

# **JEMTEC INC.**

**Financial Statements  
July 31, 2007 and 2006**



## AUDITORS' REPORT

To the Shareholders of JEMTEC Inc.

We have audited the balance sheets of JEMTEC Inc. as at July 31, 2007 and 2006, and the statements of operations and retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company'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 Company as at July 31, 2007 and 2006, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Vancouver, Canada

October 17, 2007

"Morgan & Company"

Chartered Accountants

# JEMTEC INC.

## Balance Sheets

	July 31, 2007	July 31, 2006
<b>ASSETS</b>		
<b>Current</b>		
Cash and cash equivalents	\$ 2,786,723	\$ 2,109,097
Accounts receivable	494,047	473,150
Prepaid expenses and deposits	20,733	21,525
<b>Total current assets</b>	<b>3,301,503</b>	<b>2,603,772</b>
<b>Property and equipment</b> (note 4)	<b>196,110</b>	<b>281,322</b>
<b>Future income taxes</b>	<b>31,204</b>	<b>34,258</b>
<b>Total assets</b>	<b>\$ 3,528,817</b>	<b>\$ 2,919,352</b>
<b>LIABILITIES</b>		
<b>Current</b>		
Accounts payable and accrued liabilities (notes 7(b) and 9)	\$ 436,036	\$ 367,952
Deferred revenue	31,761	27,923
Current portion of capital lease obligation (note 5)	79,606	75,788
Income taxes payable	59,827	158,721
<b>Total current liabilities</b>	<b>607,230</b>	<b>630,384</b>
<b>Capital lease obligation</b> (note 5)	<b>82,038</b>	<b>163,815</b>
<b>Total liabilities</b>	<b>689,268</b>	<b>794,199</b>
<b>SHAREHOLDERS' EQUITY</b>		
Share capital (note 7)	1,215,250	1,215,250
Contributed surplus (note 7 (c))	249,904	194,830
Retained earnings (note 7 (b))	1,374,395	715,073
<b>Total shareholders' equity</b>	<b>2,839,549</b>	<b>2,125,153</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 3,528,817</b>	<b>\$ 2,919,352</b>

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

Approved on behalf of the Board of Directors:

*"Eric Caton"*  
Director

*"Leslie Markow"*  
Director

# JEMTEC INC.

## Statements of Operations and Retained Earnings

	For the years ended July 31,	
	2007	2006
<b>Revenue</b>		
Leasing, monitoring and activation (note 8)	\$ 2,788,727	\$ 2,645,686
Interest income	90,061	55,811
	<u>2,878,788</u>	<u>2,701,497</u>
<b>Expenses</b>		
Salaries and benefits	297,368	222,851
Amortization	97,313	92,219
Repairs and maintenance	19,427	26,727
Monitoring and activation fees	577,055	538,272
Equipment rent and installation	279,533	234,591
Consulting fees	120,687	155,041
Travel	38,684	33,571
Shareholder communications	21,318	65,355
Professional fees	33,811	61,316
Office	179,338	117,081
Interest on capital leases	14,858	20,123
Other interest expenses	11,019	5,523
Stock-based compensation (note 7 (c))	55,074	170,218
Directors' fees	51,500	53,500
Accounting and administrative fees	23,226	36,835
	<u>1,820,211</u>	<u>1,833,223</u>
<b>Income before income taxes</b>	<u>1,058,577</u>	<u>868,274</u>
<b>Income tax expense</b>		
Current	396,201	367,387
Future	3,054	7,689
	<u>399,255</u>	<u>375,076</u>
<b>Net income for the year</b>	<u>659,322</u>	<u>493,198</u>
<b>Retained earnings - Beginning of year</b>	<u>715,073</u>	<u>277,868</u>
<b>Effect of share consolidation (note 7 (b))</b>	<u>-</u>	<u>(55,993)</u>
<b>Retained earnings - End of year</b>	<u>\$ 1,374,395</u>	<u>\$ 715,073</u>
Earnings per share:		
Basic	\$ 0.29	\$ 0.21
Diluted	\$ 0.28	\$ 0.20
Weighted average number of shares outstanding:		
Basic	2,295,736	2,340,768
Diluted	2,380,987	2,412,213

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

# JEMTEC INC.

## Statements of Cash Flows

	For the years ended July 31,	
	2007	2006
<b>Cash flows from (used in) operating activities</b>		
Net income for the year	\$ 659,322	\$ 493,198
Adjustments to reconcile net income to net cash used in operating activities:		
- amortization	97,313	92,219
- stock-based compensation	55,074	170,218
- future income taxes	3,054	7,689
Changes in non-cash working capital:		
- accounts receivable	(20,897)	143
- prepaid expenses	792	(20,025)
- accounts payable and accrued liabilities	69,309	8,067
- deferred revenue	3,838	4,808
- due to related parties		1,600
- income taxes payable	(98,894)	(251,022)
<b>Cash flows - operating activities</b>	<b>768,911</b>	<b>506,895</b>
<b>Cash flows (used in) investing activities</b>		
Payment to shareholders (note 7 (b))	(1,225)	(8,723)
Purchase of property and equipment	(15,685)	(8,419)
<b>Cash flows - investing activities</b>	<b>(16,910)</b>	<b>(17,142)</b>
<b>Cash flows (used in) financing activities</b>		
Payment on capital lease obligation	(74,375)	(80,412)
<b>Cash flows - financing activities</b>	<b>(74,375)</b>	<b>(80,412)</b>
<b>Net increase in cash</b>	<b>677,626</b>	<b>409,341</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>2,109,097</b>	<b>1,699,756</b>
<b>Cash and cash equivalents, end of year</b>	<b>\$ 2,786,723</b>	<b>\$ 2,109,097</b>

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

### Supplemental cash disclosures

#### Cash paid for:

Income taxes	\$ 497,867	\$ 618,409
Interest	\$ 25,877	\$ 25,646

**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 in Canada 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 includes cash on hand and demand deposits. Cash equivalents include short term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value and have maturities of three months or less from the original date of acquisition.

**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.

**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.

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

**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 for 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. 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.

The Company uses the fair value based method of accounting for stock based compensation for all grants of options to employees, non-employees and directors. All option grants are accounted for by using the fair value based method, and stock based compensation expense is computed using 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.

**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.

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

**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, 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 had net sales to two major customers during the fiscal year ended July 31, 2007, which contributed approximately 94% of revenue (2006 – 96%).

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 July 31, 2007, the Company had cash balances on deposit that exceeded federally insured limits by \$2,678,788. All of these funds are on deposit with a Schedule A bank in Canada.

**b) Fair value**

Unless otherwise noted, cash, accounts receivable, accounts payable, income tax payable and capital lease obligation are stated at amounts that approximate fair value.

**c) Foreign exchange risk**

The Company is subject to currency risk due to the fluctuations of exchange rates between the Canadian and U.S. dollars. The Company pays for replacement parts and rental and monitoring services from suppliers in U.S. dollars. All of the Company's sales are received in Canada 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.

**JEMTEC INC.**  
**Notes to Financial Statements**  
**July 31, 2007 and 2006**

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**4. Property and Equipment**

	July 31, 2007			July 31, 2006		
	Cost	Accumulated Amortization	Net Book Value	Costs	Accumulated Amortization	Net Book Value
Furniture and fixtures	\$ 40,351	\$ 36,132	\$ 4,219	\$ 40,351	\$ 35,170	\$ 5,181
Monitoring equipment	472,863	280,972	191,891	457,178	181,037	276,141
	<u>\$ 513,214</u>	<u>\$ 317,104</u>	<u>\$ 196,110</u>	<u>\$ 497,529</u>	<u>\$ 216,207</u>	<u>\$ 281,322</u>

Included in monitoring equipment are assets under capital lease at a cost of \$373,100 (2006 - \$373,100) and a net book value of \$170,530 (2006 - \$248,733).

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**

Future minimum lease payments on capital leases are payable as follows:

		Principal	Imputed Interest	Total
Year ending July 31,	2008	79,605	9,344	88,949
	2009	82,039	2,955	84,994
	2010	-	-	-
		<u>161,644</u>	<u>12,299</u>	<u>\$ 173,943</u>
Less: amounts representing interest (8%)				<u>(12,299)</u>
Present value of minimum lease payments				161,644
Less: current portion				<u>(79,606)</u>
				<u>\$ 82,038</u>

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

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

The Company has arranged an unutilized term operating loan which is available to a maximum amount of \$75,000. The loan, if utilized, 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, no par value, redeemable, \$0.60 non-cumulative dividend

**b) Issued and allotted**

	<u>Number of Common Shares</u>	<u>Amount</u>
<b>Balance July 31, 2004</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>	2,355,943	\$ 1,247,160
Effect of consolidation / deconsolidation	<u>(60,207)</u>	<u>\$ (31,910)</u>
<b>Balance July 31, 2006 and 2007</b>	<u><u>2,295,736</u></u>	<u><u>\$ 1,215,250</u></u>

Pursuant to a special resolution passed by shareholders on April 21, 2006, the Company consolidated its common shares on a 100 old shares for 1 new share basis effective April 30, 2006, subsequently followed by a 1 for 100 share split effective May 1, 2006. 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, 60,207 shares were cancelled, a charge of \$55,993 was made to retained earnings, share capital was reduced by the paid up capital of the common shares on the day of the transaction of \$31,910 and \$87,903 was accrued for shareholders entitled to redeem their shares under this agreement. At July 31, 2007, \$77,955 remains in accounts payable and accrued liabilities for the shareholders who have yet to contact 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.

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**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	300,000	\$ 0.21
Granted	330,000	\$ 0.86
Exercised	<u>(284,284)</u>	\$ 0.33
Outstanding, July 31, 2005 and 2006	345,716	\$ 0.84
Cancelled	<u>(46,668)</u>	\$ 1.10
Outstanding, July 31, 2007	<u>299,048</u>	\$ 0.80

During the year ended July 31, 2005, the Company granted 330,000 stock options. 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. The fair value of the options granted is charged to earnings over the vesting period of 18 months. 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%.

During the year ended July 31, 2005, 284,284 options were exercised, for net proceeds of \$93,712.

During the year ended July 31, 2006, stock-based compensation expense related to vesting of the 2005 stock option was credited to contributed surplus in the amount of \$170,218.

On November 30, 2006, the Company cancelled 46,668 options that had been granted to its directors on June 9, 2005. These options were to vest in December 2006. During the six month period ended January 31, 2006, stock-based compensation expense related to vesting of the 2005 stock option was credited to contributed surplus in the amount of \$55,074.

Options outstanding at July 31, 2007 are as follows:

	<u>Options Outstanding and Vested</u>					
	# of Options Granted	Expiry	Exercise Price	Number Outstanding and Vested as at July 31, 2007	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price
Granted, February 26, 2003	150,000	8-Feb-08	\$ 0.11	50,000	0.53	\$ 0.11
Granted, September 21, 2004	50,000	21-Sep-09	\$ 0.30	50,000	2.15	\$ 0.30
Granted, June 9, 2005	<u>280,000</u>	23-Jun-10	\$ 1.10	199,048	2.90	\$ 1.10
	<u>480,000</u>			<u>299,048</u>	2.38 years	<u>\$ 0.80</u>

**8. Economic Dependence**

The Company presently derives substantially all of its revenue from two customers of which one customer contributed approximately 87% of revenue in the year ended July 31, 2007 (2006 - 90%). The Company received notice in July 2007 that this customer has opted not to exercise its right to extend the present contract, referred to the Electronic Supervision Program ("ESP"), beyond the current contracted term of January 2008. However, in October 2007, the Company and this customer agreed to extend the ESP service agreement to April 30, 2008 under the same terms and conditions. The Company intends to bid on the new request for proposal when it is released by this customer.

The Company is a Canadian distributor of Pro-Tech Monitoring, Inc.'s ("Pro-Tech") and the exclusive Canadian distributor of 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 year ended July 31, 2007, \$61,000 (2006 - \$1,600) was accrued or paid to a director who is also the President of the Company under an incentive bonus plan in addition to salaries and benefits paid to the President as management compensation in the normal course of operations. At July 31, 2007, \$51,000 (2006 - \$1,600) is due to the President.

During the year ended July 31, 2007, \$51,500 (2006 - \$53,500) was paid to the directors of the Company as directors' fees.

During the year ended July 31, 2007 \$23,226 (2006 - \$19,382) was paid to an officer of the Company for accounting fees.

These fees, salary, benefits and bonus were paid or accrued as management compensation in the normal course of operations.

**10. Taxes**

A reconciliation of the combined federal and provincial income taxes at statutory rates and the Company's effective income tax expense is as follows:

	2007	2006
Net income before taxes	\$ 1,058,577	\$ 868,274
Income taxes at federal and provincial statutory rates of 35% (2006 - 36%)	370,502	312,579
Increase (decrease) by the effect of		
Non-deductible items	28,479	70,440
Other	274	(7,493)
Income tax expense	\$ 399,255	\$ 375,526

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Future tax assets of the Company are as follows:

	<u>2007</u>	<u>2006</u>
Excess of book over tax amortization	\$ 31,204	\$ 34,258
	<u>\$ 31,204</u>	<u>\$ 34,258</u>

As at July 31, 2007 and 2006, the Company believes that it is more likely than not that the excess capital cost allowance pools available of \$89,153 for tax purposes will be utilized in the future. Thus, no valuation allowance has been recorded as at July 31, 2007 and 2006, and a future tax asset representing the sum of the tax amortization pools over net book values available for application against future taxable income was recorded.

**11. 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.

	Year Ended July 31,	
	<u>2007</u>	<u>2006</u>
	Number of shares	
Basic weighted average shares outstanding	2,295,736	2,340,768
Effect of dilutive securities:		
Options	<u>85,251</u>	<u>71,445</u>
Diluted weighted average shares outstanding	<u>2,380,987</u>	<u>2,412,213</u>