

# JEMTEC INC.

## Interim Financial Statements April 30, 2006

*Notice to Reader:*

*The accompanying interim financial statements of JEMTEC Inc. for the three and nine month periods ended April 30, 2006 have been prepared by and are the responsibility of the Company's management. These statements are unaudited and have not been reviewed by independent auditors.*

# JEMTEC INC.

## Balance Sheets

April 30, 2006

July 31, 2005

### ASSETS

#### Current

Cash and cash equivalents	\$ 1,829,089	\$ 1,699,756
Accounts receivable	497,422	473,293
Prepaid expenses and deposits	14,009	1,500

**Total current assets** 2,340,520 2,174,549

**Property and equipment** (note 4) 325,299 365,122

**Future income taxes** 34,189 41,947

**Total assets** \$ 2,700,008 \$ 2,581,618

### LIABILITIES

#### Current

Accounts payable and accrued liabilities (note 7(b))	\$ 402,645	\$ 279,105
Deferred revenue	19,526	23,115
Current portion of capital lease obligation (note 5)	74,474	81,093
Income taxes payable	27,733	409,743

**Total current liabilities** 524,378 793,056

**Capital lease obligation** (note 5) 183,262 238,922

**Total liabilities** 707,640 1,031,978

### SHAREHOLDERS' EQUITY

Share capital (note 7)	1,216,408	1,247,160
Contributed surplus (note 7 (c))	194,830	24,612
Retained earnings (note 7)	581,130	277,868

**Total shareholders' equity** 1,992,368 1,549,640

**Total liabilities and shareholders' equity** \$ 2,700,008 \$ 2,581,618

The accompanying notes are an integral part of these unaudited financial statements

Approved by the Board of Directors:

*"Eric Caton"*  
Director

*"Leslie Markow"*  
Director

**JEMTEC INC.**

## Statements of Operations and Retained Earnings

	For the three month period ended April 30,		For the nine month period ended April 30,	
	2006	2005	2006	2005
<b>Revenue</b>				
Leasing, monitoring and activation (note 8)	\$ 660,321	\$ 641,232	\$ 1,973,776	\$ 1,906,868
Parts, sales and other	11,419	6,663	35,913	8,396
	671,740	647,895	2,009,689	1,915,264
<b>Expenses</b>				
Salaries and benefits	54,785	78,139	165,045	191,339
Amortization	15,990	24,780	47,868	47,072
Repairs and maintenance	3,280	15,742	19,636	34,451
Monitoring and activation fees	186,870	102,214	443,712	271,476
Equipment rent and installation	36,120	30,197	142,852	93,674
Consulting fees	44,325	43,176	127,041	98,212
Travel	6,479	5,647	29,702	23,539
Shareholder communications	19,162	9,165	44,776	22,833
Professional fees	23,109	4,250	49,691	11,262
Office	33,618	21,808	96,593	74,042
Interest on capital leases	4,841	6,447	15,595	14,721
Other interest expenses	4,952	419	5,523	1,767
Stock-based compensation (note 7 (c))	55,074	13,659	170,218	18,374
Directors' fees	15,000	8,750	42,000	32,750
Accounting and administrative fees	12,373	4,500	36,315	16,000
	515,978	368,893	1,436,567	951,512
<b>Income before income taxes</b>	<b>155,762</b>	<b>279,002</b>	<b>573,122</b>	<b>963,752</b>
<b>Income tax expense</b>				
Current	54,213	100,451	208,636	346,961
Future	2,586	-	7,758	-
	56,799	100,451	216,394	346,961
<b>Net income for the period</b>	<b>98,963</b>	<b>178,551</b>	<b>356,728</b>	<b>616,791</b>
<b>Retained earnings (deficit) - Beginning of period</b>	<b>535,633</b>	<b>1,583</b>	<b>277,868</b>	<b>(436,657)</b>
<b>Retained earnings (deficit) (note 7 (b))</b>	<b>(53,466)</b>	<b>-</b>	<b>(53,466)</b>	<b>-</b>
<b>Retained earnings - End of period</b>	<b>\$ 581,130</b>	<b>\$ 180,134</b>	<b>\$ 581,130</b>	<b>\$ 180,134</b>
Earnings per share:				
Basic	\$ 0.04	\$ 0.08	\$ 0.15	\$ 0.27
Diluted	\$ 0.04	\$ 0.07	\$ 0.15	\$ 0.26
Weighted average number of shares outstanding:				
Basic	2,328,824	2,321,659	2,347,102	2,321,659
Diluted	2,438,834	2,398,891	2,440,781	2,391,732

The accompanying notes are an integral part of these unaudited financial statements

# JEMTEC INC.

## Statements of Cash Flows

	For the three month period ended April 30,		For the nine month period ended April 30,	
	2006	2005	2006	2005
<b>Cash flows from (used in) operating activities</b>				
Net income for the period	98,963	178,551	356,728	616,791
Adjustments to reconcile net income to net cash used in operating activities:				
- amortization	15,990	24,780	47,868	47,072
- stock-based compensation	55,074	13,659	170,218	18,374
- future income taxes	2,586	-	7,758	4,986
Changes in non-cash working capital:				
- accounts receivable	(239,106)	16,608	(24,129)	(224,915)
- prepaid expenses	58,058	739	(12,509)	2,828
- accounts payable and accrued liabilities	53,004	26,413	16,822	27,978
- deferred revenue	11,373	(2,343)	(3,589)	(500)
- due to related parties	7,500	3,750	22,500	(35,500)
- income taxes payable	(74,635)	100,450	(382,010)	238,491
<b>Cash flows - operating activities</b>	<b>(11,193)</b>	<b>362,607</b>	<b>199,657</b>	<b>695,605</b>
<b>Cash flows used in investing activities</b>				
Purchase of property and equipment	-	-	(8,045)	-
<b>Cash flows - investing activities</b>	<b>-</b>	<b>-</b>	<b>(8,045)</b>	<b>-</b>
<b>Cash flows from (used in) financing activities</b>				
Shares issued for cash	-	56,000	-	56,000
Payment on capital lease obligation	(17,820)	(22,149)	(62,279)	(64,007)
<b>Cash flows - financing activities</b>	<b>(17,820)</b>	<b>33,851</b>	<b>(62,279)</b>	<b>(8,007)</b>
<b>Net increase in cash</b>	<b>(29,013)</b>	<b>396,458</b>	<b>129,333</b>	<b>687,598</b>
<b>Cash, beginning of period</b>	<b>1,858,102</b>	<b>989,138</b>	<b>1,699,756</b>	<b>697,998</b>
<b>Cash, end of period</b>	<b>1,829,089</b>	<b>1,385,596</b>	<b>1,829,089</b>	<b>1,385,596</b>

The accompanying notes are an integral part of these unaudited financial statements

### Supplemental cash disclosures

#### Cash paid for:

Income taxes	\$ 128,848	\$ -	\$ 590,741	\$ -
Interest	\$ 9,793	\$ 6,865	\$ 21,118	\$ 16,487

**1. Nature of Operations**

The Company's core business is the provision of services and technology for offender monitoring in Canadian federal and provincial correctional departments.

**2. Significant Accounting Policies**

**a) General**

These financial statements have been prepared in Canadian dollars and in accordance with Canadian generally accepted accounting principles.

**b) Use of estimates**

The preparation of these financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the revenues and expenses during the reporting periods, in addition to the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements. Actual results could differ from those estimates.

**c) Currency and foreign exchange**

The functional currency of the company is the Canadian dollar. Monetary assets and liabilities denominated in another currency are translated at exchange rates in effect at the balance sheet dates. Other non-monetary balance sheet items denominated in another currency are translated at the rates of exchange in effect at the time the items arose. Revenue and expenses are translated at the exchange rates in effect at the time of the transaction. Gains and losses arising from fluctuations in exchange rates are included in operations for the periods in which they occur.

**d) Cash and cash equivalents**

Cash and cash equivalents are defined as cash on hand and short term, highly liquid money market instruments with original maturities of three months or less.

**e) Property and equipment**

Property and equipment are stated at cost less accumulated amortization. Amortization is charged to earnings over the estimated useful lives of the respective assets at the following rates:

Furniture & fixtures	20% declining balance
Monitoring equipment	straight-line over 5 years or contract period

Expenditures for maintenance and repairs that do not improve or extend the life of the assets are expensed as operations, while major repairs are capitalized.

**2. Significant Accounting Policies (continued)**

**f) Asset impairment**

On an annual basis, or when impairment arises, the Company evaluates the future recoverability of its property and equipment. Impairment losses or write-downs are recorded in the event the net book value of such assets exceeds the estimated future cash flows attributable to such assets.

**g) Revenue recognition**

Rental and monitoring income is recognized pursuant to various lease agreements which specify the terms and conditions of rental and the services to be performed and electronic surveillance. Rental income is recognized on a straight-line basis over the terms of the leases. Revenue from the sale of parts which are required to repair and maintain the monitoring equipment is recognized upon delivery to the lessee. Maintenance and monitoring service income is recognized when the services are performed.

The Company recognizes sales and leasing revenue over the term of the applicable operating services agreements. The term of existing service agreements is between three and five years. Generally, the lessees have the option to renew or cancel the lease and service agreements upon the expiration of each lease term or, in certain circumstances, the agreements may be cancelled upon specific notice provided to the Company. In situations where leases are terminated, the leased monitoring equipment would be returned to the Company or the Company's lessors with no further obligation on behalf of the lessee.

**h) Stock-based compensation**

The Company follows the recommendations of CICA Handbook Section 3870 "*Stock-based Compensation and Other Stock-based Payments*" which establishes standards for the recognition, measurement and disclosure of stock-based compensation and other stock-based payments made in exchange for goods and services. Effective for year ends beginning on or after January 1, 2004, these recommendation require that compensation for all awards made, including stock appreciation rights, direct awards of stock and awards that call for settlement in cash or other assets, be measured and recorded in the financial statements at fair value. For the purpose of this Section, employees include directors who receive stock compensation for services provided as director. This Section also sets out fair value based methods of accounting for stock options issued to employees.

For the years ended July 31, 2002 and 2003, no compensation expense was recognized for stock options granted to employees and directors, as the company was using the intrinsic method to account for the stock option grants. During the year ended July 31, 2004, the Company adopted, on a prospective basis, the fair value based method of accounting for stock based compensation for all grants of options to employees, non-employees and directors in accordance with the prospective application provision of Section 3870. All option grants beginning August 1, 2003 are accounted by using the fair value based method, and stock based compensation expense is computed the Black-Scholes option pricing model. Accordingly, the fair value of the stock options at the date of grant is charged to operations on a straight-line basis over the vesting period. Any consideration paid on exercise of stock options together with the related portion previously recognized as stock based compensation is credited to share capital.

## **2. Significant Accounting Policies (continued)**

### **i) Earnings per share**

Basic earnings per share is computed by dividing earnings (loss) for the period by the weighted average number of common shares outstanding during the period. Diluted earnings per share has been calculated using the treasury stock method. This method assumes that common shares are issued for the exercise of warrants and options and that the assumed proceeds from the exercise of warrants and options are used to purchase common shares at the average market price during the period. The difference between the number of shares assumed issued and the number of shares assumed purchased is then added to the basic weighted average number of shares outstanding to determine the fully diluted number of common shares outstanding. No exercise or conversion is assumed during periods in which a net loss is incurred as the effect is anti-dilutive.

### **j) Income taxes**

The Company uses the asset and liability method of accounting for income taxes whereby future income tax assets are recognized for deductible temporary differences and operating loss carry-forwards, and future income tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the amounts of assets and liabilities recorded for income tax and financial reporting purposes. Future income tax assets are recognized only to the extent that management determines that it is more likely than not that the future income tax assets will be realized. Future income tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment or substantive enactment. The income tax expense or benefit is the income tax payable or refundable for the period plus or minus the change in future income tax assets and liabilities during the period.

## **3. Financial Instruments**

The Company's financial instruments recognized in the balance sheet consist of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, bank loan, due to related parties, income taxes payable, and capital lease obligations. The fair values of these instruments approximates their carrying value due to their short-term maturity or, in the case of the capital lease obligation, the rate implicit in the lease arrangements.

### **a) Credit risk**

The Company's principal business activities are located in Canada. The Company performs certain credit evaluation procedures and does not require collateral for financial instruments subject to credit risk. The Company believes that credit risk is limited because the company routinely assesses the financial strength of its customers, and based upon factors surrounding the credit risk of its customers, establishes an allowance for uncollectible accounts and, as a consequence, believes that its account receivable credit risk beyond such allowances is limited.

The Company maintains cash deposits with financial institutions, which from time to time may exceed federally insured limits. The Company has not experienced any losses and believes it is not exposed to any significant credit risk from cash. At April 30, 2006, the Company had cash balances on deposit that exceeded federally insured limits by \$1,329,089. All of these funds are on deposit with a Schedule A bank in Canada.

### **b) Fair value**

Unless otherwise noted, cash, accounts, advances and deposits receivable, loans and accounts payable are stated at amounts that approximate fair value.

**3. Financial Instruments (continued)**

**c) Foreign exchange risk**

The Company may be subject to limited currency risk due to the fluctuations of exchange rates amongst the Canadian and U.S. dollars.

**d) Liquidity risk**

The Company is exposed to liquidity risk as its continued operations are dependent upon the Company realizing its account receivable to satisfy its liabilities as they become due.

**4. Property and Equipment**

	April 30, 2006			July 31, 2005		
	Cost	Accumulated Amortization	Net Book Value	Costs	Accumulated Amortization	Net Book Value
Furniture and fixtures	\$ 39,978	\$ 34,898	\$ 5,080	\$ 35,676	\$ 34,074	\$ 1,602
Monitoring equipment	457,177	136,958	320,219	453,434	89,914	363,520
	<u>\$ 497,155</u>	<u>\$ 171,856</u>	<u>\$ 325,299</u>	<u>\$ 489,110</u>	<u>\$ 123,988</u>	<u>\$ 365,122</u>

Included in monitoring equipment are assets under capital lease at a cost of \$453,434 (July 31, 2005 - \$453,434) and a net book value of \$316,601 (July 31, 2005 -\$363,520).

The Company amortizes its monitoring equipment over its estimated useful life as described in note 2. Such estimates are based on management's experience and expectations of the continued renewal of the contracts for which equipment is acquired or the use of existing equipment in new contracts. Advances in technology and other considerations could result in significant changes to the estimated lives of these assets or otherwise impact the ability of the Company to realize on existing monitoring equipment. In these circumstances, additional provisions could be required.

**5. Capital Lease Obligation**

Further minimum lease payments to capital leases are as follows:

	Principal	Imputed Interest	Total
Year ending July 31, 2006	\$ 18,133	\$ 4,528	\$ 22,661
2007	75,788	14,857	90,645
2008	81,300	9,344	90,644
2009	82,515	2,955	85,470
2010	-	-	-
	<u>257,736</u>	<u>31,684</u>	<u>\$289,420</u>
Less: amounts representing interest (8%)			<u>(31,684)</u>
Present value of minimum lease payments			<u>257,736</u>
Less: current portion			<u>(74,474)</u>
			<u>\$183,262</u>

A general security agreement over all of the assets of the Company has been pledged as security for the capital lease obligations.

**6. Bank Credit Facility and Loan Agreement**

The Company has arranged an uncommitted term operating loan which is available to a maximum amount of \$75,000. The loan, if committed, would be due on demand, would bear interest at bank prime plus 1.3% per annum and would be secured by a general security agreement over all of the assets of the Company.

**7. Share Capital**

**a) Authorized**

Common shares: Unlimited, no par value  
 First preference shares: Unlimited, no par value, issuable in series  
 Second preference shares: 25,000 Series A, \$0.60 non-cumulative and redeemable

**b) Issued and allotted**

	Number of Common Shares	Amount
<b>Balance July 31, 2004 and 2003</b>	2,071,659	\$ 1,112,993
Shares issued for exercise of stock options	<u>284,284</u>	<u>\$ 134,167</u>
<b>Balance July 31, 2005</b>	<u>2,355,943</u>	<u>\$ 1,247,160</u>
Effect of consolidation / deconsolidation	<u>(57,684)</u>	<u>\$ (30,752)</u>
<b>Balance April 30, 2006</b>	<u><u>2,298,259</u></u>	<u><u>\$ 1,216,408</u></u>

Pursuant to a special resolution passed by shareholders on April 21, 2006, the Company consolidated its capital on a 100 old shares for 1 new share, subsequently followed by a 1 for 100 share split. Shareholders holding less than 100 pre-consolidation shares are entitled to receive a cash payment of \$1.46 per share. Accordingly, at April 30, 2006, 57,684 shares have been cancelled, a charge of \$53,466 was made to retained earnings, the capital account was reduced by \$30,752 and an additional \$84,219 has been included in accounts payable and accrued liabilities for shareholders entitled to redeem their shares under this agreement who have yet contacted the company regarding this transaction.

**c) Options**

During the year ended July 31, 2003, the Company adopted a fixed stock option plan that permits the directors of the company to grant incentive stock options to employees, directors and consultants to the Company. The maximum number of shares issuable under the plan, which follows the policies of the TSX Venture Exchange ("TSXV") regarding stock option awards, was 414,332. In January 2006, the Company amended its stock option plan to increase the number of shares reserved for issuance under the plan to 471,188. Options granted under the plan vest in 6 equal installments over a period of 18 months, with the first installment vesting immediately, and the remaining options vesting upon 6, 9, 12, 15 and 18 months after the date of grant. The option exercise price is generally set as the market price at the time of grant; however, a discount from the market price is permitted under the plan, subject to the policies of the TSX Venture Exchange.

**7. Share Capital (continued)**

The table below summarizes the options that have been granted under the Company's stock option plan.

	Number of Options	Weighted Average Exercise Price
Outstanding, July 31, 2004 and 2003	300,000	\$ 0.21
Granted	330,000	\$ 0.86
Exercised	<u>(284,284)</u>	\$ 0.33
Outstanding, July 31, 2005 and April 30, 2006	<u>345,716</u>	<u>\$ 0.84</u>

Prior to August 1, 2003, the Company applied the intrinsic value based method of accounting for stock based compensation granted under the Company's fixed stock option plan to employees and directors.

The fair value of the options granted in the fiscal year ended July 31, 2005 was estimated on the date of grant using the Black-Scholes option pricing model, assuming risk-free interest rates of 3.96%; dividend yield of \$nil; expected lives of 5 years and volatility of 122%.

	Three month period ended April 30,		Nine month period ended April 30,	
	2006	2005	2006	2005
Net Profit				
As reported	\$ 98,963	\$ 178,551	\$ 356,728	\$ 616,791
Pro-forma	\$ 98,963	\$ 176,245	\$ 356,728	\$ 614,485
Basic Profit per Share				
As reported	\$ 0.04	\$ 0.08	\$ 0.15	\$ 0.27
Pro-forma	\$ 0.04	\$ 0.07	\$ 0.15	\$ 0.26
Diluted Profit per Share				
As reported	\$ 0.04	\$ 0.07	\$ 0.15	\$ 0.26
Pro-forma	\$ 0.04	\$ 0.07	\$ 0.15	\$ 0.26

During the year ended July 31, 2005, the Company granted 330,000 stock options. The fair value of the options granted is charged to earnings over the vesting period of 18 months. During the year ended July 31, 2005, 284,284 options were exercised, for net proceeds of \$93,712. Stock-based compensation expense of \$65,067 resulted and, of this amount, \$40,455 was credited to share capital upon the exercise of previously vested stock options and \$24,612 was credited to contributed surplus.

During the three and nine month periods ended April 30, 2006, stock-based compensation expense was credited to contributed surplus in the amount of \$55,074 and \$170,218, respectively.

**7. Share Capital (continued)**

**JEMTEC INC.**  
**Notes to Financial Statements**  
**April 30, 2006**

Options outstanding at April 30, 2006 are as follows:

	# of Options Granted	Expiry	Exercise Price	Number Outstanding as at April 30, 2006	Options Outstanding		Options Exercisable	
					Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Vested as at April 30, 2006	Weighted Average Exercise Price
Granted, February 26, 2003	150,000	8-Feb-08	\$ 0.11	50,000	0.26	\$ 0.02	50,000	\$ 0.02
Granted, September 21, 2004	50,000	21-Sep-09	\$ 0.30	50,000	0.49	\$ 0.04	50,000	\$ 0.06
Granted, June 9, 2005	<u>280,000</u>	23-Jun-10	\$ 1.10	<u>245,716</u>	2.95	\$ 0.78	<u>152,383</u>	\$ 0.66
	<u>480,000</u>			<u>345,716</u>	3.70 years	\$ 0.84	<u>252,383</u>	\$ 0.74

**8. Economic Dependence**

The Company presently derives substantially all of its revenue from two customers of which one customer contributed approximately 92% of revenue in the nine month period ended April 30, 2006 (2005 - 92%). These contracts are reviewed periodically and have cancellation provisions. The non-renewal or cancellation of one or more of these contracts would have a material adverse impact on the Company.

Also, the Company is the exclusive Canadian distributor of Pro-Tech Monitoring, Inc's ("Pro-Tech") and BI Inc.'s (both U.S. companies) offender monitoring and tracking devices, the sales and leasing of which account for substantially all of the Company's revenues, capital asset additions and replacement parts purchased. The Company is economically dependent on Pro-Tech and BI Inc. for the continued supply of monitoring equipment, replacement parts, and maintenance services provided by Pro-Tech and BI Inc. for resale or rental by the Company.

**9. Related Party Balances and Transactions**

During the nine month period ended April 30, 2006, \$0 (2005 - \$36,750) was paid to a director who is the President of the Company as an incentive bonus. During the nine month period ended April 30, 2006, \$19,500 (2005 - \$14,000) was paid to the directors of the Company as directors fees, and an additional \$22,500 (2005 - \$18,750) was accrued.

**10. Earnings per Share**

The following table shows the effect of dilutive securities on the weighted average common share outstanding. No adjustments to earnings were required for the calculation of diluted earnings per share.

	Three month period ended April 30,		Nine month period ended April 30,	
	2006	2005	2006	2005
	Number of shares			
Basic weighted average shares outstanding	2,328,824	2,321,659	2,347,102	2,321,659
Effect of dilutive securities:				
Options	<u>110,010</u>	<u>77,232</u>	<u>93,679</u>	<u>70,073</u>
Diluted weighted average shares outstanding	<u>2,438,834</u>	<u>2,398,891</u>	<u>2,440,781</u>	<u>2,391,732</u>