligence by the CEO, CFO and the Board to ensure that the risk of a misstatement resulting from this weakness is minimized;
- b) the Corporation will, as necessary, consider engaging qualified consultants to assist with the accounting for any complex and non-routine accounting transactions that may arise; and
- c) a whistle blower policy has been created and implemented by the Corporation subsequent to October 31, 2006.

H. Ronald Sterne

Jeff Howe

**“signed”**

**“signed”**

President & Chief Executive Officer  
Labrador Technologies Inc.

Chief Financial Officer  
Labrador Technologies Inc.

Financial Statements of

**LABRADOR TECHNOLOGIES INC.**

Years ended October 31, 2006 and 2005

## MANAGEMENT'S REPORT TO THE SHAREHOLDERS

The accompanying financial statements and related financial information have been prepared by management, which is responsible for the integrity, objectivity and reliability of the data presented. This responsibility includes selecting appropriate accounting principles and making judgments and estimates consistent with Canadian generally accepted accounting principles. Financial information presented elsewhere in this Annual Report is consistent with that in the financial statements.

To discharge its responsibilities for financial reporting and safeguarding of assets, management depends on the Corporation's systems of internal accounting control. These systems are designed to provide reasonable cost effective assurance that the financial records are reliable and form a proper basis for the timely and accurate preparation of financial statements.

Ultimate responsibility for the financial statements rests with the Board of Directors, whom are informed regularly by management. The Board is assisted in discharging this responsibility by an Audit Committee, consisting of directors who are not officers or employees of the Corporation. This Committee reviews the financial statements and recommends them for approval by the Board. In addition, the Audit Committee reviews the recommendations of the shareholders' auditors for improvements in internal control, if any, and the action of management to implement such recommendations. In carrying out its duties and responsibilities, the Committee reviews the audit plan with the shareholders' auditors to review the scope and timing of their respective audits, to review their findings and to satisfy itself that their responsibilities have been properly discharged.

KPMG LLP, independent auditors appointed by the shareholders, have examined the financial statements of the company in accordance with Canadian generally accepted auditing standards, and have expressed their opinion upon the completion of their examination in their Report to the Shareholders. The shareholders' auditors have full and free access to the Audit Committee to discuss their audit and related findings as to the integrity of the Corporation's financial reporting and the adequacy of the systems of internal control.

H. Ronald Sterne

Jeffrey A. Howe

"signed"

"signed"

President & Chief Executive Officer  
Labrador Technologies Inc.  
February 14, 2007

Chief Financial Officer  
Labrador Technologies Inc.

## **AUDITORS' REPORT TO THE SHAREHOLDERS**

We have audited the balance sheets of Labrador Technologies Inc. as at October 31, 2006 and 2005 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, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG<sub>LLP</sub>

Chartered Accountants

Calgary, Canada  
February 22, 2007

# LABRADOR TECHNOLOGIES INC.

Balance Sheets

As at October 31

	2006	2005
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 347,536	\$ 256,158
Accounts receivable	7,458	11,294
Prepaid expenses (note 8)	7,352	7,352
	<u>362,346</u>	<u>274,804</u>
Property and equipment (note 4)	44,673	44,304
	<u>\$ 407,019</u>	<u>\$ 319,108</u>
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 20,292	\$ 25,798
Shareholders' equity:		
Common shares (note 5)	6,141,283	5,179,908
Share purchase warrants (note 5)	52,850	31,500
Contributed surplus (note 5)	266,838	227,814
Deficit	(6,074,244)	(5,145,912)
	<u>386,727</u>	<u>293,310</u>
Going concern (note 1)		
Commitments (note 8)		
Subsequent event (note 10)		
	<u>\$ 407,019</u>	<u>\$ 319,108</u>

See accompanying notes to financial statements.

H. Ronald Sterne

**“signed”**

President & Chief Executive Officer  
Labrador Technologies Inc.

George A. Wilson, Q.C.

**“signed”**

Chairman of the Audit Committee  
Labrador Technologies Inc.

# LABRADOR TECHNOLOGIES INC.

## Statements of Operations and Deficit

Years ended October 31

	2006	2005
Revenues:		
Consulting fees	\$ —	\$ 28,840
Interest income	3,238	2,910
	3,238	31,750
Expenses:		
General and administration	492,713	347,938
Computer and related costs	288,705	186,809
Sales and marketing	87,366	94,684
Stock-based compensation (note 5)	44,699	19,100
Depreciation	18,087	21,878
	931,570	670,409
Net loss	(928,332)	(638,659)
Deficit, at beginning of year, as previously reported	(5,145,912)	(4,482,633)
Change in accounting policy (note 3)	—	(24,620)
As restated	—	(4,507,253)
Deficit, at end of year	<u>\$(6,074,244)</u>	<u>\$(5,145,912)</u>
Net loss per share (note 5):		
Basic and diluted	\$ (0.06)	\$ (0.07)

See accompanying notes to financial statements.

# LABRADOR TECHNOLOGIES INC.

## Statements of Cash Flows

Years ended October 31

	2006	2005
Cash provided by (used in):		
Operating activities:		
Net loss	\$ (928,332)	\$ (638,659)
Items not involving cash:		
Shares for services performed	91,800	22,324
Stock-based compensation	44,699	19,100
Depreciation	18,087	21,878
	<u>(773,746)</u>	<u>(575,357)</u>
Changes in non-cash working capital (note 7)	(1,670)	25,590
	<u>(775,416)</u>	<u>(549,767)</u>
Investing activities:		
Additions to property and equipment	<u>(18,456)</u>	<u>(12,570)</u>
Financing activities:		
Proceeds from the sale of shares and warrants	635,050	275,000
Proceeds from the exercise of warrants	230,000	—
Proceeds from the exercise of options	20,200	4,800
	<u>885,250</u>	<u>279,800</u>
Increase (decrease) in cash and cash equivalents	91,378	(282,537)
Cash and cash equivalents, beginning of year	256,158	538,695
Cash and cash equivalents, end of year	<u>\$ 347,536</u>	<u>\$ 256,158</u>
<b>Cash and cash equivalents consist of:</b>		
Cash	247,536	156,158
Short-term deposits	100,000	100,000
	<u>\$ 347,536</u>	<u>\$ 256,158</u>

See accompanying notes to financial statements.

# LABRADOR TECHNOLOGIES INC.

Notes to Financial Statements

Years ended October 31, 2006 and 2005

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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 for the foreseeable future 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, 2006, the Corporation had cash of \$347,536, no long-term debt and a working capital balance of \$342,054. During the year, the Corporation incurred a net loss of \$928,332 (2005 - \$638,659) and utilized funds from operations totaling \$775,416 (2005 - \$549,767). As at February 13, 2007, the Corporation had received \$100,000 in proceeds related to a private placement announced on February 5, 2007 (see note 10) and the Corporation's cash balance as of February 14, 2007 was \$258,806.

During the year, the Corporation completed two private placements for proceeds of \$635,050. In addition, warrants exercised during the year generated an additional \$230,000. In fiscal 2007, in addition to any capital raised from new financings, if any, there are 2,000,000 share purchase warrants exercisable at \$0.20 expiring on March 2, 2007 and 335,785 share purchase warrants exercisable at \$0.45 expiring on August 2, 2007. Each share purchase warrant is exercisable into one common share.

While management believes that the Corporation has sufficient cash to discharge its obligations in the normal course of operations for the foreseeable future, future operations will continue to be dependent upon the successful ongoing development and marketing of the Corporation's data retrieval technology, and/or raising of sufficient capital, 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, 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. Significant areas requiring the use of management estimates include valuation of stock based compensation and share purchase warrants. However, actual results could differ from the estimates made.

# LABRADOR TECHNOLOGIES INC.

Notes to Financial Statements, Page 2

Years ended October 31, 2006 and 2005

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(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 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%

(c) Per share amounts:

Basic net loss per share is computed by dividing the net loss 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. Under this method, future income tax assets and liabilities 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 substantively 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.

(e) Cash and cash equivalents:

The Corporation considers cash equivalents to be highly liquid investments with maturity of three months or less from the date of purchase and are readily convertible into known amounts of cash.

# LABRADOR TECHNOLOGIES INC.

Notes to Financial Statements, Page 3

Years ended October 31, 2006 and 2005

### 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 totaling \$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:

2006	Cost	Accumulated depreciation	Net book value
Computer equipment	\$ 485,579	\$ 459,722	\$ 25,857
Furniture and equipment	186,903	173,486	13,417
Purchased computer software	302,408	297,009	5,399
	\$ 974,890	\$ 930,217	\$ 44,673
2005			
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
	\$ 956,434	\$ 912,130	\$ 44,304

### 5. Share capital:

#### (a) Authorized:

Unlimited preferred shares, Series A and Series B; and

Unlimited common shares.

#### (b) Common shares issued:

	2006		2005	
	Number of shares	Amount	Number of shares	Amount
Common shares				
Balance, beginning of year	11,268,507	\$ 5,179,908	8,289,685	\$ 4,909,284
Sale of units	4,671,571	582,200	2,750,000	243,500
Exercise of warrants	1,150,000	256,345	—	—
Shares for service performed	588,269	91,800	188,822	22,324
Exercise of options	185,000	20,200	40,000	4,800
Transfer from contributed surplus on exercise of stock options	—	10,830	—	—
Balance, end of year	17,863,347	\$ 6,141,283	11,268,507	\$ 5,179,908

# LABRADOR TECHNOLOGIES INC.

Notes to Financial Statements, Page 4

Years ended October 31, 2006 and 2005

During the year ended October 31, 2006, the Corporation completed two private placements as follows:

- March 2, 2006: 4,000,000 units at a price of \$0.10 per unit. 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 and expires one year from the date of the private placement. Of the 4,000,000 units issued under the private placement, 1,000,000 units were issued to directors and/or officers of the Corporation. Of the proceeds raised, \$397,350 was allocated to common share capital and \$2,650 was allocated to share purchase warrants. The value of these share purchase warrants was estimated using the Black-Scholes options-pricing model using the assumptions described in note 5(e).
- August 4, 2006: 671,571 units at a price of \$0.35 per unit. 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 \$0.45 per share and expires one year from the date of the private placement. Of the proceeds raised, \$184,850 was allocated to common share capital and \$50,200 was allocated to share purchase warrants. The value of these share purchase warrants was estimated using the Black-Scholes options-pricing model using the assumptions described in note 5(e).

(c) Share purchase warrants issued:

Warrants	2006		2005	
	Number of warrants	Amount	Number of warrants	Amount
Balance, beginning of year	1,375,000	\$ 31,500	—	\$ —
Sale of units	2,335,785	52,850	1,375,000	31,500
Exercise of warrants	(1,150,000)	(26,345)	—	—
Expired warrants	(225,000)	(5,155)	—	—
Balance, end of year	2,335,785	\$ 52,850	1,375,000	\$ 31,500

Of the 1,150,000 warrants exercised, 375,000 units were exercised by directors and/or officers of the Corporation.

# LABRADOR TECHNOLOGIES INC.

Notes to Financial Statements, Page 5

Years ended October 31, 2006 and 2005

(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, 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
Granted	950,000	\$ 0.20 – 0.43	0.42
Expired	(105,000)	0.35	0.35
Exercised	(185,000)	\$ 0.10 – 0.12	0.11
Outstanding at October 31, 2006	1,380,000	0.10 – 0.43	0.34

Exercise price	Number of Options	Weighted average remaining contractual life (months)
\$ 0.12	40,000	19
0.12	130,000	1
0.35	40,000	5
0.35	220,000	2
0.20	60,000	53
0.43	890,000	33
Stock options outstanding at October 31, 2006	1,380,000	25
Exercisable at October 31, 2006	490,000	10

# LABRADOR TECHNOLOGIES INC.

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Years ended October 31, 2006 and 2005

(e) Stock-based compensation:

During the year, 950,000 (2005 – 385,000) stock options were granted to employees, officers and directors of the Corporation. 60,000 stock options vested immediately with the remaining 890,000 share options vesting evenly over 18 months. The fair value of stock options granted was estimated using the Black-Scholes option-pricing model with the following assumptions:

	2006	2005
Dividend yield	0%	0%
Expected volatility	60% - 90%	60%
Risk free rate of return	5%	5%
Expected option life	3 – 5 years	2 - 5 years
Weighted average option value	\$ 0.25	\$ 0.05

(f) Contributed surplus:

	2006	2005
Beginning of year	\$ 227,814	\$ 208,714
Stock-based compensation	44,699	19,100
Expired warrants	5,155	—
Exercise of options	(10,830)	—
End of year	\$ 266,838	\$ 227,814

(g) Per share amounts:

The weighted average number of common shares outstanding during the year was 14,821,902 (2005 – 8,993,557).

There is no dilutive effect from the options and warrants for the year ended October 31, 2006 and 2005.

# LABRADOR TECHNOLOGIES INC.

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Years ended October 31, 2006 and 2005

## 6. Income taxes:

Total income tax recovery is different from the amount computed by applying the combined expected Canadian Federal and Provincial tax rate of 32.7% (2005 – 33.6%) to loss before income taxes and other items. The reasons for the difference are as follows:

	2006	2005
Computed expected tax recovery	\$ (305,000)	\$ (215,000)
Add (deduct) the following:		
Non-deductible expenses	22,000	12,000
Net increase in valuation allowance	35,000	131,000
Impact of reduction of future tax rate	248,000	72,000
	\$ –	\$ –

The components of the future income tax assets and liabilities at October 31, 2006 were as follows:

	2006	2005
Future income tax assets:		
Non-capital losses	\$ 1,599,000	\$ 1,568,000
Property and equipment	45,000	41,000
	1,644,000	1,609,000
Less: valuation allowance	(1,644,000)	(1,609,000)
Net future income tax asset (liability)	\$ –	\$ –

At October 31, 2006, the Corporation has investment tax credit carry-forwards of approximately \$363,000 (2005 - \$363,000) that may be used to offset federal taxes payable in future years. These investment tax credits expire at the end of the years 2007 to 2010. As at October 31, 2006, the Corporation has federal non-capital losses totaling approximately \$5,399,000 and Alberta non-capital losses totaling approximately \$5,733,000, which expire in the years 2007 to 2026. The potential income tax benefit arising from these amounts has not been reflected in these financial statements.

# LABRADOR TECHNOLOGIES INC.

Notes to Financial Statements, Page 8

Years ended October 31, 2006 and 2005

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## 7. Supplemental cash flow disclosure:

Changes in non-cash working capital are as follows:

	2006	2005
Accounts receivable	\$ 3,836	\$ 18,294
Prepaid expenses	—	25,597
Accounts payable and accrued liabilities	(5,506)	(18,301)
	\$ (1,670)	\$ 25,590

During the year, the Corporation received interest payments of \$1,784 (2005 – nil).

## 8. Commitments:

The Corporation has a lease commitment for its premises through August 2009 with minimum annual payments as follows:

2007	100,000
2008	100,000
2009	86,000
	\$ 286,000

Prepaid expenses of \$7,352 (2005 - \$7,352) relate to this lease commitment.

## 9. Fair values:

As at October 31, 2006 and 2005, the fair values of the Corporation's monetary assets and liabilities approximated their carrying values due to the short term maturity of these items.

## 10. Subsequent event:

On February 5, 2007, the Corporation announced a private placement for between 222,222 and 1,666,667 units at a price of \$0.45 per unit. 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 \$0.55 per share and expires one year from the date of the private placement. As at February 13, 2007, the Corporation had received signed subscription agreements for 222,224 units and had received \$100,000 in proceeds.

## 11. Related party transaction:

During the year ended October 31, 2006, \$20,000 in consulting fees was paid to a director of the company. This was measured at the exchange amount.