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Auditors' Report

To the Shareholders of
zed.i solutions inc.

We have audited the consolidated balance sheets of **zed.i solutions inc.** as at December 31, 2006 and 2005 and the consolidated statements of operations and deficit and of 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 consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 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.

Deloitte + Touche LLP

Calgary, Alberta
February 20, 2006

Chartered Accountants

zed.i solutions inc.

Consolidated Financial Statements

For the year ended December 31, 2006 and 2005

Consolidated Financial Statements:

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CONSOLIDATED FINANCIAL STATEMENTS

Consolidated Balance Sheets

As at <i>(In thousands)</i>	December 31, 2006	December 31, 2005
Assets		
Current assets:		
Cash and cash equivalents	\$ 9,753	\$ 6,368
Accounts receivable	9,757	7,749
Inventories (Note 3)	7,164	7,115
Prepaid expenses and deposits	157	218
	26,831	21,450
Capital assets (Note 4)	1,441	1,194
Deferred development costs (Note 5)	2,140	1,087
Intangible assets (Note 6)	4,227	4,450
Goodwill (Note 7)	8,480	7,932
Future income tax assets (Note 12)	4,275	2,380
	\$ 47,394	\$ 38,493
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable	\$ 2,018	\$ 1,985
Accrued liabilities	1,169	3,874
Deferred revenue	1,680	1,265
Current portion of long-term debt (Note 8)	2	2
	4,869	7,126
Long-term debt (Note 8)	59	61
	4,928	7,187
Shareholders' equity:		
Share capital (Note 9)	55,261	49,961
Contributed surplus (Note 14)	4,063	2,222
Deficit	(16,858)	(20,877)
	42,466	31,306
	\$ 47,394	\$ 38,493

*See accompanying notes to consolidated financial statements.

Approved on behalf of the Board:



Douglas G. Marlin
Director



Martin A. Lambert
Director

Consolidated Statements of Operations and Deficit

<i>(In thousands, except share and per share amounts)</i>	December 31, 2006	December 31, 2005
Sales	\$ 37,137	\$ 26,416
Cost of sales	20,041	13,711
Gross profit	17,096	12,705
Expenses		
Operations	1,707	1,505
Sales, general and administrative	6,406	4,563
Stock based compensation	3,115	1,649
Research and development (recovery) (Note 12d)	(634)	675
	10,594	8,392
	6,502	4,313
Amortization of capital assets and intangibles	2,500	1,653
Gain on disposal of assets	-	(1)
Interest	(236)	64
	2,264	1,716
Net Income before income taxes	4,238	2,597
Future income tax recovery (provision) (Note 12)	(219)	2,380
Net Income	4,019	4,977
Deficit, beginning of year	(20,877)	(25,854)
Deficit, end of year	\$ (16,858)	\$ (20,877)
Net Income per common share - Basic and Diluted (Note 10)	0.04	0.05
Weighted average number of common shares	100,247,769	96,589,466

*See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

<i>(In thousands)</i>	December 31, 2006	December 31, 2005
Cash Provided by (used in)		
Operations		
Net income	\$ 4,019	\$ 4,977
Adjustments for:		
Amortization	2,500	1,653
Gain on disposal of assets	-	(1)
Stock based compensation	3,115	1,649
Earnout provision	-	(2,751)
Future income taxes	219	(2,380)
Investment tax credits	(1,656)	
Changes in non-cash operating working capital (Note 13)	(1,963)	1,482
	6,234	4,629
Financing		
Proceeds from shares issued	801	869
Repayment of long-term debt	(2)	(6)
	799	863
Investing		
Acquisitions of capital assets	(3,222)	(2,224)
Acquisition of PetroNet Systems Inc., net of cash acquired	106	-
Acquisition of Roughneck.ca, net of cash acquired	-	(1,287)
Changes in non-cash working capital (Note 13)	(550)	-
Proceeds on disposal of capital assets	18	11
	(3,648)	(3,500)
Increase in cash and cash equivalents	3,385	1,992
Cash and cash equivalents, beginning of year	6,368	4,376
Cash and cash equivalents, end of year	\$ 9,753	\$ 6,368
Supplemental Disclosure of Cash Flow Information		
Income taxes paid (received)	-	-
Components of cash and cash equivalents		
Cash	1,176	2,030
Cash equivalents	8,577	4,338

*See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2006 and 2005

1. Nature of operations:

zed.i solutions inc. (the "Company") is engaged in the development, production and sale of high technology products primarily for the energy sector. Activities are directed from the Company's head office in Calgary, Canada with additional sales and service offices in Edmonton and Grande Prairie Canada.

zed.i solutions inc. is a leading provider of innovative optimization technologies for the management of production operations in the energy sector. The Company's solutions focus on well site infrastructure (flow measurement, metering shacks, optimization, well bore manipulation, plunger lift control, booster compression) and the business information needs that link the field with head office and throughout the enterprise.

2. Significant accounting policies:

(a) Basis of presentation

The consolidated financial statements have been prepared by management and include the accounts of the Company and the Company's wholly owned subsidiaries, zed.i solutions® (Canada) inc., zed.i solutions® (USA) inc., Quail Hill Mining Corporation and PetroNet Systems Inc.® All significant inter-company accounts and transactions have been eliminated. Quail Hill Mining Corporation is dormant and has no operations.

(b) Use of estimates

The preparation of financial statements in conformity with Canadian Generally Accepted Accounting Principles ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from those reported. Scientific research tax credits recoverable, amortization rates and the recoverable amounts for receivables, inventories, capital assets, intangible assets, deferred development costs, future income taxes, stock-based compensation, acquisition earnout provision and goodwill are the more significant items subject to estimates in these consolidated financial statements.

(c) Cash and cash equivalents

The Company considers all balances with banks and highly liquid investments with original maturities of three months or less to be cash equivalents.

(d) Inventory

Inventories of raw materials and consumable supplies are valued at the lower of cost and replacement cost. Inventories of work-in-progress and finished goods are valued at the lower of cost and net realizable value.

2. Significant accounting policies, continued:

(e) Revenue recognition

Revenues from the Company's well-test product-line are recorded when the goods are shipped and services are rendered. Revenue from the sale of the Company's Smart-Alek[®] product-line is recorded for the unit when it is shipped and installation fees are recognized when the installation of the Smart-Alek unit is completed.

Revenue from monthly network service fees is recorded in the month in which the services are provided.

(f) Foreign currency contracts

At December 31, 2006, the Company had no outstanding foreign currency forward contracts. At December 31, 2005 the Company had \$1,271,480 outstanding.

(g) Foreign exchange risk

The cost of certain components in sales, cost of sales and the associated accounts payable and accounts receivable that are received in a foreign currency are translated into Canadian dollars at the time of the transactions.

(h) Seasonality

The Company sells its products to the Oil and Gas Industry, primarily in Canada, which is subject to seasonal variations in activity. Traditionally, Canadian drilling activities increase during winter months and tend to slow during the spring, which may result in fluctuations in revenue throughout the year.

2. Significant accounting policies, continued:

(i) *Future income tax assets and income taxes*

The Company follows the asset and liability method for accounting for income taxes. Under this method, future income taxes are recognized for the future income tax consequences attributable to differences between the financial statement carrying values of existing assets and liabilities and their respective income tax bases (temporary differences). Changes in the net future tax asset or liability are included in the statement of operations.

Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in tax rates is included in income in the period of the substantive enactment date. Future income tax assets are evaluated and if realization is not considered more likely than not, a valuation allowance is provided for all or a portion of the future income tax assets.

The investment tax credits receivable are recoverable from the Government of Canada under the Scientific Research and Experimental Development Incentive Program as a reduction in income taxes otherwise payable. The amounts claimed under the program represent management's best estimate based on research and development costs incurred. Realization is subject to government approval. Any adjustment to the amounts claimed will be recognized in the year in which the adjustment occurs.

(j) *Guarantees*

Management of the Company believes there are no material guarantees that require disclosure.

(k) *Research and development costs*

The Company is engaged in research and development. Research costs are expensed as incurred. Development costs are expensed in the period incurred, unless they meet the criteria for deferral established by GAAP. Further, in accordance with GAAP, development costs are deferred only to the extent that their recovery can reasonably be regarded as assured. Management reviews the applicable criteria on a regular basis and if the criteria are no longer met, any remaining unamortized balance is written off as a charge to income. Research and development costs are reduced by any scientific research tax credits.

(l) *Stock-based compensation*

The Company has the following stock-based compensation plans, a stock option plan, an employee share trust and a deferred share unit plan. The Company accounts for stock options using the fair-value based method beginning January 1, 2004. Under the fair-value based method, compensation expense for stock options is measured at fair value at the date of grant and is amortized over the stock option vesting period. The Company has a deferred share unit plan for non-employee directors which allows for settlements in cash or shares at the holder's option, and is accounted for as a liability award. The Company's obligations are measured at each reporting period on a mark to market basis with any required adjustments reflected in sales, general and administrative expense.

2. Significant accounting policies, continued:

(m) Capital assets and assets under capital leases

Capital assets and assets under capital leases are recorded at acquisition cost less related investment tax credits, with amortization calculated using the following methods and annual rates:

Asset	Basis	Rate
Office furniture and fixtures	Declining balance	20%
Equipment	Declining balance	30%
Computer hardware	Declining balance	30%
Computer software	Declining balance	100%
Automotive	Declining balance	10% to 30%
Leasehold Improvements	Straight-line	3 Years

(n) Deferred development costs

Deferred development costs incurred on new product development projects, which, in the Company's view, have clearly defined market prospects, are deferred and amortized on a straight-line basis over 3 years, commencing in the year in which the new products begin generating revenue. The ability to recover the carrying value of deferred development costs is based on estimated future cash flow models, which by their nature, are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant. The net carrying amount of these costs are reviewed at least annually or when circumstances change to determine whether there has been impairment in value.

(o) Purchased intangible assets

Purchased intangible assets are recorded at cost and amortized on a straight-line basis over their expected useful lives. The net carrying amount of purchased intangible assets is reviewed at least annually or when circumstances change to determine whether there has been impairment in value. The review methodology is comprised of an assessment of the continuing contribution of the applicable product contribution to operations and an assessment of expected future cash flows. Intangibles acquired on the acquisition of WebTech 2000 Inc., D.G. Wehrhahn Company Ltd., Menex Technologies Inc., Roughneck.ca[®] Inc., and PetroNet Systems Inc. are being amortized as follows:

Intangibles – Purchased software	(5 years)
Intangibles – Employment Contracts	(2 years)
Intangibles – Employment Contracts Menex and Roughneck	(3 years)
Intangibles – Intellectual property Menex	(12 years)
Intangibles – Customer relationships Roughneck	(3 years)
Intangibles – Customer relationships PetroNet	(1 year)
Intangibles – Developed software and Patent Roughneck	(5 years)
Intangibles – Developed software PetroNet	(3 years)
Patents and Trademarks	(17 Years)

2. Significant accounting policies, continued:

(p) Goodwill

Goodwill represents the excess of the purchase price over the value attributed to net tangible assets acquired. Goodwill is assessed for impairment at least annually or when circumstances change. The impairment is based on management's best estimate of the fair value of the Company compared to the carrying amounts of the Company.

(q) Earnings per Share

Basic and diluted earnings per share is determined by dividing the net income by the weighted average number of ordinary shares outstanding during the financial period.

3. Inventories:

	December 31, 2006	December 31, 2005
Raw materials and consumable supplies	\$ 2,439,539	\$ 2,461,564
Finished goods	4,537,050	4,516,717
Work In Progress	187,890	136,893
	<u>\$ 7,164,479</u>	<u>\$ 7,115,174</u>

4. Capital assets:

December 31, 2006	Cost	Accumulated amortization	Net book value
Office furniture and fixtures	\$ 729,929	\$ 456,704	\$ 273,225
Equipment	841,561	658,996	182,565
Computer hardware	1,947,080	1,241,747	705,333
Computer software	1,501,966	1,358,108	143,858
Automotive	84,948	32,105	52,843
Leasehold Improvements	141,946	58,312	83,634
	<u>\$ 5,247,430</u>	<u>\$ 3,805,972</u>	<u>\$ 1,441,458</u>

December 31, 2005	Cost	Accumulated amortization	Net book value
Office furniture and fixtures	\$ 589,632	\$ 402,438	\$ 187,194
Equipment	838,476	598,409	240,067
Computer hardware	1,638,546	1,010,935	627,611
Computer software	1,157,972	1,077,525	80,447
Automotive	60,782	19,508	41,274
Leasehold Improvements	53,236	35,688	17,548
	<u>\$ 4,338,644</u>	<u>\$ 3,144,503</u>	<u>\$ 1,194,141</u>

As at December 31, 2006, computer hardware with a cost of \$104,482 and a net book value of \$8,083 (2005 - \$11,547) are assets held under capital lease.

5. **Deferred development costs:**

December 31, 2006	Cost	Accumulated amortization	Net book value
Deferred Development Costs	\$ 3,215,817	\$ 1,076,019	\$ 2,139,798
	\$ 3,215,817	\$ 1,076,019	\$ 2,139,798

December 31, 2005	Cost	Accumulated amortization	Net book value
Deferred Development Costs	\$ 1,341,602	\$ 254,743	\$ 1,086,859
	\$ 1,341,602	\$ 254,743	\$ 1,086,859

During 2006 the Company recognized the benefit of \$2,031,000 related to SRED Investment tax credits for qualifying expenditures of previous years. Of this amount, \$268,000 was recorded as a reduction of deferred development costs, \$107,000 was recorded as a reduction of capital assets and \$1,656,000 was recorded as the reduction of research and development expense.

6. **Intangible assets:**

December 31, 2006	Cost	Accumulated amortization	Net book value
Purchased Software	\$ 559,317	\$ 559,317	\$ -
Intellectual Property	4,094,034	918,711	3,175,323
Developed Software	1,331,954	480,321	851,633
Workforce	467,000	363,875	103,125
Patents and Trademarks	125,507	28,109	97,398
	\$ 6,577,812	\$ 2,350,333	\$ 4,227,479

December 31, 2005	Cost	Accumulated amortization	Net book value
Purchased Software	\$ 559,317	\$ 462,692	\$ 96,625
Intellectual Property	3,955,297	463,546	3,491,751
Developed Software	855,000	154,750	700,250
Workforce	342,000	267,000	75,000
Patents and Trademarks	108,157	21,416	86,741
	\$ 5,819,771	\$ 1,369,404	\$ 4,450,367

7. Goodwill

	2006	2005
Balance, beginning of year	\$7,932,186	\$3,393,618
Acquisition of Roughneck.ca Inc.	-	1,787,266
Earnout provision (Note 9(c))	-	2,751,302
Acquisition of PetroNet Systems Inc. (Note 9(c))	547,948	-
Balance, end of year	\$8,480,134	\$7,932,186

8. Long-term debt:

	December 30, 2006	December 31, 2005
Debt related to the Industry Energy Research and Development ("IERD") loan payable, Natural Resources Canada, through its program, IERD has sponsored the Company's flow control research and development. The loan commenced repayment when the product was commercially viable. The Company is required to repay the loan based on 1.5% of gross revenues from product sales until repaid in full. Payments are due no later than 30 days after the end of June and December, with interest on overdue amounts at the Bank of Canada prime rate plus 2%. The loan is unsecured. During year ended December 31, 2006 the Company made loan payments of \$2,287 (December 31, 2005-\$5,888)	61,161	63,448
	61,161	63,448
Less current portion	1,732	2,106
Long-term portion	\$ 59,429	\$ 61,342

9. Share capital

(a) Authorized and issued shares:

The Company is authorized to issue an unlimited number of common voting shares without nominal or par value. The following is a summary of the Company's issued and outstanding common shares:

	Year Ended December 31, 2006		Year Ended December 31, 2005	
	Number	Amount	Number	Amount
Balance outstanding, beginning of year	97,862,341	\$49,960,802	95,564,576	\$47,693,244
Shares issued:				
Issued pursuant to acquisition of Roughneck, net of share issuance costs	-	-	535,714	1,305,544
Issued from Treasury pursuant to earnout provision of Roughneck (note 9(c))	1,467,361	2,201,042	-	-
Stock options exercised (note 9(b))	1,804,147	1,314,318	1,762,051	962,014
Issued pursuant to acquisition of PetroNet, net of share issuance costs (note 9(d))	720,000	1,030,403	-	-
Issuance of RSU and DSU		754,000	-	-
Balance outstanding, end of year	101,853,849	\$55,260,565	97,862,341	\$49,960,802

(b) Stock options exercised:

During the year ended December 31, 2006, 1,804,147 stock options were exercised for proceeds of \$1,314,318.

(c) The board of directors approved the calculation of the earnout as part of the purchase price in the acquisition of Roughneck.ca Inc., the payment of the earnout was made on January 26, 2006. The total earnout approved for payment was \$2,751,302, which was paid as provided in the purchase and sale agreement as to 20% cash (\$550,260) and 80% common shares in zed.i solutions inc. (1,467,361 shares based on a deemed price of \$1.50 per share, based on the average closing market price for the 20 trading days prior to the execution of the letter of intent, discounted by 10%).

9. Share capital, continued:

(d) Acquisition of PetroNet Systems Inc.

On April 1, 2006 the Company completed the acquisition of all the issued and outstanding shares of PetroNet Systems Inc. ("PetroNet"). The acquisition of PetroNet was accounted for using the purchase method and the results of operations of PetroNet are included in the consolidated financial statements from April 1, 2006. PetroNet shareholders received 25% of the consideration paid on closing in cash and 75% in common shares of zed.i. Based on the achievement of revenue performance targets over the next two years, the former shareholders of PetroNet have an opportunity to earn an additional amount up to a maximum of approximately \$1.3 million. The earnout is payable as to 25% in zed.i common shares and 75% in cash, with the portion paid in zed.i common shares valued at \$1.25 per share. The maximum payout is calculated on the basis of a multiple of approximately 3.1 times 2007 earnings from PetroNet Systems Inc. The issuance of 720,000 shares of zed.i solutions inc. are accounted for at a weighted average market value of \$1.44 per share for a total value of \$1,036,800. The fair value of the net assets acquired were:

<i>Net assets acquired:</i>	\$
<i>Working capital</i>	(265,050)
<i>Property, plant and equipment</i>	8,488
<i>Future income tax asset</i>	82,670
<i>Intangibles</i>	740,691
<i>Goodwill</i>	<u>547,948</u>
	1,114,747
<i>Financed by:</i>	\$
Cash	77,947
Shares issued	<u>1,036,800</u>
Total purchase consideration	1,114,747

(e) Shares held in escrow

The following is a summary of the Company's common shares held in escrow:

	December 31, 2006	December 31, 2005
Balance outstanding, beginning of year	207,950	809,890
Shares in escrow, additional	-	45,972
Shares released from escrow in the year	(207,950)	(647,912)
Balance outstanding, end of year	-	207,950

9. Share capital, continued:

(f) Stock options outstanding:

On May 30, 2000, the Company established a stock option plan for directors, officers, employees and consultants, which permits the granting of options to purchase up to a maximum of 10% of the Company's issued and outstanding common shares. The number of options and exercise price thereof is set by the Board of Directors at the time of grant provided that such exercise price shall not be less than that from time to time permitted under the rules of any stock exchange or exchanges on which the Company's shares may be listed. The maximum number of options that may be granted to any one individual shall not exceed 5% of the Company's issued and outstanding common shares. The options granted under the plan may be exercisable for a period not exceeding five years and may vest at such times, as the Board of Directors may determine at the time of grant.

During the year ended December 31, 2006, a total of 4,306,496 options were granted.

The number of shares reserved for stock options is 10% of the total issued shares.

A summary of the status of the plan, is presented below:

	<u>December 31, 2006</u>		<u>December 31, 2005</u>	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Outstanding, beginning of year	9,143,357	\$ 1.41	4,669,239	\$ 0.36
Granted	4,306,496	1.02	6,341,835	1.76
Exercised	(1,804,147)	0.44	(1,762,051)	0.35
Expired/cancelled	(1,422,943)	1.92	(105,666)	2.09
Outstanding, end of period	10,222,763	\$ 1.33	9,143,357	\$ 1.41
Options exercisable, end of year	2,471,986		2,639,148	

Exercise Prices	<u>Options Outstanding</u>			<u>Options Exercisable</u>	
	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$0.00-\$0.20	3,334	1.4 yrs	\$0.20	3,334	\$0.20
\$0.21-\$0.49	504,702	1.1 yrs	\$0.42	342,523	\$0.42
\$0.50-\$1.00	3,457,415	3.9 yrs	\$0.91	3,333	\$0.62
\$1.01-\$2.00	4,982,083	2.8 yrs	\$1.47	1,492,868	\$1.47
\$2.01-\$2.88	1,275,229	2.0 yrs	\$2.32	629,928	\$2.32
\$0.20 - \$2.88	10,222,763	3.0 yrs	\$1.33	2,471,986	\$1.54

(f) *Stock options outstanding, continued:*

The fair-value of each option grant by the Company was estimated on the date of grant using the Black-Scholes option-pricing model with weighted-average assumptions for grants assuming no dividends are paid on common shares. The amounts computed according to the Black-Scholes pricing model may not be indicative of the actual values realized upon the exercise of these options by the holders.

	2006	2005
Risk free interest rate	4.08%	3.07%
Expected life in years	3.0	3.0
Expected Volatility	62%	78%

(g) *Deferred share unit plan for non-employee directors*

The Company maintains a deferred share unit (DSU) plan to provide directors with the option to elect to receive DSUs in lieu of cash payment for all or a portion of their director fees. When such an election is made, the Company credits to the account of each director a number of DSUs equal to the amount of fees divided by the fair market value of the common shares. DSUs vest immediately and are equivalent in value to common shares. The directors' accounts shall be credited with dividend equivalents in the form of additional DSUs if and when the Company pays dividends on the common shares. Units are redeemable, in cash or Common shares only following termination of the director's services and must be redeemed by December 31 of the following year or in certain cases a shorter time period. During the period, the Company issued an aggregate of 7,601 DSUs (2005 – nil) in respect of \$9,000 (2005 – \$nil) of director fee compensation. The Company has an obligation under the DSU plan at December 31, 2006 of \$7,221 (2005 - \$nil).

(h) *Deferred share units and Restricted share units*

During the year, the Company issued an aggregate of 250,000 DSUs (2005 – nil) and 400,000 RSUs in respect of signing bonus compensation. The Company has recorded under the DSU plan at December 31, 2006 \$290,000 (2005 - \$nil) and recorded under the RSU plan at December 31, 2006 \$464,000 (2005 - \$nil).

10. Reconciliation of earnings per share amounts:

The following table set forth the reconciliation of basic and diluted earnings per share.

	December 31, 2006	December 31, 2005
Net Income	<u>\$4,019,000</u>	<u>\$4,977,000</u>
Weighted average number of common shares outstanding – basic	100,247,769	96,589,466
Net Shares assumed issued	321,902	1,500,165
Weighted average number of common shares outstanding – diluted	<u>100,569,671</u>	<u>98,089,631</u>
Earnings per shares:		
Basic	\$0.04	\$0.05
Diluted	\$0.04	\$0.05

11. Revenue:

During the year ended December 31, 2006, the Company generated approximately 4.7% (2005- 0.2%) of its revenue in the US, 95% (2005- 99%) in Canada, 0.1 % (2005 – 0.3%) in the Middle East and 0.2% (2005 – 0.5%) in other geographic regions. The Company's operations and assets are primarily located in Canada.

12. Income taxes:

(a) Future Income Tax Assets

In assessing the realizability of future tax assets, management considers whether it is more likely than not that some portion or all of the future tax assets will not be realized. The ultimate realization of future tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of future tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. The amount of the future tax asset considered realizable could change materially in the near term based on future taxable income during the carry forward period. During the year ended December 31, 2006, the Company recognized a provision of \$219,000 in previously unrecognized tax losses carried forward.

(b) Expected tax rate:

The expected effective tax rate for a public company in Alberta will be approximately 32% in 2006 and 34% in 2005.

	2006	2005
Combined basic Canadian federal and provincial income tax rate	32%	34%
Expected combined Canadian federal and provincial tax payable (recovery) based on above rates	\$1,360,000	\$873,000
Non-deductible items	1,150,000	734,000
Creation and reversal of temporary differences	2,634,000	296,000
Other	-	1,000
Utilization of loss carryforwards	(1,610,000)	(1,904,000)
Change in valuation allowance	(3,377,000)	(2,379,500)
Rate Changes	62,000	
Consolidated income tax provision (recovery)	\$219,000	\$(2,379,500)

The Company provided a valuation allowance against the future income tax assets based on the Company's evaluation of the likelihood of realization of these assets based on positive and negative evidence. The Company will continue to evaluate and examine the valuation allowance on a regular basis.

12. Income taxes, continued:

(c) Net future tax asset:

Future income taxes arise from temporary differences which are differences between the tax basis of an asset or liability and its carrying amount in the balance sheet. The tax effects of temporary differences that give rise to significant portions of the future tax assets and liabilities at December 31, 2006 and 2005 are presented below:

	December 31, 2006	December 31, 2005
Future tax assets and (liabilities):		
Non-capital losses carried forward Canada	\$ 1,496,000	\$ 4,188,200
Scientific research tax pools and credits	2,267,000	1,053,600
Canadian exploration and development tax pools	940,000	1,090,200
Foreign exploration and development tax pools	2,335,000	2,706,900
Financing fees	75,000	143,600
Reorganization costs	166,000	195,600
Capital assets, differences between net book value and undepreciated capital cost	640,000	149,700
Other	98,000	(29,200)
Total	8,017,000	9,498,600
Less valuation allowance	(3,742,000)	(7,119,100)
Net future tax asset	\$ 4,275,000	\$ 2,379,500

The valuation allowance at December 31, 2006 is primarily in respect of Canadian and Foreign exploration and development tax pools. These pools are not subject to expiry, however the amounts are only deductible against income from prescribed activities.

The non-capital losses carried forward expire primarily between 2010 and 2016 as follows:

2007	\$ 42
2008	4,197
2009	23,477
2010	3,527,117
2014	404,115
2015	613,546
2016	<u>173,955</u>
	<u>\$4,746,449</u>

(d) Investment Tax Credits:

During 2006 the Company recognized the benefit of \$2,031,000 related to SRED Investment tax credits for qualifying expenditures of previous years. Of this amount, \$375,000 was recorded as a reduction of deferred development costs and equipment and \$1,656,000 was recorded as the reduction of research and development expense.

13. Supplemental disclosure of cash flow information:

Changes in non-cash working capital were comprised of the following:

	Dec 31, 2006	Dec 31, 2005
Accounts receivable	\$ (1,971,000)	\$ (1,894,000)
Sales Leases Receivable	-	573,000
Inventory	(49,000)	(2,790,000)
Prepaid expenses and deposits	61,000	127,000
Accounts payable	(453,000)	759,000
Accrued liabilities	(516,000)	3,442,000
Deferred revenue	415,000	1,265,000
	\$ (2,513,000)	\$ 1,482,000
Operating Activities	\$ (1,963,000)	\$ 932,000
Investing:	(550,000)	550,000
	<u>\$ (2,513,000)</u>	<u>\$ 1,482,000</u>

Non-cash transactions consisted of:

Portion of acquisition of PetroNet acquired through issuance of shares	1,030,000	
Portion of increase in goodwill related to earn-out provisions settled in shares		2,201,000
Portion of acquisition of Roughneck acquired through issuance of shares		1,312,000

14. Contributed surplus:

Contributed surplus increased in connection with the recognition of compensation cost relating to stock options. Contributed surplus is decreased when those stock options are exercised.

	Dec 31, 2006	Dec 31, 2005
Balance, beginning of year	\$ 2,222,000	\$ 791,000
Stock-based compensation expense	2,354,000	1,649,000
Exercise of Stock Options	(513,000)	(218,000)
Balance, end of year	\$ 4,063,000	\$ 2,222,000

15. Financial instruments:

Fair values:

The carrying values of cash and cash equivalents, accounts receivable, accounts payable, IERD loan payable and accrued liabilities approximate their fair values due to the relatively short periods to maturity of the instruments.

The carrying value of sales leases receivable does not differ significantly from its fair value.

Credit risk:

At December 31, 2006, no customer represented a significant percentage of total accounts receivable. The Company does not obtain collateral or other security to support financial instruments subject to credit risk but mitigates this risk by dealing with financially sound counterparties and, accordingly, does not anticipate significant loss for non-performance.

Foreign exchange risk:

The Company earns revenue and records accounts receivable and sales leases receivable in foreign currency and translates these amounts to Canadian dollars at the time of these transactions. The Company does not use derivative instruments to mitigate the effects of foreign exchange changes between the recording date of the accounts receivable or sales leases receivable and the receipt of cash. The accounts receivable are short-term in nature. The sales leases receivable are of a longer term and are subject to fluctuations in the exchange rate of the US dollar. The effect of the foreign exchange changes have not been significant and foreign exchange gains and losses are included in income as they occur.

16. Credit Facilities

The Company has credit facilities of \$5,000,000 to cover increased cash needs during peak demand periods. The interest rate is at Royal Bank Prime plus 1.5%. Security consists of a general security agreement creating a security interest in all of the Company's personal property. The credit facility contains customary covenants. Zedi is currently not using any of the credit facility available.

17. Commitments:

Operating leases:

The Company is committed to various operating leases for office premises and vehicles. The approximate annual base rental payments are as follows:

2007	\$ 574,000
2008	610,000
2009	612,000
2010	628,000
2011	642,000
	<hr/>
	\$ 3,066,000

Under the terms of the leases, the Company is also responsible for its proportionate share of operating costs.