

LETTER TO THE Shareholders

Well, the 3rd Quarter was a very exciting and rewarding quarter for AMS. We completed a financing with MGI Securities and several other groups with an over subscribed offering at \$0.40 for 16,250,000 units. Each unit contained 1 common share and a ½ common share purchase option priced at \$0.60 for the first 12 months and \$0.75 for the following 12 months. While this offering is dilutive to the current shareholders, it does give AMS the financial where with all to execute our business plan.

That plan includes the aggressive capitalization on opportunities brought to us through the Meggitt (UK) Ltd. opportunity which was signed right at the end of the 2nd quarter. In the past quarter we have been strongly engaged with 3 original equipment manufacturers (OEMs) to install AMS products as standard fit equipment on their production aircraft. OEMs are manufacturers of aircraft, both rotor and fixed wing and are an area of interest that we had virtually no access to until we were associated with Meggitt. Meggitt has relationships with virtually every OEM on the Planet including the former Soviet Union. This strength will be evident in future quarters as the AMS-Meggitt relationship plays itself out.

The 3rd quarter was slower than the 1st and 2nd quarters, from an installation point of view, but this is expected every year because the airlines do not schedule downtime for aircraft over the busy summer months. Still, on a gross basis, our sales were nearly \$300k compared to \$349k for the 1st quarter and 357K for the 2nd before taking into account the amortization of our revenues to recognize the revenue recognition policies we have adopted. That brings our year to date sales to \$1,002,349 up from \$651,635 for the same period last year. We are expecting a strong 4th quarter because we have signed 2 new airlines that are expected to complete their installations in the quarter and Skyservice has begun their installations on 26 aircraft.

We also had very good news on China in the 3rd Quarter. We successfully completed our test flight on the Boeing 737 in China in August and have both the Canadian and Chinese Supplemental Type Certificate (STC) in hand for AFIRS Global Voice for the Boeing 737 models 200, 300, 400, 500, 600, 700 and 800 and have filed that STC with the FAA for final approval. That approval is expected in November and the installations at China Eastern will proceed in the new year. We also have agreements from Hainan Airlines and China Southern Airlines to commence installations on their 737 fleets.

Applications are being completed for complete AFIRS 200 installations including phone, integrated audio, text messaging in the cockpit and full AFIRS functionality being completed in the 4th quarter for Boeing 737 models 200, 300, 400, 500, 600, 700 and 800, Boeing 757 and 767 and Airbus 319, 320 and 321. We expect to have Canadian STCs for all of these by December 31 and the appropriate paperwork filled with EASA (Europe's Transport Canada equivalent) and the FAA. We already have the Transport Canada approval for the DHC-8 100, 200, and 300 for this full suite of functions.

These developments, and the strong approval and acceptance of our technologies we are seeing with our growing customer base, provide us with reasons to be very optimistic about our future growth.

We would like to take this time to thank a very dedicated and loyal staff for their outstanding contribution to get us to here and the loyalty of our shareholders in allowing us to make this all come together. While we are not out of the woods, we can clearly see the path and believe we have the formula perfected to give great rewards to our shareholders, staff and customers because of the patience shown by all.

Sincerely,



Bill Tempany
CEO



Darryl Jacobs
Founder and President

Financial Statements

This management discussion and analysis ("MD&A") should be read in conjunction with the audited annual consolidated financial statements for the year ended December 31, 2005 of AeroMechanical Services Ltd. ("AMS" or the "Company") and AMS' audited consolidated financial statements, notes thereto, and MD&A for the year ended December 31, 2005. Additional information with respect to AMS can be found on the SEDAR website at www.sedar.com. The reporting and measurement currency is the Canadian dollar.

This MD&A contains forward-looking statements. Forward-looking statements are based on current expectations that involve a number of risks and uncertainties which could cause actual events or results to differ materially from those reflected in the MD&A. Forward-looking statements are based on the estimates and opinions of AMS' management at the time the statements were made. AMS assumes no obligation to update forward looking statements, should circumstances or management's estimates change.

This MD&A is dated November 16, 2006.

Overview

AeroMechanical Services Ltd. is a designer, developer and service provider of innovative solutions to the global aerospace business. The Company's solutions are designed to improve the productivity and profitability of our customers.

The major products of the Company are Automated Flight Information Reporting System, (AFIRS™), UpTime™, Underfloor Stowage Unit and AeroQ™. These products are marketed globally by a team of individuals: five based in Calgary, one in Cornwall Ontario, and one in Switzerland. One of the Calgary staff is currently spending 60% of his time in China dealing with opportunities there. AMS has sales coverage in many countries around the world.

Financing Activities

On September 1st, 2006 a private placement was completed with MGI Securities Inc. The private placement was as follows: 16,250,000 units of the Company at a price of \$0.40 per unit for gross proceeds of \$6,500,000 and cash proceeds, net of all issuance costs, of \$5,973,919. The use of proceeds included rectifying a working capital deficit of \$1,200,000 and the balance will handle our business requirements for the foreseeable future. Each unit comprises of one (1) Class A common share and one half of one (1/2) Common Share purchase warrant. Each whole Warrant will entitle the holder thereof to purchase one (1) Common Share until September 1st, 2008 at a price of \$0.60 until September 1st, 2007 and thereafter at an exercise price of \$0.75.

The cost of the placement was \$365,879 and an additional 1,304,396 warrants were issued to the agent whereby each warrant will entitle the holder thereof to purchase one (1) common share at \$0.40 until September 1st, 2009 and also ½ warrant whereby one full warrant would allow the holder to purchase one (1) common share at a price of \$0.60 until September 1st, 2008 and until September 1 2009 at a price of \$0.75 per common share.

The private placement was approved by the TSX Venture Exchange on August 10th, 2006

Results of Operations

During the three months ending September 30, 2006 the Company:

Revenue and Marketing

As shown in the following tables the AFIRS™/Uptime™ Rental Revenue and Unearned Revenue are showing the results forecasted. AMS' long term investment in marketing and relationship building has given the Company a strong pipeline of prospective clients around the world. The ongoing revenue streams from our existing client base will continue to expand throughout this and future years.

AMS has adopted a conservative revenue recognition policy, where by, network access fees are capitalized as unearned revenue and revenue is recognized over the term of the initial contracts. This has the effect of smoothing the revenue through the life of the contract which in the early stages will show less booked revenue than cash received.

The effect in the quarter is we received \$296,442 in cash revenues with \$258,813 reported as revenue and \$37,629 being included in unearned revenue.

Recognized revenue increased \$143,316 in the third quarter compared to the third quarter of last year. AFIRS™ / UpTime™ revenues increased by \$25,248 over third quarter 2005. Sales revenue is up by \$118,068. AMS now has the AFIRS box with the most recent upgraded technology products that is tested, certified, and ready to install on aircraft. Revenues are expected to grow at a significantly higher rate than our costs because the Company has the infrastructure, sales people and support organization in place to support revenue growth.

Sales and marketing expenses increased from \$60,317 to \$168,694 from third quarter 2005 to 2006. These figures do not include salaries, and are indicative of the increased activity in the marketing and sales area of our company. We expect that expenses in marketing will remain the same or increase into the future. Our plans are to continue to attend shows globally that focus on market places that we want our products to penetrate. The costs of the shows are relatively high because of the specific nature of these shows and the locations in far away places they always seem to be held. Because our product is a very niche product attendance at the shows is mandatory as advertising does not yield significant results.

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The recognition of the AFIRS™Uptime™ product superiority and innovation has allowed us to be key note speakers at several of these events. This shows that AMS' products are being recognized as leading edge in this industry.

Cost of Sales and Gross Margins

Percentage Cost of Sales in the third quarter of 2006 is 75% of Sales compared to 28% in 2005. This is as a result of our product mix and on lower volume installations. This is an expected trend in our business as summer is our customer's busiest time and installations are accomplished on a reduced level. Included in cost of sales are costs of non-routable parts and travel expenses of our engineers on initial installations of aircraft. As part of our service we assist new clients with engineering support on their initial installations. This cost is covered in our access fee. Non-routable parts are parts involved in the installation process that are non-reusable (such as cables) and do not form part of the rental asset. They would remain on the aircraft if the AFIRS™ unit was extracted. The travel and support costs form part of the non-routable parts and are expensed in the period. The effect is an increase in cost of sales. As we move forward with more clients and the corresponding recurring revenue streams, we will see the cost of sales decline and our margins increase.

Third quarter 2006 Gross Margin was 25% compared to second quarter 2006 of 37% compared to third quarter 2005's of 72% and 49% in the second quarter of 2005.

Net Loss and General Administrative Expenses

The net loss in the quarter ending September 30, 2006 was \$1,176,113 (2005—\$603,377). Included in General Administrative Expenses are increased marketing costs. Marketing expenses increased by \$108,377 to \$168,694 over the 3rd quarter in 2005. The Company's focus is on generating new customers and will continue to engage resources in marketing.

Interest and bank charges were considerably lower in the 2006 third quarter compared to the 2005 third quarter as the Company had no debt in the 2006 year. Office expenses increased by \$48,540 in third quarter 2006 over 2005 primarily due to \$36,606 increase in investor relations costs. The Company is working with the investment community to inform them of the Company to provide shareholder value in the stock price and we are communicating with our customers and the investment community more. Also, Professional Fees increased by \$191,888 in the third quarter primarily due to increased accounting fees related to the 2005 audit and the legal costs associated with financing activities in the quarter.

Salaries continue to be the main cost of doing business for AMS. We are hiring good qualified personnel on an ongoing basis as our customer base grows and AMS is preparing for the growth of the company as a result of our strategic business alliances that are opening many opportunities for rapid growth in sales.

All other expenses are tracking as planned.

Research and Development

Research and development costs are being expensed as incurred. The third quarter development costs for 2006 were \$108,562 as compared to \$1,737 in 2005. The Company completed the development of the AFIRS unit which includes new technological capabilities that the aviation industry is requesting. The D0-160 testing on the unit was completed in August 2006 and is now certified for use. The majority of R&D costs are salaries and consulting expenses related to ongoing design, testing and certification of AFIRS™ and the design and testing of UpTime™. This development was forced by Iridium discontinuing the modem the AFIRS™ uses and deploying it with a new modem. There are also minor expenses being incurred in the preliminary phases of AeroQ™.

Foreign Exchange

All international sales of the Company's products and services are denominated in U.S. dollars. Accordingly, the Company is susceptible to foreign exchange fluctuations. In 2006, nearly 90% of the Company's gross sales were made outside of Canada.

Liquidity and Capital Resources

At September 30, 2006 the company had working capital of \$4,656,127 compared to a working capital deficiency of \$225,773 in the same period in 2005. The increase in the working capital is attributed primarily to increased cash of \$4,051,629 due to the share offering, and increased sales which led to increased receivables of \$276,628, an increase in short term unearned revenue of \$59,195, and a decrease in accounts payable of \$971,901.

The company's ability to continue is dependent upon attaining and sustaining profitable operations and obtaining additional financing in order to fund its working capital requirements and on-going operations. The company's ability to attain profitable operations and positive cash flow in the future is dependent upon various factors including its ability to acquire new customer contracts, the success of management's continued cost controls and general economic conditions.

The Company currently has no bank debt.

Financial **Statements****Summary of Quarterly Results**

	Q4-04	Q1-05	Q2-05	Q3-05	Q4-05	Q1-06	Q2-06	Q3-06
Revenue	118,593	156,001	115,582	107,271	132,669	218,328	298,852	258,813
Loss	1,045,435	718,303	687,659	600,000	1,127,856	1,166,402	965,349	1,176,113
Loss/Share	\$0.06	\$0.04	\$0.04	\$0.03	\$0.05	\$0.04	\$0.03	\$0.03

The Company has entered into various leases for its operating premises and equipment. Future minimum annual payments under these operating leases are as follows:

	Premises	Equipment	Total
2006	\$191,993	\$ 85,657	\$277,650
2007	\$191,993	\$ 35,881	\$227,874
2008	\$191,993	\$ 10,730	\$202,723
2009	<u>\$ 31,999</u>	<u>\$ 4,588</u>	<u>\$ 36,587</u>
	<u>\$607,978</u>	<u>\$ 136,856</u>	<u>\$744,834</u>

In addition, the Company has repayment obligations related to two Government of Canada loan programs. Under the Industrial Research Assistance Program (IRAP), the Company has received \$351,940 which is to be repaid, as a percentage of gross revenues, over a five to ten year period commencing in October 2005. Under the Technology Partnerships Canada (TPC) program, the Company has received \$123,635 to be repaid over a ten year period commencing in April 2005.

Looking Forward

The Company has been developing a sales networking system around the world to leverage its marketing and delivery capabilities. In June, Meggitt Aerospace, a world leader and supplier of aerospace sensor and monitoring equipment, entered into a licensing agreement with AMS to jointly market our product and services. Meggitt is on nearly every aircraft in the world with its engine sensor monitoring systems. In the past 2 months, Meggitt has opened doors into the OEM market. AMS is currently completing an RFP for a major manufacturer to be included on their new jets. This is a significant move forward in the marketing timelines.

Hawker Pacific is an installation facility in the AustralAsia market that is a large aviation repairs and services facility that saw the value of AFIRS™ / UpTime™ earlier this year and signed an agreement to provide marketing and installation support with their clients. Hawker is one of the largest companies providing that service in the area of the world. They are currently in active negotiations with several companies that we expect orders from early in 2007.

These strategic relationships leverage our marketing capability worldwide as these leading organizations have completed their due diligence on AMS's product and service capabilities. The inclusion of AMS as a strategic relationship with both Meggitt and Hawker Pacific provides AMS a higher standard of credibility with all customers around the world. We are seeing the results through increased activity in airlines contacting our sales group and having been asked to visit and speak with the major OEMs around the world in the past 2 months.

On October 24, 2006 the final signed agreement for AFIRS™, AFIRS™ Voice and Data, and Global Voice was received from Aviation Data Communications Corporation in China. Once FAA approval is received, shipment and installation will commence.

AFIRS™ with text and voice was test flown by Voyageur Airlines Ltd. on October 19th, 2006 and will be installed on their fleet of 13 DHC-8.

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CONSOLIDATED BALANCE SHEET
(UNAUDITED)

	<u>September 30</u>	<u>December 31</u>
	<u>2006</u>	<u>2005</u>
	(Unaudited)	(Audited)
ASSETS		
CURRENT		
Cash and deposits	\$ 4,053,603	\$ 84,009
Accounts receivable	380,968	177,282
Prepaid expenses	49,879	52,308
Inventory	<u>502,944</u>	<u>283,885</u>
	<u>4,987,394</u>	<u>597,484</u>
CAPITAL ASSETS – Note 2	145,554	120,628
RENTAL ASSETS – Note 3	<u>634,200</u>	<u>669,301</u>
	<u>779,754</u>	<u>789,929</u>
TOTAL ASSETS	<u>\$ 5,767,148</u>	<u>\$ 1,387,413</u>
LIABILITIES		
CURRENT		
Accounts payable and accrued liabilities	\$ 207,128	\$ 1,392,017
Unearned revenue – Current portion - Note 4	73,577	250,459
Current portion of loans payable – Note 5	<u>50,562</u>	<u>82,263</u>
	331,267	1,724,739
LONG TERM		
Term Loans	-	990,000
Loans payable – Note 5	425,013	403,749
Unearned Revenue - Note 4	304,165	-
Warranty	<u>16,200</u>	<u>12,240</u>
	<u>1,076,645</u>	<u>3,130,728</u>
SHAREHOLDERS' EQUITY		
SHARE CAPITAL – Note 6	17,696,807	8,375,377
CONTRIBUTED SURPLUS – Note 6	688,439	268,187
DEFICIT	<u>(13,694,743)</u>	<u>(10,386,879)</u>
	<u>4,690,503</u>	<u>(1,743,315)</u>
TOTAL LIABILITIES AND EQUITY	<u>\$ 5,767,148</u>	<u>\$ 1,387,413</u>

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CONSOLIDATED STATEMENTS OF LOSS AND DEFICIT
(UNAUDITED)

	For the nine months ended September 30, 2006	For the nine months ended September 30, 2005	For the three months ended September 30, 2006	For the three months ended September 30, 2005
AFIRST™ / UpTime™ revenues	\$ 368,602	\$ 247,290	\$ 134,397	\$ 109,149
Sales revenues	<u>407,391</u>	<u>150,338</u>	<u>124,416</u>	<u>6,348</u>
	775,993	397,628	258,813	115,497
COST OF SALES				
Cost of sales	<u>561,830</u>	<u>128,489</u>	<u>193,194</u>	<u>32,370</u>
GROSS MARGIN	<u>214,163</u>	<u>269,139</u>	<u>65,619</u>	<u>83,127</u>
EXPENSES				
Salaries and benefits	1,435,078	1,179,024	489,848	360,699
Share based compensation	420,252	20,300	14,650	-
Marketing	403,910	144,250	168,694	60,317
Office	270,204	119,765	94,212	45,672
Development costs	217,296	52,178	108,562	1,737
Third party contracts	147,434	79,994	52,430	42,678
Rent	143,238	148,728	49,398	47,666
Professional fees	279,454	68,296	209,261	17,373
Computer services	88,625	80,699	33,225	18,504
Interest and bank charges	25,129	214,216	(9,123)	48,156
Insurance	39,561	47,819	13,177	15,846
Depreciation	29,116	54,708	13,120	18,238
Loss on foreign currency exchange	12,036	-	2,853	-
Stock exchange fees	<u>10,694</u>	<u>34,988</u>	<u>1,425</u>	<u>9,618</u>
	3,522,027	2,244,965	1,241,732	686,504
NET LOSS FOR THE PERIOD	<u>\$ (3,307,864)</u>	<u>\$ (1,975,826)</u>	<u>\$ (1,176,113)</u>	<u>\$ (603,377)</u>
DEFICIT - Beginning of the year	\$ (10,386,879)	\$ (7,027,157)	\$ (12,518,630)	\$ (8,399,606)
NET LOSS	(3,307,864)	(1,975,826)	(1,176,113)	(603,377)
DIVIDENDS – Preferred Shares		(164,110)		(164,110)
DEFICIT – End of the Year	<u>\$ (13,694,473)</u>	<u>\$ (9,167,093)</u>	<u>\$ (13,694,743)</u>	<u>\$ (9,167,093)</u>
LOSS PER SHARE	\$ (0.08)	\$ (0.11)	\$ (0.03)	\$ (0.033)
Weighted Average Number of Common Shares	40,598,304	17,899,781	40,598,304	17,899,781

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CONSOLIDATED STATEMENT OF CASH FLOWS
(UNAUDITED)

	For the nine months ended September 30, 2006	For the nine months ended September 30, 2005	For the three months ended September 30, 2006	For the three months ended September 30, 2005
CASH PROVIDED BY (USED IN)				
OPERATING ACTIVITIES				
Net (loss) for the period	\$ (3,307,864)	\$ (1,975,826)	\$ (1,176,113)	\$ (603,377)
Add items not affecting cash				
Depreciation and amortization	64,217	54,708	26,521	18,238
Stock based compensation	420,252	20,300	14,650	-
Warranty expense	3,960	-	(540)	-
Non-cash expenses	<u>1,735,477</u>	<u>-</u>	<u>149,425</u>	<u>-</u>
	(1,083,958)	(1,900,818)	(986,057)	(585,139)
Net change in non-cash working capital items	<u>(1,605,205)</u>	<u>908,955</u>	<u>(1,024,992)</u>	<u>183,356</u>
	<u>(2,689,163)</u>	<u>(991,863)</u>	<u>(2,011,049)</u>	<u>(401,783)</u>
FINANCING ACTIVITIES				
Issuance of common shares	8,630,804	295,207	6,260,035	-
Issuance of convertible debenture	(400,000)	-	-	400,000
Repayment of short term loan		(706,040)		-
Short term loan	(990,000)	1,390,000	-	-
Share issuance costs	(517,567)	-	(263,816)	-
IRAP and TPC loans	<u>(10,438)</u>	<u>-</u>	<u>(222)</u>	<u>-</u>
	<u>6,712,799</u>	<u>979,167</u>	<u>5,995,997</u>	<u>400,000</u>
INVESTING ACTIVITIES				
Purchase of capital assets	(54,042)	-	(56,274)	-
Rental assets	<u>-</u>	<u>(18,592)</u>	<u>47,240</u>	<u>-</u>
	<u>(54,042)</u>	<u>(18,592)</u>	<u>(9,034)</u>	<u>-</u>
CHANGE IN CASH POSITION	(3,969,594)	(31,288)	3,975,914	(1,783)
CASH - Beginning of the period	<u>84,009</u>	<u>33,263</u>	<u>77,689</u>	<u>3,758</u>
CASH - End of the period	<u>\$ 4,053,603</u>	<u>\$ 1,975</u>	<u>\$ 4,053,603</u>	<u>\$ 1,975</u>

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2006 (UNAUDITED)**NOTE 1 SIGNIFICANT ACCOUNTING POLICIES**

These interim Unaudited Consolidated Financial Statement do not include all of the disclosures required by Canadian generally accepted accounting principals (GAAP) for annual financial statements. They should be read in conjunction with Audited Consolidated Financial Statements, including the Notes thereto, for the year ended December 31, 2005 (the "2005 Financial Statements").

NOTE 2 CAPITAL ASSETS

	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Sept 30 2006</u>	<u>Dec 31 2005</u>
Computers	\$ 200,058	\$ 139,431	\$ 60,627	\$64,873
Equipment	103,034	35,214	67,820	36,477
Leasehold Improvements	32,239	15,132	17,107	19,278
	<u>\$335,331</u>	<u>\$189,777</u>	<u>\$145,554</u>	<u>120,628</u>

NOTE 3 RENTAL ASSETS

	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Sept 30 2006</u>	<u>Dec 31 2005</u>
Assets available for Lease	\$ 381,600	\$ -	\$ 381,600	\$ 460,799
Leased assets	<u>324,000</u>	<u>71,400</u>	<u>252,600</u>	<u>208,502</u>
	<u>\$ 705,600</u>	<u>\$ 71,400</u>	<u>\$ 634,200</u>	<u>\$ 669,301</u>

NOTE 4 UNEARNED REVENUE

	<u>AFIRSTM / UpTimeTM</u>	<u>Sales Deposits</u>	<u>Total</u>
Balance December 31, 2005	\$ 109,770	\$ 140,689	\$ 250,459
Cash receipts	-	-	-
Installation Access Fees	131,752	-	131,752
Earned revenues	(6,642)	(68,779)	(75,421)
Balance March 31, 2006	\$ 234,880	\$ 71,910	\$ 306,790
Cash receipts	-	11,223	11,223
Installation Access Fees	49,520	-	49,520
Earned Revenues	(10,267)	-	(10,267)
Balance June 30, 2006	\$ 274,133	\$ 83,133	\$ 357,266
Cash Receipts	102,600	(61,560)	41,040
Installation Access Fees	-	-	-
Earned Revenues	(13,373)	(7,191)	(20,565)
Balance September 30, 2006	<u>363,360</u>	<u>14,382</u>	<u>377,741</u>
Current Portion	59,195	14,382	73,577
	<u>\$ 304,165</u>	<u>\$ -</u>	<u>\$ 304,165</u>

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NOTE 5 LOAN PAYABLE

	<u>Sept 30</u> <u>2006</u>	<u>Dec 31</u> <u>2005</u>
The IRAP loan is non-interest bearing and is to be repaid as a percentage of gross revenues commencing October 2005.	\$ 351,940	\$ 362,377
The TPC loan is non-interest bearing. Principal repayments, which are dependent on the Company achieving specified revenue targets, will be made over a ten-year period commencing April 2005.	<u>123,635</u>	<u>123,635</u>
	475,575	486,012
	<u>(50,562)</u>	<u>(82,263)</u>
Less: Current portion	<u>\$ 425,013</u>	<u>\$ 403,749</u>

NOTE 6 SHARE CAPITAL

Authorized:
Unlimited number of:
Common shares
Class A, B and C preferred shares, issuable in series

The preferred shares may be issued in one or more series and the directors are authorized to fix the number of shares in each series and to determine the designation, rights, privileges, restrictions, and conditions attached to the shares of each series.

ISSUED:a) **Common shares**

	<u>Number of shares</u>	<u>Value</u>
Balance December 31, 2005	27,849,007	\$ 7,975,377
Issued for cash	25,207,542	8,113,237
Issued for debt	<u>(5,298,144)</u>	<u>(1,608,193)</u>
Balance September 30, 2006	<u>58,354,693</u>	<u>\$ 17,696,807</u>

b) **Stock Option Plan**

	<u>Number Of Shares</u>	<u>Weighted Average Exercise Price</u>
Outstanding December 31, 2005	1,333,720	\$ 0.42
Options granted	1,530,000	0.27
Options exercised	<u>186,500</u>	<u>(0.32)</u>
Outstanding September 30, 2006	<u>2,677,220</u>	<u>\$ 0.34</u>

c) **Contributed Surplus**

Balance December 31, 2005	\$ 268,187
Share based compensation	<u>420,252</u>
Balance September 30, 2006	<u>\$ 688,439</u>

d) **Warrants**

	<u>Number of Warrants</u>	<u>Weighted Average Exercise Price</u>
Balance December 31, 2005	3,046,457	\$ 0.45
Warrants granted	14,482,059	0.52
Expired	<u>(317,500)</u>	<u>(0.65)</u>
Exercised	<u>(75,000)</u>	<u>(0.40)</u>
Outstanding September 30, 2006	<u>17,136,016</u>	<u>\$ 0.39</u>

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The calculation of basic loss per share is based on the weighted-average number of common shares outstanding during the nine months ending September 30, 2006 of 40,598,304 (2005 – 17,899,781).

NOTE 7 CHANGE IN ACCOUNTING POLICY

Effective January 1, 2004, the Company elected to retroactively adopt the fair value method of accounting for stock options granted on or after January 1, 2002 under its stock-based compensation plan as recommended by the Canadian Institute of Chartered Accountants. Accordingly, retained earnings at January 1, 2004 have been adjusted by \$120,935 with a corresponding increase to contributed surplus.

In prior periods, the Company accounted for stock option compensation using intrinsic values as defined by the CICA. The Company granted all of its stock options at or above market value, thereby having no intrinsic value at the time of grant. Accordingly, the Company was not required to recognize any compensation expense in the prior period financial statements.