

# CONSOLIDATED BALANCE SHEETS

AS AT  
SEPTEMBER 30, DECEMBER 31,

(\$ thousands)

	2006	2005
	(Unaudited)	(Unaudited)
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
CASH AND CASH EQUIVALENTS	\$ 10,161	\$ 6,368
ACCOUNTS RECEIVABLE	6,287	7,749
INVENTORIES	7,758	7,115
PREPAID EXPENSES AND DEPOSITS	198	218
	24,404	21,450
<b>CAPITAL ASSETS</b>		
DEFERRED DEVELOPMENT COSTS	1,494	1,194
INTANGIBLE ASSETS	2,131	1,087
GOODWILL	4,477	4,450
FUTURE INCOME TAX ASSETS	8,480	7,932
	3,616	2,380
	\$ 44,602	\$ 38,493
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
ACCOUNTS PAYABLE	\$ 1,422	\$ 1,985
ACCRUED LIABILITIES	1,658	3,874
DEFERRED REVENUE	2,746	1,265
CURRENT PORTION OF LONG-TERM DEBT	1	2
	5,827	7,126
LONG-TERM DEBT	60	61
	5,887	7,187
<b>SHAREHOLDERS' EQUITY:</b>		
SHARE CAPITAL	53,544	49,961
CONTRIBUTED SURPLUS	3,788	2,222
DEFICIT	(18,617)	(20,877)
	38,715	31,306
	\$ 44,602	\$ 38,493

See accompanying notes to consolidated financial statements.

On behalf of the Board:



**DOUGLAS G. MARLIN**

Director



**MARTIN A. LAMBERT**

Director

# CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT

(\$ thousands, except share and per share amounts)	THREE MONTHS ENDED SEPT. 30		NINE MONTHS ENDED SEPT. 30	
	2006	2005	2006	2005
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
<b>SALES</b>	<b>\$ 6,793</b>	<b>\$ 5,986</b>	<b>\$ 26,377</b>	<b>\$ 17,068</b>
<b>COST OF SALES</b>	<b>3,800</b>	<b>2,895</b>	<b>14,607</b>	<b>8,877</b>
<b>GROSS PROFIT</b>	<b>2,993</b>	<b>3,091</b>	<b>11,770</b>	<b>8,191</b>
<b>EXPENSES</b>				
OPERATIONS	403	332	1,183	1,122
SALES, GENERAL AND ADMINISTRATIVE	1,238	1,175	4,712	3,087
STOCK-BASED COMPENSATION	1,333	382	2,420	1,149
RESEARCH AND DEVELOPMENT	257	171	762	529
	3,231	2,060	9,077	5,887
	(238)	1,031	2,693	2,304
AMORTIZATION OF CAPITAL ASSETS AND INTANGIBLES	669	465	1,732	1,155
GAIN ON DISPOSAL OF ASSETS	–	–	–	(1)
INTEREST	(78)	27	(145)	(36)
	591	492	1,587	1,118
NET INCOME (LOSS) BEFORE INCOME TAXES	(829)	539	1,106	1,186
FUTURE INCOME TAXES	(21)	1,978	1,154	1,978
NET INCOME (LOSS)	(850)	2,517	2,260	3,164
DEFICIT, BEGINNING OF PERIOD	(17,767)	(25,207)	(20,877)	(25,854)
DEFICIT, END OF PERIOD	\$ (18,617)	\$ (22,690)	\$ (18,617)	\$ (22,690)
NET INCOME (LOSS) PER COMMON SHARE – BASIC AND DILUTED	(0.008)	0.026	0.023	0.033
WEIGHTED AVERAGE NUMBER OF COMMON SHARES	100,475,282	96,826,689	99,979,354	96,280,424

See accompanying notes to consolidated financial statements.

# CONSOLIDATED STATEMENTS OF CASH FLOWS

(\$ thousands)	THREE MONTHS ENDED SEPT. 30		NINE MONTHS ENDED SEPT. 30	
	2006	2005	2006	2005
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
<b>CASH PROVIDED BY (USED IN)</b>				
<b>OPERATIONS</b>				
NET INCOME (LOSS)	\$ (850)	\$ 2,517	\$ 2,260	\$ 3,164
ADJUSTMENTS FOR:				
AMORTIZATION	669	465	1,732	1,155
GAIN ON DISPOSAL OF ASSETS	–	–	–	(1)
STOCK-BASED COMPENSATION	1,333	382	2,420	1,149
EARNOUT PROVISION	–	(1,217)	–	(1,217)
FUTURE INCOME TAXES	21	(1,978)	(1,154)	(1,978)
CHANGES IN NON-CASH OPERATING WORKING CAPITAL	654	475	1,196	2,506
	1,827	644	6,454	4,778
<b>FINANCING</b>				
PROCEEDS FROM SHARES ISSUED	3	221	258	588
REPAYMENT OF LONG-TERM DEBT	(2)	(2)	(2)	(6)
	1	219	256	582
<b>INVESTING</b>				
ACQUISITIONS OF CAPITAL ASSETS	(727)	(343)	(2,257)	(1,882)
ACQUISITION OF PETRONET SYSTEMS INC., NET OF CASH ACQUIRED	–	–	(127)	–
ACQUISITION OF ROUGHNECK.CA, NET OF CASH ACQUIRED	–	–	–	(1,287)
ACQUISITION OF ROUGHNECK.CA, PAYMENT OF EARNOUT	–	–	(550)	–
PROCEEDS ON DISPOSAL OF CAPITAL ASSETS	17	2	17	11
	(710)	(341)	(2,917)	(3,158)
INCREASE IN CASH AND CASH EQUIVALENTS	1,118	522	3,793	2,202
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	9,043	6,056	6,368	4,376
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 10,161	\$ 6,578	\$ 10,161	\$ 6,578
<b>COMPONENTS OF CASH AND CASH EQUIVALENTS</b>				
CASH	1,871	3,067	1,871	3,067
CASH EQUIVALENTS	8,290	3,511	8,290	3,511

See accompanying notes to consolidated financial statements.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the nine months ended September 30, 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. These consolidated financial statements do not include all of the disclosures applicable to annual financial statements; therefore, they should be read in conjunction with the December 31, 2005 audited consolidated financial statements.

**(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) FOREIGN CURRENCY CONTRACTS** At September 30, 2006, the Company had no outstanding foreign currency forward contracts.

**[2] SIGNIFICANT ACCOUNTING POLICIES: (CONTINUED)**

**(D) FOREIGN EXCHANGE RISK** The cost of certain components in cost of sales and the associated accounts payable are denominated in foreign currency.

**(E) 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.

**(F) 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.

**(G) GUARANTEES** Management of the Company believes there are no material guarantees, which require disclosure.

**(H) 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.

## **[2] SIGNIFICANT ACCOUNTING POLICIES: (CONTINUED)**

**(I) 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. 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.

**(J) 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.

**(K) 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<sup>®</sup> Inc., and PetroNet Systems Inc. are being amortized as follows:

Intangibles – Purchased software	(5 years)
Intangibles – Workforce	(2 years)
Intangibles – Workforce 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)

**[3] 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:

	NINE MONTHS ENDED SEPTEMBER 30,		YEAR ENDED DECEMBER 31,	
	2006		2005	
	NUMBER	AMOUNT	NUMBER	AMOUNT
<b>BALANCE OUTSTANDING, BEGINNING OF PERIOD</b>	<b>97,862,341</b>	<b>\$ 49,960,802</b>	95,564,576	\$ 47,693,244
<b>SHARES ISSUED:</b>				
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 3(c))	1,467,361	2,201,042	–	–
STOCK OPTIONS EXERCISED (note 3(b))	431,630	351,984	1,762,051	962,014
ISSUED PURSUANT TO ACQUISITION OF PETRONET, NET OF SHARE ISSUANCE COSTS (note 3(d))	720,000	1,030,403	–	–
<b>BALANCE OUTSTANDING, END OF PERIOD</b>	<b>100,481,332</b>	<b>\$ 53,544,231</b>	97,862,341	\$ 49,960,802

(B) **STOCK OPTIONS EXERCISED:** During the nine months ended September 30, 2006, 431,630 stock options were exercised for proceeds of \$351,984.

(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%).

### **[3] 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. is 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 was:

<b>NET ASSETS ACQUIRED:</b>	<b>\$</b>
<b>WORKING CAPITAL</b>	<b>(265,050)</b>
<b>PROPERTY, PLANT AND EQUIPMENT</b>	<b>8,488</b>
<b>FUTURE INCOME TAX ASSET</b>	<b>82,670</b>
<b>INTANGIBLES</b>	<b>740,691</b>
<b>GOODWILL</b>	<b>547,948</b>
	<b>1,114,747</b>
<b>FINANCED BY:</b>	<b>\$</b>
<b>CASH</b>	<b>77,947</b>
<b>SHARES ISSUED</b>	<b>1,036,800</b>
<b>TOTAL PURCHASE CONSIDERATION</b>	<b>1,114,747</b>

**[3] SHARE CAPITAL: (CONTINUED)**

**(D) SHARES HELD IN ESCROW** The following is a summary of the Company's common shares held in escrow:

	SEPTEMBER 30,	DECEMBER 31,
	2006	2005
<b>BALANCE OUTSTANDING, BEGINNING OF PERIOD</b>	<b>207,950</b>	809,890
<b>SHARES IN ESCROW, ADDITIONAL</b>	–	45,972
<b>SHARES RELEASED FROM ESCROW IN THE PERIOD</b>	<b>(207,950)</b>	(647,912)
<b>BALANCE OUTSTANDING, END OF PERIOD</b>	–	207,950

**(E) 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 nine months ended September 30, 2006, a total of 855,748 options were granted. On November 8, 2002, the Company's Board of Directors approved a re-pricing of 1,062,200 options, held by employees who were not executives or officers, at an exercise price of \$0.20.

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

**[3] SHARE CAPITAL: (CONTINUED)**

**(E) STOCK OPTIONS OUTSTANDING: (CONTINUED)**

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

	SEPTEMBER 30,		DECEMBER 31,	
	2006		2005	
	OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE	OPTIONS	WEIGHTED AVERAGE EXERCISE PRICE
OUTSTANDING, BEGINNING OF PERIOD	9,143,357	\$ 1.41	4,669,239	\$ 0.36
GRANTED	855,748	1.45	6,341,835	1.76
EXERCISED	(431,630)	0.60	(1,762,051)	0.35
EXPIRED/CANCELLED	(482,002)	1.68	(105,666)	2.09
OUTSTANDING, END OF PERIOD	9,085,473	\$ 1.44	9,143,357	\$ 1.41
OPTIONS EXERCISABLE, END OF PERIOD	3,320,011		2,639,148	

EXERCISE PRICES	Options Outstanding			Options Exercisable	
	NUMBER OUTSTANDING	WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE	WEIGHTED AVERAGE EXERCISE PRICE	NUMBER EXERCISABLE	WEIGHTED AVERAGE EXERCISE PRICE
\$0.00 – \$0.20	285,071	0.1 yrs	\$0.20	285,071	\$0.20
\$0.21 – \$0.49	1,250,486	1.0 yrs	\$0.42	1,088,306	\$0.42
\$0.50 – \$1.00	351,667	0.4 yrs	\$0.50	348,333	\$0.50
\$1.01 – \$2.00	5,192,416	3.0 yrs	\$1.47	214,685	\$1.56
\$2.01 – \$2.88	2,005,833	2.1 yrs	\$2.33	1,383,617	\$2.32
\$0.20 – \$2.88	9,085,473	2.3 yrs	\$1.44	3,320,011	\$1.27

**[3] SHARE CAPITAL: (CONTINUED)**

*(E) 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	3.39%	3.07%
EXPECTED LIFE IN YEARS	3.0	3.0
VOLATILITY	72%	78%

*(F) 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 6,022 DSUs (2005 – nil) in respect of \$7,500 (2005 – \$nil) of director fee compensation. The Company has an obligation under the DSU plan at September 30, 2006 of \$6,986 (2005 – \$nil).

*(G) DEFERRED SHARE UNITS AND RESTRICTED SHARE UNITS* During the period, the Company issued an aggregate of 250,000 DSUs (2005 – nil) and 400,000 RSUs in respect of \$650,000 (2005 – \$nil) of signing bonus compensation. The Company has an obligation under the DSU plan at September 30, 2006 of \$290,000 (2005 – \$nil) and an obligation under the RSU plan at September 30, 2006 of \$464,000 (2005 – \$nil).

#### **[4] INCOME TAXES:**

**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 nine months ended September 30, 2006, the Company recognized the benefit of \$1,154,000 in previously unrecognized tax losses carried forward.