



**ADEPTRON TECHNOLOGIES CORPORATION**

**ANNUAL REPORT 2006**

**TSX – 'ATQ'**

## TABLE OF CONTENTS

<b>MESSAGE FROM THE PRESIDENT AND CEO</b> .....	1
<b>MANAGEMENT'S DISCUSSION AND ANALYSIS</b> .....	3
<b>FINANCIAL STATEMENTS OF ADEPTRON TECHNOLOGIES CORPORATION</b> .....	18
<b>MANAGEMENT RESPONSIBILITY FOR FINANCIAL STATEMENTS</b> .....	19
<b>DIRECTORS, OFFICERS AND SENIOR MANAGEMENT</b> .....	44
<b>SHAREHOLDER INFORMATION</b> .....	45

## MESSAGE FROM THE PRESIDENT AND CEO

### Year 2006

The Company entered 2006 with a plan to increase revenue, reduce or contain various expenses relative to revenue, achieve ongoing profitability, develop an alliance with a China-based manufacturing partner and revitalize its balance sheet during the year. Another longer-term aspect of this plan was, and continues to be, that the Company engage in mergers & acquisitions (“M&A”) activity to help accelerate the growth of revenue and net income.

Adeptron accomplished, or made great progress towards the accomplishment of, all of its objectives for 2006. Revenue in 2006 increased by 15% over revenue in 2005. The gross profit percentage in 2006 of 17.6% of revenue was approximately 28% improved over the 2005 gross profit percentage of 13.8%. This signifies a reduction in the average cost required to produce each dollar of the Company’s revenue. The Company’s selling, general and administrative expenses expressed as a percentage of revenue fell in 2006 to 11.4% from 12.3% in 2005, providing further evidence of cost containment. The Company generated net income in all four quarters of the year, a first time occurrence in this decade. During 2006, the Company achieved an alliance with a China based manufacturing partner which resulted in full production runs on behalf of Adeptron occurring in China in December. As described in detail in other areas of this Annual Report, in the third quarter of 2006 the Company announced new relationships with both senior and subordinated debt lenders. As a result, the Company’s working capital position and the overall condition of its balance sheet were greatly improved.

The Company’s revenue is dependent upon the level of orders from its existing customers and the introduction of new customers. The level of orders from the Company’s existing customers fluctuate from month to month based on a variety of factors unique to each customer. At this time, the Company expects to experience a significant reduction in the amount of orders for 2007 from its previous largest revenue-contributing customer. At the same time the Company expects increases in the amount of orders for 2007 from other existing customers, including its previous second largest revenue-contributing customer. Also, the Company expects the amount of orders in 2007 from labour-only customers to be higher than in 2006 and further mitigate the effect on gross profit margin exerted by the previously mentioned reduction in orders. In addition, the Company will see the benefit in 2007 of new customer relationships developed in 2006. Overall for 2007, the Company currently expects annual revenue to be comparable to 2006. This is subject to change as the year unfolds and circumstances change.

As part of the Company’s continuing bolstering of its value proposition, it has hired, or is in the midst of hiring, certain key personnel that will enhance the Company’s ability to attract prospective customers and will lead to greater operational efficiencies as 2007 progresses. The Company has strengthened its business development capability for 2007 and anticipates continued expansion of its sales capabilities during the year. These investments will assist the frontline business development personnel in accomplishing their task of developing new long-term customer relationships and growing the Company’s revenue.

The amount of revenue generated from the delivery of product manufactured by the Company’s partner in China is expected to grow steadily throughout 2007. This positive development further supports the value proposition that the Company represents to prospective customers in its niche of “low to medium volume with high mix and multiple technology requirements”.

As a result of the Company’s greatly improved financial position, it is actively seeking appropriate and accretive acquisition opportunities to increase not only its immediate revenue and net income, but to enhance its sales and marketing capability in the geographic areas surrounding any acquired sites. In addition, the Company expects to capitalize on synergies related to increased raw material purchasing power and other aspects of related manufacturing operations resulting from any acquisitions.

The investments described above regarding personnel, the expansion of business development capabilities, the increasing involvement with our China based partner, and the efforts to aid corporate

growth by accretive acquisitions, should result in robust activity throughout 2007 and set the stage for solid increases in revenue and profitability in 2008.

I always acknowledge that the progress in our Company is an effort that involves all members of our team. This has never been truer than in the past year. I want to thank all our employees and directors for their perseverance and tenacity, in the face of many headwinds which enabled Adeptron to accomplish the objectives I outlined at the outset of this message.

I am confident that our leadership team will be successful in its execution of the next phase of our plan, which is to solidify our ability to increase our customer base, pursue M&A activity and strengthening our ability to penetrate new geographic markets.

I look forward to meeting shareholders at our annual shareholders' meeting on May 15, 2007, whether for the first time or to renew acquaintances.

Signed

*"F. Michael Marti"*

F. Michael Marti  
President and Chief Executive Officer

## MANAGEMENT'S DISCUSSION AND ANALYSIS

For the year ended December 31, 2006:

*The following discussion of the financial condition and results of operations of Adeptron Technologies Corporation ("Adeptron" or the "Company") should be read in conjunction with the Company's Financial Statements for the Year-ended December 31, 2006. All dollar amounts are expressed in Canadian dollars unless otherwise indicated.*

*Certain statements contained in the following Management's Discussion and Analysis, and elsewhere in Adeptron's Annual Report, including, without limitation, statements containing the words believes, anticipates, estimates, expects, and words of similar import, constitute forward-looking statements within the meaning of applicable laws and regulations. Forward-looking statements are not guarantees of future performance and involve risks and uncertainties which could cause actual results to differ materially from those anticipated in these forward-looking statements. These risks and uncertainties include, but are not limited to: foreign currency fluctuations; variability of quarterly and annual operating results; intense competitive pressures; fluctuations in global industry conditions; narrow margins; risks related to human resources recruiting and retention; vulnerability of management information systems; indebtedness of the Company; product-related risks; sales concentration risks; risks related to the availability of future financing; component shortages and sublease-related credit risks. These and other risks and uncertainties and factors are discussed in the Company's filings with applicable Canadian securities regulators, including the Company's Annual Information Form dated March 31, 2006 and other documents filed by the Company with Canadian securities regulators from time to time. Additional information related to the Company is available on SEDAR at [www.sedar.com](http://www.sedar.com).*

*We disclaim any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. You should read this Annual Report and Management's Discussion and Analysis with the understanding that Adeptron's actual future results may be materially different from what we expect. All forward-looking statements attributable to us are expressly qualified by these cautionary statements.*

### **Date**

This Management's Discussion and Analysis ("MD&A") is dated as of March 7, 2007.

### **Overview and Business of the Company**

Adeptron was organized by amalgamating Adeptron Technologies Corporation with its two wholly-owned subsidiaries, J.F.B. Technologies Inc. and Continuum Technologies Inc. on January 1, 2003 under the *Business Corporations Act* (Alberta). The Company was previously known as Electronics Manufacturing Group Inc. ("EMG") until December 31, 2002.

Adeptron's head office is located in Markham, Ontario, a suburb of Toronto. The Company operates out of two adjacent leased facilities in Markham, Ontario comprising approximately 55,000 square feet in total and a 56,000 square foot leased facility in Ottawa, Ontario.

Adeptron provides its customers with an array of electronics manufacturing services ("EMS") in relation to third party electronic products and assemblies and derives all of its sales from the provision of these services. Adeptron services the North American electronics industry with a focus on low and medium volume, high complexity, commercial and industrial electronic products. Adeptron produces electronic assemblies under both turnkey and labour-only build contracts for customers whose products and end users represent a wide variety of markets.

The Company also provides many additional services related to the printed circuit board assembly process either on a stand-alone basis or as value-added services to its customers. In all aspects of its EMS business including raw materials procurement, flexible supply arrangements and design-related

services, Adeptron continuously strives to achieve cost reductions and optimal quality outcomes for its customers.

### **Significant Transactions**

Adeptron concluded two significant financing transactions in 2006 and 2005.

On September 21, 2006, the Company completed a private placement financing consisting of a subordinated debenture and common share purchase warrants for aggregate gross proceeds of \$5.0 million. As part of the private placement, the Company issued 6,851,000 common share purchase warrants, each of which entitles the holder thereof to purchase one common share of the Company for \$0.20 per common share for a period of 5 years. The subordinated debenture has a principal amount of \$5.0 million, a term of 66 months and carries interest at 12% per annum, payable monthly. Beginning on November 1, 2008, the Company will make principal repayments of \$35,000 per month for 42 months with the remaining outstanding principal due at the end of the 66 month term. The debenture is collateralized by a second ranking general security agreement covering substantially all of the Company's assets.

The Company has allocated the \$5.0 million gross proceeds received from the private placement to debt and equity based on the relative fair values of the common share purchase warrants and the subordinate debenture. The fair value of the common share purchase warrants was determined to be \$822,000 using an option-pricing model. The fair value allocated to the subordinated debenture was based on an effective interest rate of 17% and was determined to be \$4,178,000. Interest expense on the subordinated debenture will be charged to earnings at the effective rate of 17%.

The subordinated debenture agreement contains various covenants that the Company must comply with including financial covenants related to the ratio of current assets to current liabilities, debt coverage, interest coverage and debt to equity.

The Company incurred financing costs of \$473,000 related to the private placement and these costs have been allocated on a pro-rata basis to debt and equity, amounting to \$395,000 and \$78,000, respectively. The amount related to the issuance of the subordinated debenture has been recorded on the balance sheet as deferred financing costs. These deferred financing costs will be amortized over the 66 month term of the subordinated debenture and will be included in the statement of operations and deficit as interest on long-term debt. The amount allocated to equity is included as a reduction in the warrant value within shareholders' equity.

Also on September 21, 2006, the Company entered into a three-year credit agreement with a senior lender that provides the Company with a senior lending facility in the aggregate amount of up to \$6,750,000. The total senior lending facility is comprised of a \$6.0 million revolving credit facility and a \$750,000 term loan facility. The senior lending facility is collateralized by a first ranking general security agreement covering substantially all of the Company's assets.

Under the revolving credit facility, the Company can borrow by way of Canadian dollar prime rate loans or U.S. dollar base rate loans. In addition, the revolving credit facility allows for the issuance of letters of credit and has a foreign exchange trading component. The maximum availability under the revolving credit facility is based on certain terms and conditions, including, but not limited to, the levels of accounts receivable and inventory and is established on an ongoing basis. Borrowings under this facility are subject to interest at the bank's prime rate plus 1% for Canadian dollar loans and U.S. base rate plus 0.5% for U.S. dollar loans and is payable monthly.

The term loan is repayable over 36 months in equal monthly instalments commencing on November 1, 2006. The term loan is subject to interest on the outstanding balance at the bank's prime rate plus 1.5% and interest is payable monthly. The term loan is classified as long term debt on the balance sheet, of which \$250,000 is shown in current liabilities as current portion of long-term debt.

The credit agreement contains various covenants that the Company must comply with including financial covenants related to minimum levels of net assets and interest coverage and maximum levels of capital spending.

The Company incurred financing costs of \$253,000 related to the credit agreement and these costs have been recorded on the balance sheet as deferred financing costs. These deferred financing costs will be amortized over the three-year term of the agreement and will be included in the statement of operations and deficit as interest expense.

The Company used the proceeds of the private placement to repay the subordinated notes and the new senior lending facility was used to refinance the then existing senior lending facility.

### **Overall Performance**

The Company's financial performance in 2006 significantly improved on many fronts in comparison to the prior year. The Company was able to generate growth in sales, improvement in gross profit and achieved a record level of annual net income.

In 2006, sales increased by 15% to \$43.8 million from \$38.2 million in 2005. This represented the Company's third consecutive year of double digit percentage growth in sales.

The Company's net income of \$1,614,000 was a significant improvement in bottom line results in comparison to the prior year's net loss of \$411,000. This net income represents a turnaround of approximately \$2.0 million compared to the net loss in 2005. Moreover, the 2005 net loss had significantly decreased over the 2004 net loss of \$3.2 million.

EBITDA<sup>(1)</sup> for 2006 was \$3.3 million compared to \$1.0 million in 2005. The Company recorded depreciation and amortization expense of \$604,000 in the year. The Company also recorded \$132,000 in non-cash interest expense and \$180,000 in non-cash stock based compensation expense in 2006. Excluding changes in non-cash working capital balances, the Company generated \$2.5 million in cash from operating activities in 2006.

Consistent with prior years, the strengthening of the Canadian dollar ("CDN\$") relative to the US dollar ("US\$") during 2006 had a negative effect on the Company's sales and gross profit. This negative foreign exchange trend reduced the Company's sales and gross profit, when compared to the sales and gross profit that Adeptron would have achieved had the 2005 exchange rate prevailed in 2006. Even with the negative impact of the strengthening CDN\$, the Company was still able to grow sales by 15% in 2006.

In order to mitigate the adverse effect of the strengthening CDN\$ relative to the US\$, the Company continues to denominate as many of its expenses as possible in US\$ to drive the expenses lower when converted to CDN\$. However, management's primary emphasis in its approach to managing the effect of the \$US trend on Adeptron has been and continues to be on generating long-term sales growth. Adeptron's objective continues to be to develop significant customer relationships that are enduring and have meaningful sales growth potential. Having a core business offering that offers compelling value to existing and prospective customers is crucial to achieving this result and to this end, the Adeptron team remains committed to its goal of ongoing operational improvement initiated several years ago.

Entering 2006, the Company had a working capital deficit of \$2.1 million. The deficit position in working capital originated in 2004 as a result of the inclusion in current liabilities of the subordinated notes liability in the amount of \$2.25 million plus accrued interest. As described above in the section "Significant Transactions", the Company completed two financing transactions during the third quarter of 2006. The proceeds generated from the financing transactions provided the necessary funding to fully repay the Company's subordinated notes liability and to repay the outstanding bank operating loan liability existing with the former senior lender at the time. In addition, the new revolving credit facility provides the Company with additional borrowing availability that it did not have under its credit agreement with the former senior lender.

As a result of these financing transactions, the Company's balance sheet has been significantly enhanced. As at December 31, 2006, the Company's working capital balance was \$4.8 million, which compares very favourably to the working capital deficit of \$2.1 million at December 31, 2005.

At 2006 year-end, the Company's bank operating loan balance with its new senior lender was \$0.7 million which left significant borrowing capacity under the terms of the loan which is based on accounts receivable and inventory margining conditions in its agreement with this lender.

The Company had deferred income tax assets of approximately \$7.2 million at 2006 year-end, which were offset with an equivalent valuation allowance. These deferred income tax assets are available to offset income taxes payable on profits that may be earned in the future and thus future positive cash flows would be enhanced.

### **Selected Consolidated Financial Information**

**(as at and for the years ended December 31 and in thousands of dollars, except per share information and gross profit percentages)**

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Sales	\$43,832	\$38,202	\$33,465
Gross profit	\$7,733	\$5,274	\$2,836
Gross profit %	17.6	13.8	8.5
Net income (loss)	\$1,614	(\$411)	(\$3,180)
Basic and diluted income (loss) per share <sup>(1)</sup>	\$0.05	(\$0.01)	(\$0.09)
Current assets	\$11,859	\$12,008	\$9,738
Total assets	\$20,158	\$19,770	\$17,905
Current liabilities	\$7,031	\$14,068	\$11,740
Long term liabilities <sup>(2)</sup>	\$4,830	\$240	\$376

Notes:

(1) In 2005 and 2004, diluted loss per share equals basic loss per share, as the effect of options and warrants is anti-dilutive. In 2006, as a result of rounding, diluted and basic income per share are shown to be the same.

(2) Does not include current portion of long term debt.

#### *2006: Record annual profit, revitalization of balance sheet*

In 2006, the Company continued the trend in profitability that it began in the fourth quarter of 2005. The Company recorded net income in each quarter of 2006 and generated a record annual profit of approximately \$1.6 million.

The Company was also able to significantly strengthen its balance sheet during 2006. Cashflow from operating activities increased to approximately \$1.2 million in 2006 from a cash usage of \$240,000 in 2005. This had a direct impact on the balance sheet as it improved the Company's working capital position throughout the year. In addition, the Company concluded two significant financing transactions in the latter part of 2006. The private placement debenture transaction provided the necessary funding required to settle the subordinated notes liability reflected in current liabilities. In effect, the Company refinanced the short-term debt with long-term debt, thus, improving the Company's working capital position. The second financing transaction involved a \$6.0 million revolving credit facility that has provided the Company with greater borrowing availability than it previously had with its former senior lender.

### *2005: Improved Operating Results and Fourth Quarter Profitability*

2005 proved to be a turnaround year for the Company from an operating results perspective. As in 2004, the Company continued to grow top line sales, in this case, by 14% over the prior year, even though the strengthening of the CDN\$ relative to the US\$ during 2005 was having a negative effect on overall sales.

More importantly, the Company made significant improvements in its gross profit and gross profit percentage in 2005. Gross profit percentage increased to 13.8% in 2005 from 8.5% in 2004 while gross profit increased by \$2.5 million, or over 85%, to \$5.3 million in 2005. Furthermore, even with sales increasing in 2005, the Company was able to lower selling, general and administrative expenses in 2005 compared to 2004.

The net result of the sales growth, improved gross profit and reductions in selling, general and administrative expenses was a significant improvement in the Company's operating performance. The net loss for 2005 was \$411,000 compared to a net loss of \$3.2 million in 2004. The Company's results improved progressively in each quarter culminating in a net income of \$153,000 in the fourth quarter of 2005.

### *2004: Continued Sales Growth, New Financing and Acquisition*

2004 saw continued sales growth as sales increased sequentially in the first two quarters consistent with 2003 quarterly sequential growth. In addition, sales increased in every quarter of 2004 when compared to the corresponding quarter of the prior year. Total sales generated in 2004 grew by over 120% to \$33.5 million. The acquisition of the Ottawa operations in early 2004 was a large part of the growth in 2004 as it contributed \$10.5 million in sales. However, organic growth accounted for \$7.9 million or 52% of the total year over year sales increase.

As a result of the acquisition of the Ottawa operations, the Company experienced immediate benefits in the form of added sales and gross profit as well as expanding the range of service offerings the Company can provide. The acquisition of the Ottawa operations and related working capital requirements was financed through the issuance of debt and equity.

The Company recorded a loss from operations in 2004, as the gains in sales and gross profit were not enough to offset adverse foreign exchange movements and increases in expenses. The Company continued to target increases in sales as the most effective strategy to bring the Company to profitability.

## **Results of Operations**

### *Sales*

Sales for the year ended December 31, 2006 were \$43.8 million compared to \$38.2 million for the year ended December 31, 2005, representing an increase of \$5.6 million, or 15%. This increase is primarily attributable to continued growth from the customer base existing at the end of 2005. In addition, the Company saw an improvement in sales mix as the percentage increase in labour only sales was far greater than the percentage increase in turnkey sales.

In 2006, approximately 66% of the Company's sales were derived from USA-based and domestic-based customers with sales denominated in US\$. Since US\$ sales are converted to CDN\$ using the appropriate exchange rate on the date of the transaction, fluctuations in exchange rates between the CDN\$ and US\$ have a direct impact on the Company's reported sales and gross profit. The continued strengthening of the CDN\$ in 2006 when compared to the prior year, had a negative effect on the Company's sales and, consequently, gross profits. The average annual US\$ to CDN\$ exchange rate for 2006 declined by 7% when compared to the annual average exchange rate in 2005. This continued the trend of declining annual average exchange rates that began in 2002. If the effect of the change in currency rates were removed, the increase in sales in 2006 in comparison to 2005 would have been even greater.

### *Cost of Goods Sold and Gross Profit*

Cost of goods sold for the year ended December 31, 2006 was \$36.1 million compared to \$32.9 million for the year ended December 31, 2005, an increase of \$3.2 million, or 9.7%, from 2005. The increase in cost of goods sold in 2006 in comparison to the prior year can be primarily attributed to the higher material and labour costs directly associated with higher sales. However, the increase in cost of goods sold of 9.7% was proportionately less than the increase in total sales of 15%.

Gross profit for the year ended December 31, 2006 was \$7.7 million compared to gross profit of \$5.3 million for the year ended December 31, 2005, an increase of \$2.4 million, or over 45%. Gross profit, expressed as a percentage of sales for the year ended December 31, 2006, was 17.6% compared to 13.8% for the year ended December 31, 2005. The increase in gross profit dollars and percentage in 2006 in comparison to 2005 in spite of the adverse foreign exchange fluctuations, is attributable to several factors including: 1) increase in sales during 2006 in comparison to 2005; 2) favourable changes in product and customer mix resulting in lower material costs as a percentage of sales; and 3) continued improvement in manufacturing efficiencies resulting in lower direct labour costs as a percentage of sales.

Depreciation of \$503,000 has been allocated between cost of goods sold and other expenses in 2006 compared to \$438,000 in 2005. The depreciation on manufacturing assets that have been employed to generate the sales reported for the year is allocated to cost of goods sold and the depreciation on non-manufacturing assets that have been employed in selling, general and administrative areas of the business is not included in gross profit.

Depreciation of \$426,000 has been allocated to cost of goods sold in 2006, compared to \$368,000 in 2005. The remainder of the depreciation has been charged to expenses below the gross profit line.

During 2006, the Company spent approximately \$536,000 to acquire capital assets compared to \$214,000 in 2005. The increase in capital spending was primarily due to the purchase of testing equipment in the second quarter of 2006 to support a new customer project. The increase in capital spending in 2006 resulted in an increase in depreciation expense charged to cost of sales compared to the prior year.

Adeptron's management does not expect an increase in capital expenditures in 2007 over the levels incurred in 2006 unless a new customer project can financially justify such a purchase or significant future operational efficiencies can be realized through such expenditures.

### *Selling, General and Administrative Expense*

Selling, general and administrative ("SG&A") expenses for the year ended December 31, 2006 were \$5.0 million, an increase of approximately \$0.3 million, or 6%, from \$4.7 million for the prior year. The increase is attributable to higher professional service costs, travel related expenses, payroll costs and stock-based compensation expense incurred in 2006. Conversely, in 2006, certain other SG&A expense items declined when compared to levels incurred in 2005. In particular, there was a decline in expensed financing costs and commissions expense in 2006 that partially offset the overall increase in SG&A costs.

It is important to note that even though SG&A expense in the current year has increased, sales and gross profits have increased significantly more during this same period. This is consistent with management's strategy of achieving long-term sales growth while minimizing SG&A expense increases.

### *Interest on Subordinated Notes*

Interest on subordinated notes for the year ended December 31, 2006 was \$302,000 compared to \$403,000 for the year ended December 31, 2005, a decrease of \$101,000. The decrease is primarily due to the fact that the subordinated notes liability was fully repaid at the end of the third quarter in 2006 and as a result, the Company did not incur any further interest on this debt in the fourth quarter. In 2005, interest on subordinated notes was incurred for the entire year.

### *Interest on long-term debt*

As described in the section "Significant Transactions", on September 21, 2006, the Company completed a private placement financing that included the issuance of a subordinated debenture. Additionally, the Company borrowed \$750,000 under its new term loan facility. Net of \$250,000 of this term loan facility which is classified as a current liability, both of these obligations are classified as long-term debt on the Company's balance sheet. In 2006, interest expense relating to the Company's long-term debt obligation was \$235,000. Included in interest expense is approximately \$23,000 relating to the amortization of deferred financing costs and \$28,000 related to non-cash interest accrued but not paid. In 2005, interest on long-term debt was nil as the Company did not have any long-term debt outstanding in the prior year.

### *Interest on bank operating loan*

Interest on bank operating loan is the interest and associated loan fees paid on the bank operating loan. Interest for the year ended December 31, 2006 was \$405,000 compared to \$398,000 for the year ended December 31, 2005, an increase of \$7,000 or 2%.

The small increase is due to higher borrowing levels and interest rates for the first three quarters of 2006 in comparison to 2005. However, this increase was partially offset in the fourth quarter of 2006 as borrowing rates and levels decreased due to the new financing transactions that were concluded at the end of the third quarter. As described in the section "Significant Transactions", the Company entered into a credit agreement with a new senior lender on September 21, 2006. Subsequent to September 21, 2006, the Company's bank operating line borrowings were subject to the terms and conditions as contained in the new senior credit facility. In the short term, the Company expects its bank operating line cash interest expense to be lower than previously incurred due to more favourable borrowing rates and lower borrowing levels. This decrease in the cash borrowing expense will be partially offset by deferred financing cost amortization expense going forward.

### *Depreciation*

Depreciation and amortization on non-manufacturing Company assets for the year ended December 31, 2006 was \$178,000 compared to a similar amount for the year ended December 31, 2005. Depreciation of manufacturing assets is included in cost of goods sold and is discussed above in "Results of Operations – Cost of Goods Sold and Gross Profit".

Management expects the charge for depreciation and amortization on non-manufacturing Company assets in 2007 to be slightly lower than that charged in 2006.

### *Income Tax Provision*

For the years ended December 31, 2006 and 2005, the Company did not record any income tax provision in its financial statements. At December 31, 2005, the Company had approximately \$18.1 million of non-capital loss carryforwards available to apply against income of future periods. The Company was able to apply these loss carryforwards against the income it generated in the current year. After applying the non-capital loss carryforwards against the 2006 income, the amount of non-capital loss carryforwards available to the company to apply against future income is \$15.5 million at December 31, 2006.

### *Balance Sheet*

Cash at December 31, 2006 was \$234,000 compared to \$1,000 at December 31, 2005. The increase in the cash balance is due to the fact that the Company changed senior lenders during the third quarter of 2006. Currently, the Company maintains bank accounts for cheque clearing activities with its former senior lender and conducts its bank lending activities with its new senior lender. As a result, cash balances are maintained with its former senior lender to facilitate timely payment of outstanding accounts payable.

Restricted cash at 2006 year-end was nil compared to a 2005 year-end balance of \$322,000. This was cash that was being held by the Company's former senior lender as security for the Company's obligations. The balance is nil at December 31, 2006 as the funds were included as part of the final pay out by the Company of the outstanding balance due to its former senior lender.

Working capital, defined as current assets less current liabilities, at December 31, 2006 was \$4.8 million compared to a working capital deficit of \$2.1 million at December 31, 2005. The significant increase in working capital is largely due to the private placement and credit facility financings that were completed in September 2006. In particular, the private placement financing consisting of long-term debt and common share purchase warrants provided the Company with net cash proceeds of over \$4.5 million that were used to repay the subordinated notes obligation, which had been classified as a current liability. The additional proceeds were applied to reduce the Company's outstanding bank operating loan liability. Additionally, the Company's operating activities provided approximately \$2.0 million in cash that factored into the improvement in working capital in 2006.

Accounts receivable at 2006 year-end were approximately \$6.8 million, which is unchanged from the 2005 year-end balance of approximately the same amount. Sales in the fourth quarter of 2006 were \$10.9 million, which is consistent with fourth quarter 2005 sales of \$10.7 million. As a result, the accounts receivable balance did not change year over year.

Inventory at 2006 year-end was approximately \$4.5 million, which is also unchanged from the 2005 year-end balance of approximately the same amount. The Company continues to closely monitor inventory levels to ensure its investment in inventory is optimized.

Accounts payable and accrued liabilities at 2006 year-end were approximately \$6.0 million, compared to approximately \$6.8 million at 2005 year-end, a decrease of \$0.8 million. The decrease in accounts payable and accrued liabilities is due to a conscious effort to improve the payment cycle with some of our key vendors.

The subordinated notes liability at December 31, 2006 was nil compared to \$2.8 million at 2005 year-end. This liability was fully repaid during the third quarter of 2006.

As described in the section "Significant Transactions", on September 21, 2006, the Company completed a private placement financing that included the issuance of a subordinated debenture. The subordinated debenture liability is included in long term debt at its fair value of approximately \$4.2 million. Additionally, the Company borrowed \$750,000 under its new term loan facility that is repayable in thirty-six equal monthly instalments. Accordingly, \$250,000 is classified as a current liability and the remainder, net of monthly principal instalments, is classified as long-term debt. At December 31, 2005 the Company did not have any outstanding long-term debt obligation.

The current and long-term portions of the restructuring accrual at December 31, 2006 were \$68,000 and \$166,000, respectively. The comparative balances at December 31, 2005 year-end were \$80,000 and \$216,000, respectively. The net decrease of \$62,000 during 2006 is due to lease payments made, net of amounts received.

In November 2006, the Company completed a private placement with a newly appointed director of the Company. Simultaneously, the Company entered into a consulting arrangement with this director. The private placement was for aggregate gross proceeds of \$200,000 on the issuance of 1,000,000 units and share issue costs related to the private placement were \$12,000. Each unit includes one common share and one-half common share purchase warrant and the net proceeds were recorded as share capital.

The fair value of the units exceeded the gross proceeds by approximately \$49,000. This amount has been recorded as stock-based compensation in the statements of operations and deficit and warrants on the balance sheet.

The 2006 year-end restructuring accrual (current and long-term) balances relate to the subsidization of a Calgary sub-lease and will be paid out over the remaining lease period, which extends through to December 31, 2011.

### Summary of Quarterly Results

(in thousands of dollars, except per share information and gross profit percentages)

	<u>2006</u>				<u>2005</u>			
	<u>Q4</u>	<u>Q3</u>	<u>Q2</u>	<u>Q1</u>	<u>Q4</u>	<u>Q3</u>	<u>Q2</u>	<u>Q1</u>
<b>Sales</b>	\$10,852	\$10,609	\$11,655	\$10,716	\$10,645	\$9,694	\$9,396	\$8,467
<b>Gross profit</b>	\$1,970	\$1,935	\$1,995	\$1,833	\$1,663	\$1,383	\$1,296	\$932
<b>Gross profit %</b>	18.2	18.2	17.1	17.1	15.6	14.3	13.8	11.0
<b>Net income (loss)</b>	\$307	\$506	\$489	\$312	\$153	(\$11)	(\$90)	(\$463)
<b>Basic &amp; diluted income (loss) per share</b>	\$0.01	\$0.01	\$0.01	\$0.01	\$0.00	\$0.00	\$0.00	(\$0.01)

Adeptron's results of operations for the most recent eight fiscal quarters are primarily affected by the volume of sales but are also influenced by other factors such as fluctuating foreign exchange rates between the CDN\$ and US\$ and the mix of sales between various customers and the provision of turnkey and labour-only services. The Company has not been able to determine any specific seasonality or other cyclical influences that affect the predictability of its sales and results of operations. Instead, the Company's performance is more closely tied to the general economic conditions prevailing in the electronics products sector.

2005 began with first quarter sales that were relatively flat in comparison to the fourth quarter of 2004. However, the Company observed increased demand from long standing customers and quarterly sales increased sequentially throughout 2005 and peaked at \$10.6 million in the fourth quarter. At the same time, cost reduction initiatives that had been implemented, beginning in the fourth quarter of 2004, were complemented with additional expense reductions in early 2005 that created a much improved cost structure for the business. As a result, the Company's quarterly operating results improved not only in comparison to the corresponding quarter of the prior year, but also sequentially throughout 2005. The net result was a \$153,000 profit in the fourth quarter. This was the Company's first quarterly profit in over five years.

The Company entered 2006 with expectations of continued sales growth on an annual basis. Quarterly sales continued to increase sequentially in the first two quarters of 2006 while quarterly net income increased sequentially through the first three quarters of 2006. In addition, each quarter in 2006 showed increases in sales, improvements in gross profit and higher earnings than its corresponding quarter in 2005.

The Company's sales are dependent upon the level of orders from its existing customers and the introduction of new customers. The level of orders from the Company's existing customers fluctuate from month to month based on a variety of factors unique to each customer. At this time, the Company expects to experience a significant reduction in the amount of orders for 2007 from its previous largest sales-contributing customer. At the same time the Company expects increases in the amount of orders for 2007 from other existing customers, including its previous second largest sales-contributing customer. Also, the company expects the amount of orders in 2007 from labour-only customers to be higher than in

2006 and further mitigate the effect on gross profit margin exerted by the previously mentioned reduction in orders from its previous largest customer. In addition, the Company expects to see the benefit in the latter half of 2007 of new customer relationships developed in 2006.

As part of the Company's continuing bolstering of its value proposition, it has hired, or is in the midst of hiring, certain key personnel that will enhance the Company's ability to attract prospective customers and will lead to greater operational efficiencies as 2007 progresses. The Company has strengthened its business development capability for 2007 and anticipates continued expansion of its sales capabilities during the year. These investments will assist the frontline business development personnel in accomplishing their task of developing new long-term customer relationships and growing the Company's sales.

## Liquidity

The Company's operating activities, before changes in non-cash working capital balances, generated approximately \$2.5 million in cash in 2006 compared to \$367,000 in 2005. Including changes in non-cash working capital items, cash generated in 2006 was approximately \$1.2 million compared to a cash usage of \$240,000 in 2005. The improvement in cash provided by operating activities, before and after changes in non-cash working capital balances, is due to the significant increase in the Company's earnings in 2006.

Cash used to support changes in non-cash working balances was approximately \$1.3 million in 2006, compared to \$607,000 in 2005. The make up of the cash usage to support changes in non-cash working capital balances was different between the two years. In 2006, the cash usage was primarily the result of a decrease in accounts payables and the payment of all the accrued interest on the subordinated notes. In 2005, increases in accounts receivable and inventory, partially offset by increases in accounts payable, were the driving factors.

In 2006, the Company's financing activities utilized approximately \$450,000 in cash in comparison to generating \$454,000 in the same period of the prior year. The issuance of long-term debt, net of issue costs, provided over \$4.5 million in proceeds during the year. Additionally, the issuance of common shares and warrants in 2006 provided proceeds of \$980,000, net of issue costs. Included in this total is \$744,000 of the private placement financing proceeds that were allocated to the issuance of common share purchase warrants and \$188,000 related to a private placement with a newly appointed director. The funds provided by the financing transactions were used to fully repay the outstanding principal and accrued interest on the subordinated notes liability totalling \$3.0 million and decrease the Company's outstanding bank operating loan liability at that time. As at December 31, 2006, the bank operating loan balance is \$0.7 million compared to the 2005 year-end 2005 balance of \$4.4 million.

For 2006, the Company's investing activities utilized \$536,000 in cash in comparison to \$214,000 in the prior year. The increase is primarily due to manufacturing equipment purchased during the second quarter of 2006 to support a new customer project.

At December 31, 2006, the Company had total long-term debt outstanding of approximately \$4.9 million and the total amount of its restructuring accrual was \$234,000.

As at December 31, 2006, principal repayments of long-term debt, the contractual obligations for restructuring accrual and all Company operating lease future payments were as follows:

(\$ in thousands)	<b>Total</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>Beyond</b>
Long-term debt	5,708	250	320	628	420	420	3,670
Restructuring accrual	234	68	59	68	39	—	—
Operating leases	4,685	776	799	821	814	471	1,004
Total contractual obligations	10,627	1,094	1,178	1,517	1,273	891	4,674

## **Capital Resources**

Under the bank credit agreement entered into on September 21, 2006 with its new senior lender, the Company has a revolving credit facility of up to a maximum of \$6.0 million based on certain terms and conditions that is secured by a general security agreement. The new operating credit facility provides the Company with approximately \$1.5 million of additional available credit compared to the facility with its previous senior lender. The Company will use this credit facility to finance working capital requirements and for other corporate purposes as required. The availability of credit under this new facility is established based on certain terms and conditions, including the amount of accounts receivable and inventory available to secure the Company's borrowings. As at December 31, 2006, the Company's operating loan balance of approximately \$0.7 million was well within its borrowing limit based on accounts receivable and inventory margining conditions in its agreement with this lender.

The Company believes that it will generate positive cashflow from operations and have sufficient availability under its new senior credit facility to fund working capital requirements over the next 12 months.

As at December 31, 2006, the Company estimates that it could significantly increase its 2006 level of sales of \$43.8 million, based on turnkey sales, without requiring significant investment in capital assets. The Company expects that if sales increases in the future it will lead to more optimal utilization of its automated surface mount lines, sophisticated test platforms and other equipment. The only expected significant capital expenditures in the normal course of business over the next fiscal year would be due to the execution of a supply contract with a customer providing sufficient sales and gross profit margin to cost justify the expenditures.

The Company cannot state with certainty that capital resources in the form of debt, including capital lease debt, or equity, in sufficient amount and on reasonable terms, will be available in the event that funding for capital expenditures should become necessary.

## **Related Party Transactions**

During the year, the Company entered into a consulting agreement and completed a private placement with a newly appointed director of the Company. During 2006, the Company did not pay any fees in respect to this consulting agreement. There were no related party transactions in 2005.

## **Fourth Quarter**

Sales for the fourth quarter of 2006 were approximately \$10.9 million, an increase of approximately \$200,000, or 2%, from \$10.7 million in the corresponding quarter of the prior year. In comparison to the third quarter of 2006, sales increased by over \$300,000. The gross profit for the fourth quarter of 2006, expressed as a percentage of sales, increased to 18.2% compared to 15.6% in 2005. This increase is largely due to higher sales in the current quarter, complimented by positive product and customer mix, which resulted in favourable material variances and other manufacturing efficiencies. Gross profit of 18.2% in the current quarter was the same as it was in the third quarter of the current year.

SG&A expenses in the fourth quarter of 2006 were approximately \$1.3 million, which is consistent with the corresponding quarter of 2005. Even though the total amount of SG&A expenses did not change, there were changes in the spending levels of various components in this category of expense. In particular, there were increases in payroll and benefit costs, travel and living expenses and stock-based compensation. These increases were offset by decreases in expensed financing costs and commissions expense in the fourth quarter 2006 compared to 2005.

Interest on subordinated notes in the fourth quarter of 2006 was nil as the liability was fully repaid in the third quarter of the current year. In the fourth quarter of 2005, interest on subordinated notes was \$68,000. Interest on long-term debt was \$211,000 in the fourth quarter of 2006 compared to nil in the corresponding quarter of the prior year. As described above in the section "Significant Transactions", the

Company completed a private placement financing consisting of a subordinated debenture and common share purchase warrants for aggregate gross proceeds of \$5.0 million at the end of the third quarter 2006. The proceeds were used to repay the subordinated notes in September 2006. Therefore, no interest expense related to the subordinated notes was incurred in the fourth quarter. However, in the fourth quarter 2006, interest expense on the debenture was charged to earnings at the effective interest of 17%, which largely makes up the \$211,000 of interest on long-term debt. On the other hand, interest on the bank operating loan was lower in the fourth quarter of the current year due to the fact that the Company had lower borrowing levels in 2006 when compared to 2005.

EBITDA<sup>(1)</sup> for the fourth quarter of 2006 was \$889,000, compared to \$488,000 in the corresponding quarter of 2005. Fourth quarter net income was \$307,000 in 2006 compared to \$153,000 in the fourth quarter of the prior year.

Adeptron experienced no extraordinary items, or material adjustments during the quarter or at year-end, other than the kind anticipated in the normal course of business or as previously described.

### **Outstanding Share Data**

Adeptron has one class of voting securities for which there are securities outstanding: common shares. As at the date hereof, there are 35,804,000 common shares issued and outstanding.

Adeptron also has stock options outstanding that have been granted pursuant to its stock option plan for directors, officers, employees and consultants. As at the date hereof, there are 3,325,000 such stock options outstanding, each exercisable for one common share, with various vesting and expiry dates and exercise prices ranging from \$0.18 to \$0.51. Accordingly, up to 3,325,000 common shares are issuable on exercise of the foregoing stock options.

Adeptron also has a total of 8,700,000 warrants outstanding, as at the date hereof, each entitling the holder to purchase one common share for a specified price. 1,349,000 warrants have an exercise price of \$0.25 and expire on August 31, 2007. 6,851,000 warrants have an exercise price of \$0.20 and expire on September 20, 2011. 500,000 warrants were issued on November 21, 2006 and have an exercise price of: [i] \$0.30 for the period between the date of issuance and the second anniversary of issuance; [ii] \$0.40 for the period between the second and third anniversaries of issuance; and [iii] \$0.50 for the period between the third anniversary and expiry of the warrants. These warrants expire on November 20, 2010. Accordingly, up to 8,700,000 common shares are issuable on exercise of the foregoing warrants.

### **Disclosure procedures and controls**

The Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure procedures and controls are effective, based on their evaluation of the effectiveness of these procedures and controls as of the end of the period covered by this report.

### **Internal controls over financial reporting**

Management of the Company is responsible for designing internal controls over financial reporting for the Company. Management has designed such internal controls over financial reporting, or caused them to be designed under their supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the financial statements for external purposes in accordance with GAAP.

### **Critical Accounting Policies and Estimates**

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of sales and expenses during the year. Note 2 to the 2006 audited Financial Statements discloses the significant accounting policies and methods used by Adeptron in the

preparation of its financial statements. Estimates and assumptions are assessed regularly by Adeptron in light of historical results, information currently available and perceptions regarding future developments. Actual results may differ materially from these estimates and assumptions. The Company has identified the critical accounting policies affecting its Audited Financial Statements below. These policies are affected by the assumptions, judgements and estimates used by management in the preparation of these statements.

#### *Revenue Recognition*

Adeptron's revenue is derived from the sale of electronics based assemblies and sub-assemblies that have been built to customer specifications. Revenue from product sales is recognized upon shipment, when title has passed to the customer, persuasive evidence of an arrangement exists, performance has occurred, specified test criteria have been met and the earnings process is complete. The Company has no further performance obligations other than its standard manufacturing warranty.

#### *Allowance for Doubtful Accounts*

Adeptron records an allowance for doubtful accounts related to accounts receivable considered by management to be impaired. The assessment of the potential or actual impairment of accounts receivable is performed on each individual customer account and reflects the Company's knowledge of the financial condition of the customer, historical payment patterns, the ageing of the account, and any other information pertinent to the assessment. Material changes in any of the assessment parameters could affect the allowance for doubtful accounts and the provision for bad debts recorded in the statements of operations and deficit.

#### *Inventory Valuation*

Inventories comprise raw materials, work-in-process and finished goods, which are valued at the lower of cost or market value, on a first-in first-out basis. Cost for work-in-process and finished goods includes the cost of materials, principally electronic components, direct labour and an allocation of overheads. Market value for raw materials inventory is replacement cost, and for work-in-process and finished goods is net realizable value. In determining market value, the Company considers factors, such as shrinkage, the ageing and future demand of the inventory, past experience with specific customers and the ability to redistribute inventory to other programs or return inventory to suppliers. A change to these assumptions may affect the valuation of inventory and gross profits.

#### *Income Tax Valuation Allowance*

Adeptron records a valuation allowance against deferred income tax assets until management believes it is more likely than not that the deferred income tax asset will be realized. In light of the Company's history of losses prior to the current year, and the lack of certainty of future profitability, Adeptron has recorded a valuation allowance for the full amount of its deferred income tax assets. A material change to profitability could affect the estimated income tax valuation and related income tax expense.

#### *Goodwill*

Adeptron performs its goodwill impairment test annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. Initially, the carrying amount of the reporting unit is compared with its fair value. When the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not to be impaired. The second step is carried out if the carrying amount of a reporting unit exceeds its fair value. In this case, the implied fair value of the reporting unit's goodwill is compared with its carrying amount to measure the amount of the impairment loss. The exercise of determining fair values is subject to management's expectations of future results for such items as sales and expenses, cash flows and discount rates. Adeptron recorded no impairment losses in 2006 and 2005. The Company has one reporting unit at December 31, 2006. Future goodwill impairment charges may result from future goodwill impairment tests.

### *Long-Lived Assets*

The valuation of long-lived assets is based on the Company's expectations regarding the future cash flows to be generated by such assets. These cash flow expectations are affected by the Company's assumptions regarding specific customer and general industry conditions and the revenue streams of future periods correlating to the expected useful lives of such assets. Adeptron recorded no long-lived asset impairment in 2006 and 2005. Material changes to these assumptions could affect the estimated useful lives or valuation of such assets resulting in changes to depreciation or the recording of impairment charges.

### **Accounting Developments – Changes in Accounting Policies Including Initial Adoption**

#### *Financial Instruments – Recognition and Measurement*

In January of 2005, the CICA released CICA Handbook Section 3855, "Financial Instruments – Recognition and Measurement", and two related standards, Section 3865, "Hedges" and Section 1531, "Comprehensive Income". These standards reflect the view that fair value, not historical cost, is the appropriate way for measuring financial instruments. This new section is effective for the 2007 fiscal year. Under the new standards, the only financial instruments that can be carried at historical costs are items such as trade receivables, trade payables and certain financial liabilities. Otherwise, financial instruments should generally be classified as "trading", "held to maturity" or "available for sale". Financial instruments that are classified as trading will generally be stated at fair value, with unrealized gains and losses being recorded through income. Financial instruments that are classified as "held to maturity" should be carried at amortized cost. Financial instruments that are designated as "available for sale" must also be stated as fair value, but unrealized gains and losses will be applied directly to shareholders, equity in a new category called "other comprehensive income". Realized gains and losses and impairments in values on "available for sale" securities will continue to be reflected through income. Equity accounted investment will continue to be accounted for based on the principles of equity accounting. Furthermore, Section 3865 restricts which hedging relationships qualify for hedge accounting. For example, it restricts the ability to designate a non-derivative financial instrument as the hedging instrument to hedge certain foreign currency risks. The Company is currently evaluating the impact of applying the new standards.

## **CORPORATE GOVERNANCE**

Adeptron Technologies Corporation is an Alberta Corporation. The Business Corporations Act (Alberta) states that it is the responsibility of the Board of Directors to manage the business and affairs of the Company. The Board discharges this responsibility by selecting and holding accountable the management to whom the Board delegates operations. Business and operations are to be managed in the best interest of the Company with the long-term goal of maximizing shareholder value.

---

#### **Note:**

- (1) EBITDA represents earnings before interest, tax, depreciation, amortization and stock-based compensation. EBITDA is not a recognized measure under Canadian generally accepted accounting principles. However, management believes that EBITDA is a useful supplemental measure to net income (loss), as it provides investors with an indication of cash earnings prior to debt service, capital expenditure, income tax and other non-cash items. Readers should be cautioned, however, that EBITDA should not be construed as an alternative to net income (loss) determined in accordance with generally accepted accounting principles as an indicator of the Company's performance or to cash flows from operating, investing and financing activities as a measure of liquidity and cash flows. The Company's method of calculating EBITDA may differ from the methods by which other companies calculate EBITDA and, accordingly, the EBITDA used herein may not be comparable to measures used by other companies.

EBITDA reconciliation to GAAP income/(loss) for the three-month and twelve-month periods ended December 31, 2006 and 2005 are shown below (All numbers expressed in thousands):

	<u>3-Month Period</u> <u>December 31,</u> <u>2006</u>	<u>3-Month Period</u> <u>December 31,</u> <u>2005</u>	<u>12-Month Period</u> <u>December 31,</u> <u>2006</u>	<u>12-Month Period</u> <u>December 31,</u> <u>2005</u>
Net income/(loss) per GAAP	\$307	\$153	\$1,614	(\$411)
Add:				
Interest on subordinated notes	0	68	302	403
Interest on long-term debt	211	0	235	0
Interest on bank operating loan	71	102	405	398
Depreciation and amortization	163	140	604	540
Stock-based compensation	137	25	180	78
EBITDA	\$889	\$488	\$3,340	\$1,008

**FINANCIAL STATEMENTS OF ADEPTRON TECHNOLOGIES CORPORATION**

**December 31, 2006 and 2005**

## **MANAGEMENT RESPONSIBILITY FOR FINANCIAL STATEMENTS**

The accompanying financial statements have been prepared by management and approved by the Board of Directors of the Company. Management is responsible for the information and representations contained in these financial statements and in other sections of the Annual Report.

The Company maintains appropriate internal controls and processes to ensure that relevant and reliable financial information is produced. The financial statements have been prepared in accordance with generally accepted accounting principles in Canada. The significant accounting policies, which management believes are appropriate for the Company, are described in Note 2 to the financial statements.

The Board of Directors is responsible for reviewing and approving the financial statements and overseeing management's performance of its financial reporting responsibilities. The Board appoints an Audit Committee of three independent Directors.

The Audit Committee reviews the financial statements, adequacy of internal controls, audit process and financial reporting with management and with the external auditors. The Audit Committee reports to the Board of Directors prior to the approval of the audited financial statements for publication.

The Shareholders have appointed Ernst & Young LLP as the external auditors of the Company and, in that capacity, they have audited the financial statements to enable them to express their opinion to the shareholders. Their report is presented herein.

F. Michael Marti,  
President and Chief Executive Officer

## AUDITORS' REPORT

To the Shareholders of  
**Adeptron Technologies Corporation**

We have audited the balance sheets of **Adeptron Technologies Corporation** as at December 31, 2006 and 2005 and the statements of operations and deficit 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 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.

Toronto, Canada,  
March 7, 2007.

*Ernst & Young LLP*

Chartered Accountants

## Adeptron Technologies Corporation

### BALANCE SHEETS

[in thousands of dollars]

As at December 31

	2006	2005
	\$	\$
<b>ASSETS</b> <i>[notes 6 and 8]</i>		
<b>Current assets</b>		
Cash	234	1
Restricted cash	—	322
Accounts receivable <i>[note 16]</i>	6,818	6,800
Inventories <i>[note 3]</i>	4,528	4,462
Prepaid expenses and deposits	279	423
<b>Total current assets</b>	<b>11,859</b>	<b>12,008</b>
Property, plant and equipment <i>[note 4]</i>	2,015	1,982
Other assets <i>[note 5]</i>	753	249
Goodwill	5,531	5,531
	<b>20,158</b>	<b>19,770</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current liabilities</b>		
Bank operating loan <i>[note 6]</i>	712	4,428
Accounts payable and accrued liabilities <i>[note 16]</i>	6,001	6,787
Current portion of restructuring accruals <i>[note 7]</i>	68	80
Subordinated notes <i>[note 9]</i>	—	2,773
Current portion of long-term debt <i>[note 6]</i>	250	—
<b>Total current liabilities</b>	<b>7,031</b>	<b>14,068</b>
Restructuring accruals <i>[note 7]</i>	166	216
Other long-term liabilities	—	24
Long-term debt <i>[note 8]</i>	4,664	—
<b>Total liabilities</b>	<b>11,861</b>	<b>14,308</b>
Commitments and contingencies <i>[notes 11 and 12]</i>		
<b>Shareholders' equity</b>		
Share capital <i>[note 10]</i>	35,315	35,058
Contributed surplus <i>[note 10]</i>	918	787
Warrants <i>[notes 8, 9, and 10]</i>	945	112
Deficit	(28,881)	(30,495)
<b>Total shareholders' equity</b>	<b>8,297</b>	<b>5,462</b>
	<b>20,158</b>	<b>19,770</b>

See accompanying notes

On behalf of the Board:

"F. Michael Marti"  
Director

"A.J. Robertson"  
Director

## Adeptron Technologies Corporation

### STATEMENTS OF OPERATIONS AND DEFICIT

[in thousands of dollars, except per share information]

Years ended December 31

	2006	2005
	\$	\$
<b>Sales</b> <i>[notes 16 and 17]</i>	<b>43,832</b>	38,202
Cost of goods sold <i>[note 4]</i>	<b>36,099</b>	32,928
<b>Gross profit</b>	<b>7,733</b>	5,274
<b>Expenses</b> <i>[note 16]</i>		
Selling, general and administrative <i>[note 10]</i>	<b>4,999</b>	4,712
Interest on subordinated notes <i>[note 9]</i>	<b>302</b>	403
Interest on long-term debt <i>[notes 6 and 8]</i>	<b>235</b>	—
Interest on bank operating loan <i>[note 6]</i>	<b>405</b>	398
Depreciation and amortization <i>[notes 4 and 5]</i>	<b>178</b>	172
	<b>6,119</b>	5,685
<b>Net income (loss) for the year</b>	<b>1,614</b>	(411)
Deficit, beginning of year	<b>(30,495)</b>	(30,084)
<b>Deficit, end of year</b>	<b>(28,881)</b>	(30,495)
<b>Income (loss) per share</b>		
Basic	<b>0.05</b>	(0.01)
Diluted	<b>0.05</b>	(0.01)
<b>Weighted average number of shares outstanding [000's]</b> <i>[note 14]</i>		
Basic	<b>34,742</b>	34,613
Diluted	<b>35,213</b>	34,613

*See accompanying notes*

## Adeptron Technologies Corporation

### STATEMENTS OF CASH FLOWS

[in thousands of dollars]

Years ended December 31

	2006	2005
	\$	\$
<b>OPERATING ACTIVITIES</b>		
Net income (loss) for the year	1,614	(411)
Add items not involving cash:		
Depreciation and amortization	604	540
Stock-based compensation <i>[note 10]</i>	180	78
Non-cash interest expense	132	133
Amortization of lease costs	—	27
	<u>2,530</u>	<u>367</u>
Changes in non-cash working capital balances related to operations:		
Accounts receivable	(18)	(1,210)
Inventories	(66)	(1,032)
Prepaid expenses and deposits	144	(47)
Accounts payable and accrued liabilities	(786)	1,552
Interest payable on subordinated notes	(523)	270
Restructuring accruals	(62)	(140)
<b>Cash provided by (used in) operating activities</b>	<u>1,219</u>	<u>(240)</u>
<b>FINANCING ACTIVITIES</b>		
Decrease (increase) in restricted cash	322	(8)
Increase (decrease) in bank operating loan	(3,716)	527
Issuance of long-term debt, net of issuance costs	4,533	—
Repayment of long-term debt	(42)	—
Repayment of subordinated notes	(2,250)	—
Issuance of common shares and warrants, net of issuance costs	980	—
Repayment of other long-term liabilities	(24)	(65)
Deferred financing costs of operating loan	(253)	—
<b>Cash provided by (used in) financing activities</b>	<u>(450)</u>	<u>454</u>
<b>INVESTING ACTIVITIES</b>		
Acquisition of property, plant and equipment	(536)	(214)
<b>Cash used in investing activities</b>	<u>(536)</u>	<u>(214)</u>
<b>Net increase in cash during the year</b>	<u>233</u>	<u>—</u>
Cash, beginning of year	1	1
<b>Cash, end of year</b>	<u>234</u>	<u>1</u>
<b>Supplemental cash flow information</b>		
Interest paid	1,253	315

*See accompanying notes*

## **Adeptron Technologies Corporation**

### **NOTES TO FINANCIAL STATEMENTS**

[in thousands of dollars, except as noted]

December 31, 2006

#### **1. DESCRIPTION OF THE BUSINESS**

Adeptron Technologies Corporation [the "Company"] is a public company traded on the Toronto Stock Exchange under the symbol ATQ and was formed under the Business Corporations Act (Alberta). The Company's principal business activities include providing a full range of electronics manufacturing services to the global electronics market. Substantially all of the Company's identifiable assets are located in Canada and all of the Company's sales are in Canada and the United States.

#### **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

These financial statements have been prepared by management on the historical cost basis in accordance with Canadian generally accepted accounting principles. The significant accounting policies are summarized as follows:

##### **Use of estimates**

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the year. The most significant assumptions made by management in the preparation of the Company's financial statements include, but are not limited to, the allowance for doubtful accounts, inventory valuation, valuation allowances for income taxes, restructuring accruals, the useful lives and recoverability of property, plant and equipment, fair value of stock-based compensation and the valuation of goodwill. Actual results could differ from those estimates.

##### **Inventories**

Inventories comprise raw materials, work-in-process and finished goods, which are valued at the lower of cost or market value, on a first-in, first-out basis.

Cost for work-in-process and finished goods includes the cost of materials, principally electronic components, direct labour and an allocation of overhead.

Market value for raw materials inventory is replacement cost, and for work-in-process and finished goods is net realizable value. In determining market value, the Company considers factors, such as shrinkage, the aging and future demand of the inventory, past experience with specific customers and the ability to redistribute inventory to other programs or return inventory to suppliers.

## **Adeptron Technologies Corporation**

### **NOTES TO FINANCIAL STATEMENTS**

[in thousands of dollars, except as noted]

December 31, 2006

#### **Property, plant and equipment**

Property, plant and equipment are recorded at cost less accumulated depreciation. Depreciation is calculated using the straight-line method, commencing when the assets become available for productive use, based on the following estimated useful lives:

Manufacturing equipment	5 to 10 years
Computer hardware and software	3 years
Furniture and office equipment	5 years
Vehicles	5 years
Leasehold improvements	Term of lease

The Company reviews the recoverability of property, plant and equipment annually or more frequently, if events or circumstances indicate that the carrying amount may not be recoverable. Recoverability is measured by comparing the carrying amounts of a group of assets to future undiscounted cash flows expected to be generated by that group of assets. When an asset is not recoverable, the impairment loss recognized is measured as the amount by which the carrying amount of the asset exceeds its fair value.

#### **Goodwill**

Goodwill represents the excess of the purchase consideration over the fair value of the net tangible and intangible assets acquired at the date of acquisition.

Goodwill is not amortized and is tested for impairment annually. The impairment test is carried out in two steps.

In the first step, the carrying amount of the reporting unit is compared with its fair value. When the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not to be impaired and the second step of the impairment test is not required. The fair value of the reporting unit is principally based on management's estimates of future discounted cash flows.

## **Adeptron Technologies Corporation**

### **NOTES TO FINANCIAL STATEMENTS**

[in thousands of dollars, except as noted]

December 31, 2006

The second step is carried out when the carrying amount of a reporting unit exceeds its fair value, in which case, the implied fair value of the reporting unit's goodwill is compared with its carrying amount to measure the amount of the impairment loss, if any. The implied fair value of goodwill is determined in the same manner as the value of goodwill is determined in a business combination described in the preceding paragraph, using the fair value of the reporting unit as if it was the purchase consideration. When the carrying amount of a reporting unit's goodwill exceeds the implied fair value of the goodwill, an impairment loss is recognized in an amount equal to the excess.

The Company is also required to evaluate goodwill for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Certain indicators of potential impairment that could impact the Company's reporting unit include, but are not limited to, the following: [a] a significant long-term adverse change in the global electronics business industry that is expected to cause a substantial decline in sales and/or gross margins and [b] a significant technological change that results in a substantially more cost-effective method of production and [c] the continued appreciation of the Canadian dollar relative to the U.S. dollar may result in reduced contributions.

As at December 31, 2006, the Company has one reporting unit. The Company has calculated the fair value of its reporting unit as at December 31, 2006 and 2005 and compared this to the carrying amount and determined that no impairment of goodwill existed.

#### **Other assets**

Other assets consist of up-front lease costs, customer relationships and deferred financing costs.

Up-front lease costs represent lump sum amounts paid on the initiation of operating leases and are amortized on a straight-line basis over the life of the related lease.

Deferred financing costs represent the costs incurred by the Company related to the issuance of long-term debt and the bank financing. The costs are being amortized over the expected term of the long-term debt and the bank financing. In the event of early settlement of the long-term debt or the bank financing, the unamortized balance of the respective deferred financing costs will be written off.

## **Adeptron Technologies Corporation**

### **NOTES TO FINANCIAL STATEMENTS**

[in thousands of dollars, except as noted]

December 31, 2006

Customer relationships are carried at cost less accumulated amortization and are amortized on a straight-line basis over their economic life, which is estimated to be three years. The cost of customer relationships represents the fair value of customer relationships acquired as part of a business acquisition. Internal costs incurred on developing customer relationships are expensed as incurred. Management periodically reviews the carrying value of the customer relationships whenever events or changes in circumstances indicate that the carrying amount of the customer relationships may not be recoverable which is determined by comparing the carrying amount to the estimated undiscounted future net cash flows. The Company writes down the costs associated with customer relationships to their fair value when the value is determined to be impaired.

#### **Revenue recognition**

Revenue is derived from the sale of electronics based assemblies and sub-assemblies that have been built to customer specifications. Revenue from product sales is recognized upon shipment, when title has passed to the customer, persuasive evidence of an arrangement exists, performance has occurred, specified test criteria have been met and the earnings process is complete. The Company has no further performance obligations other than its standard manufacturing warranty.

#### **Income taxes**

The Company follows the liability method of accounting for income taxes. Under this method, the future tax assets or liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities, as well as for the benefit of losses available to be carried forward to future years for tax purposes that are more likely than not to be realized. Future tax assets and liabilities are measured using the substantively enacted tax rates and laws which are expected to be in effect when the differences are expected to reverse. The Company records a valuation allowance against the future income tax asset until management believes it is more likely than not that the future income tax asset will be realized.

#### **Stock-based compensation plan**

The Company has a stock-based compensation plan which is described in note 10[d].

Stock options are accounted for using the fair value method. The fair value of stock options granted is recognized on a straight-line basis over the applicable stock option vesting period as compensation expense included in selling, general and administrative expenses in the statements of operations and deficit and contributed surplus within shareholders' equity on the balance sheets. On the exercise of stock options, the total of the consideration received and the accumulated contributed surplus is credited to share capital.

## Adeptron Technologies Corporation

### NOTES TO FINANCIAL STATEMENTS

[in thousands of dollars, except as noted]

December 31, 2006

Fair value is calculated using the Black-Scholes option pricing model with the assumptions described in note 10[d].

#### Income (loss) per share

Basic income (loss) per share is computed using the weighted average number of shares outstanding during the year. Diluted income (loss) per share is computed in accordance with the treasury stock method. Diluted income (loss) per share reflects the dilution that would occur if outstanding stock options and warrants were exercised or converted into common shares using the treasury stock method.

#### Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars using exchange rates at the year end. Revenue and expenses are translated into Canadian dollars at the rates of exchange in effect on the dates of the transactions. Gains or losses arising from the translation of foreign currencies are included in the statements of operations and deficit.

### 3. INVENTORIES

Inventories consist of the following:

	<b>2006</b>	<b>2005</b>
	\$	\$
Raw materials	<b>2,835</b>	2,447
Work-in-process	<b>1,408</b>	1,687
Finished goods	<b>285</b>	328
	<b>4,528</b>	4,462

## Adeptron Technologies Corporation

### NOTES TO FINANCIAL STATEMENTS

[in thousands of dollars, except as noted]

December 31, 2006

#### 4. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of the following:

	2006		
	Cost \$	Accumulated depreciation \$	Net book value \$
Manufacturing equipment	11,090	9,355	1,735
Computer hardware and software	644	553	91
Furniture and office equipment	291	271	20
Vehicles	28	23	5
Leasehold improvements	461	297	164
	<b>12,514</b>	<b>10,499</b>	<b>2,015</b>

  

	2005		
	Cost \$	Accumulated depreciation \$	Net book value \$
Manufacturing equipment	10,620	8,945	1,675
Computer hardware and software	598	507	91
Furniture and office equipment	285	261	24
Vehicles	28	17	11
Leasehold improvements	447	266	181
	<b>11,978</b>	<b>9,996</b>	<b>1,982</b>

Depreciation of property, plant and equipment during the year ended December 31, 2006 amounted to \$503 [2005 - \$438], of which \$426 [2005 - \$368] is recorded in cost of goods sold.

## Adeptron Technologies Corporation

### NOTES TO FINANCIAL STATEMENTS

[in thousands of dollars, except as noted]

December 31, 2006

#### 5. OTHER ASSETS

Other assets consist of the following:

	2006	2005
	\$	\$
Up-front lease costs	141	161
Customer relationships	7	88
Deferred financing costs <i>[notes 6 and 8]</i>	605	—
	<b>753</b>	<b>249</b>

Up-front lease costs are net of accumulated amortization of \$59, of which \$20 [2005 - \$21] was recorded as amortization expense in the statements of operations and deficit in 2006.

Customer relationships are net of accumulated amortization of \$236, of which \$81 [2005 - \$81] was recorded as amortization expense in the statements of operations and deficit in 2006.

Deferred financing costs are net of accumulated amortization of \$43, which was included as interest on long-term debt and other interest in the statements of operations and deficit. In 2005, deferred financing costs of \$80 were recorded as interest on subordinated notes in the statements of operations and deficit.

#### 6. BANK CREDIT AGREEMENT

On September 21, 2006, the Company entered into a three-year credit agreement with a senior lender that provides the Company with an aggregate senior lending facility in the amount of up to \$6,750. The total senior lending facility is comprised of a \$6,000 revolving credit facility and a \$750 term loan facility. The aggregate senior lending facility is collateralized by a first ranking general security agreement covering substantially all of the Company's assets.

The credit agreement contains various covenants that the Company must comply with including financial covenants related to minimum levels of net assets and interest coverage, and maximum levels of capital spending.

The Company incurred financing costs of \$253 related to the credit agreement and these costs have been recorded on the balance sheets as deferred financing costs in other assets. These deferred financing costs will be amortized over the three-year term of the agreement and will be included in the statements of operations and deficit as interest expense.

## **Adeptron Technologies Corporation**

### **NOTES TO FINANCIAL STATEMENTS**

[in thousands of dollars, except as noted]

December 31, 2006

#### **[a] Revolving credit facility**

Under the revolving credit facility, the Company can borrow by way of Canadian dollar prime rate loans or U.S. dollar base rate loans. In addition, the revolving credit facility allows for the issuance of letters of credit and has a foreign exchange trading component. The maximum availability under the revolving credit facility is based on certain terms and conditions, including, but not limited to, the levels of accounts receivable and inventory and is established on an ongoing basis. Borrowings under this facility are subject to interest at the bank's prime rate plus 1% for Canadian dollar loans and U.S. base rate plus 0.5% for U.S. dollar loans and is payable monthly.

As at December 31, 2006, the Company's bank operating loan balance of \$712 was within its borrowing limit based on the accounts receivable and inventory margining conditions in its agreement with its senior lender. Under the revolving credit facility, the effective interest rate for the year was 7.1%.

#### **[b] Term loan facility**

In addition, the Company borrowed \$750 under its term loan facility with its senior lender. The term loan is repayable over 36 months in equal monthly installments commencing on November 1, 2006. The term loan is subject to interest on the outstanding balance at the bank's prime rate plus 1.5% and interest is payable monthly. The effective interest rate for the year was 7.5%. The term loan is classified as long term debt on the balance sheet, of which \$250 is shown as current portion of long-term debt.

Up to September 21, 2006, the Company had an agreement with another senior lender that provided the Company with a credit facility with a limit of \$4,500, subject to certain terms and conditions. On September 21, 2006, the Company paid to the senior lender the outstanding balance relating to this credit facility, net of the restricted cash held with the senior lender, and this credit agreement was terminated. The operating line was subject to interest at bank prime plus 3% and interest was payable monthly. The effective interest rate for the year was 8.7% [2005 – 7.1%].

## Adeptron Technologies Corporation

### NOTES TO FINANCIAL STATEMENTS

[in thousands of dollars, except as noted]

December 31, 2006

#### 7. RESTRUCTURING ACCRUALS

During the year ended December 31, 2001, the Company restructured its operations resulting in the closing of its manufacturing facilities in Calgary, Alberta and the consolidation of all operations in Markham, Ontario. The restructuring resulted in staff reductions, consolidation of office and manufacturing space and the sale of non-core assets.

Restructuring accrual activity for the years ended December 31 is as follows:

	2006	2005
	\$	\$
Balance, beginning of year	296	436
Severance accrual and related payments	—	(53)
Lease payments, net of sublease income	(62)	(87)
Balance, end of year	234	296
Less current portion	68	80
	<b>166</b>	<b>216</b>

The remaining obligation consists of a facility lease that will be paid out over the remaining lease period, net of sublease income, which extends through 2011.

#### 8. LONG-TERM FINANCING

On September 21, 2006, the Company completed a private placement financing consisting of a subordinated debenture and common share purchase warrants in the amount of \$5,000. As part of the private placement, the Company issued 6,851,000 common share purchase warrants, each of which entitles the holder thereof to purchase one common share of the Company for \$0.20 per common share for a period of 5 years. The subordinated debenture has a principal amount of \$5,000, a term of 66 months and carries interest at 12% per annum, payable monthly. In addition, beginning on November 1, 2008, the Company will make principal repayments of \$35 per month for 42 months with the remaining outstanding principal due at the end of the 66 month term. The subordinated debenture is collateralized by a second ranking general security agreement covering substantially all of the Company's assets.

The Company has allocated the \$5,000 gross proceeds received from the private placement to debt and equity based on the relative fair values of the common share purchase warrants and the subordinate debenture. The fair value of the common share purchase warrants was determined to be \$822 using an option-pricing model. The fair value allocated to the subordinated debenture was based on an effective interest rate of 17% and was determined to be \$4,178. Interest expense on the subordinated debenture will be charged to earnings at the effective rate of 17%.

## Adeptron Technologies Corporation

### NOTES TO FINANCIAL STATEMENTS

[in thousands of dollars, except as noted]

December 31, 2006

The carrying value for the debenture is as follows:

	<b>December 31, 2006</b>
	\$
Principal of debenture	<b>5,000</b>
Amount allocated to warrants	<b>(822)</b>
Amount allocated to debenture	<b>4,178</b>
Interest accrued but not paid	<b>28</b>
	<b>4,206</b>

The subordinated debenture agreement contains various covenants that the Company must comply with including financial covenants related to the ratio of current assets to current liabilities, debt coverage, interest coverage and debt to equity.

The Company incurred financing costs of \$473 related to the private placement and these costs have been allocated on a pro-rata basis to debt and equity, amounting to \$395 and \$78, respectively. The amount related to the issuance of the subordinated debenture has been recorded on the balance sheet as deferred financing costs in other assets. These deferred financing costs will be amortized over the 66 month term of the subordinated debenture and will be included in the statements of operations and deficit as interest on long-term debt. The amount allocated to equity is included as a reduction in the warrant value within shareholders' equity.

As at December 31, 2006, 6,851,000 common share purchase warrants related to the private placement financing remain outstanding.

Long-term debt includes the term loan facility as disclosed in note 6[b].

## Adeptron Technologies Corporation

### NOTES TO FINANCIAL STATEMENTS

[in thousands of dollars, except as noted]

December 31, 2006

#### 9. SUBORDINATED NOTES

During 2004, the Company issued debt and equity totalling \$3,250. The offering consisted of \$1,000 in common share subscription receipts ["CSRs"] and \$2,250 in unit subscription receipts ["USRs"].

The CSRs were each automatically converted, for no additional consideration, into one share of the Company's common stock. Each CSR was issued for \$0.35. The proceeds, net of the pro-rata share of \$250 of issuance costs, are included in share capital.

The USRs were each automatically converted, for no additional consideration, into 22,500 subordinated notes payable with a principal amount of \$100 per note and 70 common share purchase warrants per note. The subordinated notes were scheduled to mature 18 months from the date of issuance and accrue simple interest at a rate of 12% per annum. These notes were subordinated to the bank operating loan. Each common share purchase warrant was originally exercisable for one common share at a price of \$0.35 for a period of 24 months. In addition, the Company's agent for the financing transaction was issued common share purchase warrants entitling the agent to acquire up to a maximum of 557,000 common shares at a price of \$0.35 per share for a 24-month period.

The \$2,250 of proceeds from the USRs had been split between liability and equity based on the residual method used to estimate the fair values of the subordinated notes and the warrants. The amount allocated to debt and equity was \$2,141 and \$109, respectively. Interest expense on the subordinated notes was accrued at 16%, being the effective rate, over the original 18-month term and was charged to the statements of operations and deficit as incurred.

During the period from August 2005 through to July 2006, the Company extended the maturity date of the subordinated notes and the outstanding common share purchase a number of times. Until December 31, 2005, interest continued to accrue at a rate of 12% per annum and was calculated based on the original principal balance of \$2,250. Subsequent to December 31, 2005, the Company agreed to accrue interest at a rate of 12% per annum based, effective January 1, 2006, on the combined amount of original principal and the unpaid interest to December 31, 2005. The Company also reduced the exercise price of the outstanding common share purchase warrants from \$0.35 to \$0.25 and extended the term of the warrants held by note holders to August 31, 2007. The terms of the warrants issued to the Company's agent for the financing were not changed and they expired unexercised during February 2006.

The Company determined the cost related to changing the terms of the note holder warrants to be \$61 using the fair value method. The cost was allocated on a straight-line basis over the period of the extension and for the year ended December 31, 2006, the Company recorded \$61 as interest expense in this regard.

## Adeptron Technologies Corporation

### NOTES TO FINANCIAL STATEMENTS

[in thousands of dollars, except as noted]

December 31, 2006

In September 2006, the Company paid \$3,014 to the note holders which represented full payment of the original principal and all interest accrued and unpaid up to September 29, 2006. As a result of this payment, the Company has no further debt obligation related to these subordinated notes.

During 2006, 191,000 common share purchase warrants were exercised for cash proceeds of \$48. As at December 31, 2006, 1,349,000 common share purchase warrants related to the issuance of the subordinated notes remain outstanding.

#### 10. SHARE CAPITAL

##### [a] Authorized

Unlimited non-voting preferred shares

Unlimited voting common shares without nominal or par value

##### [b] Common shares issued

	Common shares #	Amount \$
	[000's]	
<b>Balance, December 31, 2005 and 2004</b>	34,613	35,058
Issued on private placement	1,000	188
Exercise of common share purchase warrants <i>[note 9]</i>	191	69
<b>Balance, December 31, 2006</b>	<b>35,804</b>	<b>35,315</b>

On November 21, 2006, the Company completed a private placement with a newly appointed director of the Company. Simultaneously, the Company entered into a consulting arrangement with this director. The private placement was for aggregate gross proceeds of \$200 on the issuance of 1,000,000 units and share issue costs related to the private placement were \$12. Each unit includes one common share and one-half common share purchase warrant *[see 10 [c]]*

The fair value of the units exceeded the gross proceeds by approximately \$49. This amount has been recorded as stock-based compensation in the statements of operations and deficit.

## Adeptron Technologies Corporation

### NOTES TO FINANCIAL STATEMENTS

[in thousands of dollars, except as noted]

December 31, 2006

#### [c] Warrants

	Warrants #	Amount \$
	[000's]	
<b>Balance, December 31, 2004 [i]</b>	<b>2,097</b>	<b>106</b>
Modification of warrants [i]	—	6
<b>Balance, December 31, 2005</b>	<b>2,097</b>	<b>112</b>
Expired unexercised [i]	(557)	—
Modification of warrants [i]	—	61
Exercise of common share purchase warrants [i]	(191)	(21)
Issued on private placement, net of issuance costs [ii]	6,851	744
Issued on private placement, net of issuance costs [iii]	500	49
<b>Balance, December 31, 2006</b>	<b>8,700</b>	<b>945</b>

[i] Warrants outstanding at December 31, 2004 include 1,540,000 common purchase share warrants issued in relation to the subordinated notes [note 9] where each warrant was originally exercisable for one common share at a price of \$0.35 for a period of 24 months. During 2006, the Company modified the warrants whereby each warrant is exercisable for one common share at a price of \$0.25 and the warrants expire on August 31, 2007. During 2006, 191,000 warrants were exercised for cash proceeds of \$48. As at December 31, 2006, 1,349,000 warrants related to the issuance of the subordinated notes remain outstanding.

In addition, the Company's agent for the subordinated notes was issued common share purchase warrants entitling the agent to acquire up to a maximum of 557,000 common shares at a price of \$0.35 per share for a 24-month period. During 2006, these warrants expired unexercised.

[ii] As part of the private placement described in note 8, the Company issued 6,851,000 common share purchase warrants, each of which entitles the holder thereof to purchase one common share of the Company for \$0.20 per common share for a period of 5 years. The fair value of the common share purchase warrants was determined to be \$822 using an option-pricing model. The Company incurred financing costs related to the private placement and the pro-rata amount of these costs allocated to equity amounts to \$78.

## Adeptron Technologies Corporation

### NOTES TO FINANCIAL STATEMENTS

[in thousands of dollars, except as noted]

December 31, 2006

[iii] As part of the private placement described in note 10[b], the Company issued 500,000 common share purchase warrants, each of which is exercisable into one common share for a period of 48 months at an exercise price of: [i] \$0.30 for the period between the date of issuance and the second anniversary of issuance; [ii] \$0.40 for the period between the second and third anniversaries of issuance; and [iii] \$0.50 for the period between the third anniversary and expiry of the warrants. The fair value of the common share purchase warrants was determined to be \$49 using an option-pricing model.

#### [d] Stock options

The Company has established a stock option plan for its directors, officers, employees and consultants, whereby options to a maximum of 3,656,000 common shares may be granted subject to certain terms and conditions. Stock options vest over a period of up to three years and expire at various dates through 2011.

Changes in the number of options, with their weighted average exercise prices, are summarized below:

	<u>2006</u>		<u>2005</u>	
	<u>Number</u>	<u>Weighted</u>	<u>Number</u>	<u>Weighted</u>
	<u>of</u>	<u>average</u>	<u>of</u>	<u>average</u>
	<u>options</u>	<u>exercise</u>	<u>options</u>	<u>exercise</u>
	<u>[000's]</u>	<u>price</u>	<u>[000's]</u>	<u>price</u>
		<u>\$</u>		<u>\$</u>
<b>Outstanding, beginning of year</b>	<b>2,434</b>	<b>0.43</b>	2,677	0.45
Granted	<b>1,270</b>	<b>0.28</b>	270	0.18
Forfeited/expired	<b>(464)</b>	<b>0.61</b>	(513)	0.37
<b>Outstanding, end of year</b>	<b>3,240</b>	<b>0.34</b>	2,434	0.43
<b>Options exercisable, end of year</b>	<b>2,537</b>	<b>0.37</b>	2,256	0.44

## Adeptron Technologies Corporation

### NOTES TO FINANCIAL STATEMENTS

[in thousands of dollars, except as noted]

December 31, 2006

The following table summarizes information about the stock options at December 31, 2006:

Range of exercise price \$	Options outstanding			Options exercisable	
	Number of options [000's]	Weighted average remaining contractual life [years]	Weighted average exercise price \$	Number of options [000's]	Weighted average exercise price \$
0.00 - 0.19	250	3.9	0.18	225	0.18
0.20 - 0.29	460	4.1	0.22	150	0.23
0.30 - 0.39	790	4.9	0.32	422	0.32
0.40 - 0.49	1,565	0.8	0.40	1,565	0.40
0.50 - 0.59	175	2.3	0.51	175	0.51
	<b>3,240</b>	<b>2.6</b>	<b>0.34</b>	<b>2,537</b>	<b>0.37</b>

The estimated fair value of the options is amortized to expense over the options' vesting period on a straight-line basis, and was determined using the Black-Scholes option pricing model with the following assumptions:

	2006	2005
Risk-free interest rate	3.9%	3.3%
Volatility factor of the future expected market price of common shares	82%	103%
Weighted average expected life of the options	3 years	3 years

During the year, the Company recorded \$131 [2005 - \$78] of stock-based compensation expense. These amounts are included in selling, general and administrative expenses and contributed surplus. For options granted in 2006, the weighted average estimated fair value at the date of the grant was \$0.15 [2005 - \$0.11] per option.

## Adeptron Technologies Corporation

### NOTES TO FINANCIAL STATEMENTS

[in thousands of dollars, except as noted]

December 31, 2006

#### 11. COMMITMENTS

Future minimum annual operating lease payments for office space and equipment are as follows:

	\$
2007	776
2008	799
2009	821
2010	814
2011	471
Thereafter	1,004
	<hr/> 4,685

Excluded from the amounts noted above is \$1,335 [2005 - \$1,643], representing certain lease costs for the years 2007 to 2011. Offsetting these commitments is \$1,101 [2005 - \$1,347] of sublease income that has been committed to the Company from sub-tenants. These amounts were recorded as part of the 2001 restructuring charges and are included in restructuring accruals [note 7].

#### 12. CONTINGENCIES

##### [a] Contingent consideration

In connection with the Company's February 2004 acquisition of its Ottawa operations, certain key managers signed non-competition and non-solicitation agreements, which apply whether their employment or consulting engagement is terminated either by the individual or by the Company. The agreements also provide for the payment of consideration to these individuals, based on the ongoing performance of the Ottawa operations during the first three years after the acquisition. The amount of compensation payable, if earned, will depend on a specified percentage of gross margin for the Ottawa operations, ranging from 6% to 10% of gross margin and increasing as gross margin increases. Compensation is only payable under this arrangement if specified minimum gross margin and revenue thresholds are met. The total of all such compensation paid to all recipients over the course of the potential compensation period cannot exceed \$3,000. For this maximum amount of compensation to be earned, the Ottawa operations would need to have achieved over \$30,000 in gross margin in aggregate during the applicable three-year calculation period. No amounts have been recorded for the period to December 31, 2006 as the performance targets have not been met and the contingency expired in February 2007.

## Adeptron Technologies Corporation

### NOTES TO FINANCIAL STATEMENTS

[in thousands of dollars, except as noted]

December 31, 2006

#### [b] Pay equity

In December of 2006, the Company received an order from the Pay Equity Commission of Ontario requiring it to develop and implement a pay equity plan for its operations in Ontario. In addition, the order requires the Company to pay any retroactive pay equity adjustments, in accordance with Ontario pay equity legislation, that may be warranted as a result of the plan's implementation. The Company is in the midst of a process that will allow it to achieve compliance with the order before the end of 2007. At this time, the Company is unable to determine the likelihood and amount, if any, of any potential retroactive pay equity adjustments.

#### 13. INCOME TAXES

The income tax expense (recovery) differs from the amount obtained by applying the combined federal and provincial income tax rates to income before income taxes. The difference relates to the following items:

	2006	2005
	\$	\$
Combined statutory income tax rate	<b>34.0%</b>	34.0%
Expected income tax expense (recovery)	<b>548</b>	(140)
Decrease in income tax expense (recovery) resulting from		
Benefit of tax losses (utilized) not recognized	<b>(966)</b>	90
Change in future tax rates	<b>383</b>	—
Permanent differences	<b>63</b>	50
Other	<b>(28)</b>	—
	—	—

## Adeptron Technologies Corporation

### NOTES TO FINANCIAL STATEMENTS

[in thousands of dollars, except as noted]

December 31, 2006

The components of the Company's net future tax assets at December 31, none of which has been recorded in these financial statements, are as follows:

	2006	2005
	\$	\$
<b>Future tax assets</b>		
Non-capital losses	5,009	6,138
Share issue costs	22	86
Non-deductible reserves	474	363
Property, plant and equipment	1,725	1,609
	7,230	8,196
Valuation allowance	(7,230)	(8,196)
	—	—

The non-capital loss carryforwards expire as follows:

	\$
2007	—
2008	10,920
2009	2,369
2010	—
2011	—
2012	—
2013	—
2014	695
2015	1,473
	15,457

## Adeptron Technologies Corporation

### NOTES TO FINANCIAL STATEMENTS

[in thousands of dollars, except as noted]

December 31, 2006

#### 14. INCOME (LOSS) PER SHARE

The dilutive effect of stock options and warrants on the weighted average number of shares outstanding in 2006 is as follows:

	2006 # [000's]
Basic weighted average number of shares outstanding	34,742
Dilutive effect of stock options	80
Dilutive effect of warrants	391
<b>Diluted weighted average number of shares outstanding</b>	<b>35,213</b>

In 2005, all stock options and warrants were excluded from the calculation of diluted loss per share, as the effect of including them would have been anti-dilutive. The potential dilutive effect of stock options and warrants on the basic weighted average number of shares outstanding balance of 34,613,000 was an increase of 6,000 to 34,619,000.

#### 15. RELATED PARTY TRANSACTIONS

During the year, the Company entered into a consulting agreement and completed a private placement [note 10[b]] with a newly appointed director of the Company. During 2006, the Company did not pay any fees in respect to this consulting agreement.

#### 16. FINANCIAL INSTRUMENTS

##### [a] Fair values

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

The carrying value of long-term debt approximates its fair value due to the short period since the debt instruments were issued. Management has concluded that there have been minimal changes in prevailing interest rates and the risk profile of the Company during the period between the issuance and the balance sheet dates.

## Adeptron Technologies Corporation

### NOTES TO FINANCIAL STATEMENTS

[in thousands of dollars, except as noted]

December 31, 2006

#### [b] Credit risk

At December 31, 2006, the Company's two largest customer accounts receivable balances represent 46% [2005 - 48%] of the total accounts receivable balance.

#### [c] Foreign currency risk

The Company's activities that result in exposure to fluctuations in foreign currency exchange rates consist of the sale of products to customers invoiced in foreign currencies and the purchase of services, raw materials and property and equipment from suppliers invoiced in foreign currencies. The Company does not use derivative instruments to hedge its currency risk. Of the Company's accounts receivable and accounts payable, 67% [2005 - 61%] and 57% [2005 - 57%], respectively, are denominated in foreign currencies. During the year, approximately 66% [2005 - 63%] of revenue and approximately 45% [2005 - 42%] of expenses were incurred in U.S. dollars.

### 17. SEGMENTED INFORMATION

The Company operates in one business segment, which is the supply of electronics manufacturing services. The Company markets its services primarily in Canada and the United States.

Sales attributable to geographic location based on the location of the customer are as follows:

	2006	2005
	\$	\$
Canada	35,024	31,099
United States	8,808	7,103
	<b>43,832</b>	<b>38,202</b>

Substantially all of the Company's identifiable assets as at December 31, 2006 and 2005 are located in Canada.

For the year ended December 31, 2006, sales to the Company's two largest customers represent 47% [2005 - 47%] of the Company's total sales. The two customers represent 31% [2005 - 35%] and 16% [2005 - 12%] of total sales, respectively.

### 18. COMPARATIVE FINANCIAL STATEMENTS

The comparative financial statements have been reclassified from statements previously presented to conform to the presentation of the 2006 financial statements.

## DIRECTORS, OFFICERS AND SENIOR MANAGEMENT

### Board of Directors

Luke Chan.....	Associate Vice-President of International Affairs at McMaster University
Peter A. Kirsch .....	Chief of Staff of the Office of James Kimsey, Founder and CEO Emeritus of America Online
F. Michael Marti.....	President and CEO, Adeptron Technologies Corporation
William (Bill) J. McClean .....	Special Executive Assistant to the President, IBM Canada Ltd.
Tim G. Osby .....	Owner and operator, GDC Enterprises, Inc.
Alastair J. Robertson (Non-executive Chairman, Adeptron Technologies Corporation).....	Business Consultant
Paul Walker.....	Business Consultant
David Wilson .....	Vice President, Finance, Mission Hill Family Estate

### Officers and Senior Management

F. Michael Marti.....	President and Chief Executive Officer
George Tepelenas .....	Chief Financial Officer and Corporate Secretary
Geoff Beale .....	Vice-President, Global Supply Chain
Michael Pang .....	Vice-President, Engineering
David Perry .....	Vice-President, Markham Operations
Frank Piccolo .....	Vice-President, Quality
Darwin Stevens.....	Vice-President, Ottawa Operations

## SHAREHOLDER INFORMATION

### Stock Exchange Listing

Listed: Toronto Stock Exchange (TSX)  
Trading Symbol: ATQ

### Shares Outstanding

(As at December 31, 2006)  
Basic 35,804,235

### Common Share Trading Activity

<u>2006</u>	<u>Share Price (\$)</u>		<u>Volume</u>
	<u>High</u>	<u>Low</u>	
Q1	0.25	0.13	1,701,665
Q2	0.24	0.14	2,138,050
Q3	0.30	0.16	1,644,546
Q4	0.42	0.12	5,306,572

### Closing Price of Common Shares

(As at December 29, 2006)  
TSX \$0.38

### Auditor

Ernst & Young LLP  
Chartered Accountants  
Ernst & Young Tower  
P.O. Box 251, 222 Bay Street  
Toronto-Dominion Centre  
Toronto, ON M5K 1J7

### Registrar and Transfer Agent

Olympia Trust Company  
2300, 125 – 9th Avenue S.E.  
Calgary, Alberta  
T2G 0P6

### Company Contact

F. Michael Marti  
President and CEO  
Adeptron Technologies Corporation  
96 Steelcase Road West, Markham, Ontario, L3R 3J9  
Phone: (416) 705-6534 Fax: (604) 574-6538  
Web site: [www.adeptron.com](http://www.adeptron.com)

### Investor Relations

Gerry Wimmer  
[Investorfile.com](mailto:Investorfile.com)  
95 King Street E., Suite 301, Toronto, Ontario, M5C 1G4  
Phone: (416) 360-8895 Fax: (416) 594-6561  
Toll-free (US & Canada): 1-888-894-8222  
e-mail: [gwimmer@investorfile.com](mailto:gwimmer@investorfile.com)

### Annual Meeting of Shareholders

The Annual Meeting of Adeptron Shareholders will be held on Tuesday, May 15, 2007 at 2:00 pm (Eastern) in Markham, Ontario at the offices of the Company at 96 Steelcase Road West, Markham, Ontario.

