BULLDOG TECHNOLOGIES INC
Form 10QSB
August 22, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-QSB

x QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended May 31, 2006

o TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

For the transition period from to

Commission file number: 000-50321

BULLDOG TECHNOLOGIES, INC.

(Exact name of small business issuer as specified in its charter)

Nevada	**98-0377543**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

Riverside Place, Suite 301 11120 Horseshoe Way, Richmond, B.C., Canada V7A 5H7

(Address of principal executive offices)

(604) 271-8656

(Issuer s telephone number)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. x Yes o No

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). o Yes x No

As of August 18, 2006, the number of shares issued and outstanding of the registrar s class of Common Stock was 24,980,372 and 24,880,372, respectively.

Transitional Small Business Disclosure Format (Check One): o Yes x No

BULLDOG TECHNOLOGIES, INC.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

Our consolidated financial statements are stated in United States dollars and are prepared in accordance with United States generally accepted accounting principles.

BULLDOG TECHNOLOGIES, INC.

(A Development Stage Company)

CONSOLIDATED BALANCE SHEETS

(Unaudited - Amounts stated in thousands of US dollars, except share and per share amounts)

	May 31, 2006	August 31, 2005
ASSETS		
Current assets:		
Cash	$ 314	$ 150
Short-term investments (Note 5)	345	465
Accounts receivable	98	27
Inventory (Note 6)	334	329
Prepayment to trade suppliers	136	172
Prepaid expense	114	241
Total current assets	1,341	1,384
Property, plant and equipment, net	572	574
Deferred financing costs (Note 9)	1,701	
Total assets	$ 3,614	$ 1,958
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$ 402	$ 243
Customer deposit	117	
Liability for warrants subject to registration (Note 9 and 10)	2,843	499
Total current liabilities	3,362	742
Convertible notes payable (Note 9)	402	
Commitments and contingent liabilities (Note 1 and 12)		
Stockholders equity (capital deficit):		
Preferred stock; $.01 par value; 10,000,000 shares authorized; none issued and outstanding as of May 31, 2006 and August 31, 2005, respectively		
Common stock; $.001 par value; 100,000,000 shares authorized; 24,904,787 and 24,047,317 shares issued and outstanding as of May 31, 2006 and August 31, 2005, respectively	25	24
Additional paid-in capital	9,649	7,201
Deficit accumulated in the development stage	(10,249)	(6,194)
Accumulated other comprehensive income	425	185
Total stockholders equity (capital deficit)	(150)	1,216
Total liabilities and stockholders equity	$ 3,614	$ 1,958

The accompanying notes are an integral part of these consolidated financial statements.

BULLDOG TECHNOLOGIES, INC.

(A Development Stage Company)

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited - Amounts stated in thousands of US dollars, except share and per share amounts)

	Three Months Ended May 31, 2006	**2005**	**Nine Months Ended May 31, 2006**	**2005**	**Cumulative from September 23, 1998 (Date of Inception) through May 31, 2006**
Revenues	$ 45	$ 183	$ 125	$ 243	$ 448
Cost of goods sold	38		93		93
Gross margin	7	183	32	243	355
Expenses:					
General and administrative:					
Consulting fees and commissions	74	119	241	458	1,660
Depreciation	44	24	135	60	283
Office and general	167	158	568	402	1,632
Professional fees	182	67	335	205	901
Rent	37	34	109	75	337
Salaries and wages	631	521	1,651	1,532	5,811
Trade shows, travel and marketing	166	133	403	378	1,196
Research and development	473	119	925	362	2,111
	1,774	1,175	4,367	3,472	13,931
Loss from operations	(1,767)	(992)	(4,335)	(3,229)	(13,576)
Interest and other income and expense:					
Gain on revaluation of liability for warrants (Note 9 and 10)	2,092	126	1,372	537	5,272
Interest and other income	14	8	27	48	85
Interest expense	(335)		(723)		(761)
Loss on settlement of accounts payable					(954)
Foreign exchange gain (loss)	(22)	19	(64)	(72)	17
Amortization of deferred financing costs	(294)		(332)		(332)
Other income, net	1,455	153	280	513	3,327
Net loss	$ (312)	$ (839)	$ (4,055)	$ (2,716)	$ (10,249)
Net loss per common share, basic and diluted	$ (0.01)	$ (0.03)	$ (0.17)	$ (0.12)	
Weighted average common shares used in computing net loss per common share, basic and diluted	24,891,265	23,987,475	24,527,767	23,634,961	

The accompanying notes are an integral part of these consolidated financial statements.

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BULLDOG TECHNOLOGIES, INC.

(A Development Stage Company)

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

(Unaudited - Amounts stated in thousands of US dollars, except share and per share amounts)

	Common Stock Number of Shares	Amount	Additional Paid-in Capital	Cumulative Translation Adjustment	Deficit Accumulated During the Development Stage	Total Stockholders Equity
Balance at September 1, 2005	24,047,317	$ 24	$ 7,201	$ 185	$ (6,194)	$ 1,216
Beneficial conversion option on the August 2005 convertible notes (Note 9)			836			836
Issuance of common stock upon November 2005 conversion of August 2005 convertible notes @ $1.06 per share (Note 9)	212,264	1	137			138
Stock option compensation (Note 11)			123			123
Issuance of common stock upon exercise of Series A warrants @ $1.25 per share (Note 10)	12,500		16			16
Issuance of common stock upon December 2005 conversion of August 2005 convertible notes @ $1.06 per share (Note 9)	350,000		214			214
Beneficial conversion option on the February 2006 convertible notes			789			789
Modification to conversion option of February 2006 convertible notes			125			125
Issuance of common stock in December 2005 in lieu of cash for interest on August 2005 convertible notes @ $1.39 per share (Note 10)	30,007		42			42
Issuance of common stock in lieu of cash for services provided @ $1.07 per share (Note 10)	3,200		3			3
Issuance of common stock in March 2006 in lieu of cash for interest on August 2005 convertible notes @ $1.12 per share (Note 10)	20,499		23			23
Issuance of common stock upon March 2006 conversion of August 2005 convertible notes @ $1.00 per share (Note 10)	229,000		140			140
Net loss					(4,055)	(4,055)
Foreign exchange translation adjustment				240		240
Balance at May 31, 2006	24,904,787	$ 25	$ 9,649	$ 425	$ (10,249)	$ (150)

The accompanying notes are an integral part of these consolidated financial statements.

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BULLDOG TECHNOLOGIES, INC.

(A Development Stage Company

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited - Amounts stated in thousands of US Dollars)

	For The Nine Months Ended May 31, 2006	2005	Cumulative from September 23, 1998 (Date of Inception) through May 31, 2006
Cash flows from operating activities:			
Net loss	$ (4,055)	$ (2,716)	$ (10,249)
Adjustments to reconcile net loss to net cash flows:			
Depreciation and amortization	135	60	283
Amortization of beneficial conversion option	570		570
Amortization of deferred financing costs	332		332
Gain on revaluation of liability for warrants	(1,372)	(537)	(5,272)
Issuance of common stock for services	3	362	1,601
Issuance of common stock for interest expense	65		65
Fair value ascribed to options granted to non-employees	123	279	905
Expenses paid by affiliates			301
Loss on settlement of accounts payable			954
Changes in assets and liabilities:			
Accounts receivable	(71)	(178)	(97)
Inventory	20	(74)	(291)
Prepayment to suppliers	36	(72)	(136)
Prepaid expenses	140	94	(3)
Accounts payable, accrued liabilities and deposit from customer	424	(165)	1,149
Net cash flows (used in) by operating activities	(3,650)	(2,947)	(9,888)
Cash flows from investing activities:			
Purchase of property, plant and equipment	(90)	(257)	(774)
Short-term investments	149	2,197	(183)
Net cash flows (used in) provided by investing activities	59	1,940	(957)
Cash flows from financing activities:			
Loans payable			55
Shares repurchased			(20)
Issuance of common stock	16	1,073	7,494
Issuance of convertible notes payable, net of issue costs	3,757		3,757
Net cash flows provided by financing activities	3,773	1,073	11,286
Net change in cash and cash equivalents	182	66	441
Effect of exchange rate changes on cash	(18)	1	(127)
Cash and cash equivalents at beginning of period	150	46	
Cash and cash equivalents at end of period	$ 314	$ 113	$ 314
Supplemental Disclosure of Cash Flow Information:			
Interest received	$	$	$ 18
Non-cash Investing and Financing Activities:			
Issuance of shares in settlement of accounts payable	$ 68	$ 173	$ 1,624
Issuance of shares upon conversion of convertible notes	491		351
Issuance of shares for services included in prepaid		114	252
Issuance of shares in settlement of loans payable			54
Issuance of shares on recapitialization (Note 3)			1

The accompanying notes are an integral part of these consolidated financial statements.

BULLDOG TECHNOLOGIES, INC.
(A Development Stage Company)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

May 31, 2006 and August 31, 2005
(Unaudited amounts stated in US$000 s, except share and per share amounts)

1. Description of Business and Accounting for Reverse Acquisition

The Company was incorporated under the laws of the State of Nevada on June 18, 2002 as Northward Ventures, Inc. (Northward) and was previously involved in mineral exploration activity. In November 2003, the Company acquired control of Bulldog Technologies (BC) Inc. (Bulldog BC) and Bulldog Technologies Inc. (Bulldog Nevada). Bulldog BC was incorporated under the laws of British Columbia on September 23, 1998 and carries on the business of developing and commercializing security systems for the cargo transportation industry. Bulldog Nevada was incorporated in the State of Nevada on January 18, 2000 primarily to raise financing for Bulldog BC. Prior to the share exchange, Bulldog BC and Bulldog Nevada were under common control. On November 7, 2003, the Company changed its name to Bulldog Technologies Inc. and merged with Bulldog Nevada such that after closing the consolidated entity consists of Bulldog Technologies Inc. (formerly Northward Ventures, Inc.) and its subsidiary, Bulldog BC.

In accordance with provisions governing the accounting for reverse acquisitions, the accounts are presented as a continuation of Bulldog BC and Bulldog Nevada, combined.

In September 2005, Bulldog BC incorporated a wholly owned subsidiary in Mexico, Bulldog Technologies Mexico, S.A. de C.V., to conduct business in Mexico. As of May 31, 2006, Bulldog Technologies Mexico, S.A. de C.V. was inactive.

2. Summary of Significant Accounting Policies

Principles of Consolidation and Ability to Continue as a Going Concern

The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America, and include the accounts of the Company and its subsidiaries, Bulldog Technologies (BC) Inc. and Bulldog Technologies Mexico, S.A. de C.V. All significant inter-company transactions have been eliminated on consolidation. The Company is currently in the development stage and presents its financial statements in accordance with Statement of Financial Accounting Standard (SFAS) No. 7, Accounting and Reporting by Development Stage Enterprises.

These accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities and commitments in the normal course of business. As of May 31, 2006, the Company has accumulated consolidated operating losses since inception of $10,249. The continuation of the Company is dependent upon the successful completion of development and marketing of its security systems, the continuing support of creditors and stockholders as well as achieving a profitable level of operations. In August 2005, the Company entered into an agreement with four (4) investors to raise $2,100 through the issuance of convertible notes (Note 9). This financing was funded in September 2005 and the Company received proceeds of $1,883, net of transaction costs of $217. In February 2006, the Company entered into an agreement with ten (10) investors to raise $2,000 through the issuance of additional convertible notes (Note 9). In February 2006 and March 2006, the Company received aggregate proceeds of $1,874, net of transaction costs of $126. In July 2006, the Company raised $750 pursuant to a subordinated secured promissory note which is due on September 28, 2006 (Note 13). Management believes it will require approximately $3,900 over the twelve (12) month period ending May 31, 2007 to continue operations. We intend to raise additional funds through the issuance of equity and/or debt; and through the negotiation of strategic relationships that may provide funding as a result of distribution, technology or product development, or licensing arrangements. However, there can be no assurance that additional financing will be available to us when needed or, if available, that it can be obtained on commercially reasonable terms. If we are not able to obtain the additional financing on a timely basis, if and when it is needed, we will be forced to scale down or perhaps even cease the operation of our business. Amounts raised, if any, will be used to continue the development, marketing and sales of the Company s products; and for general working capital purposes.

These conditions raise substantial doubt about the Company s ability to continue as a going concern. Although there are no assurances that management s plans will be realized, management believes that the Company will be able to continue operations in the future if the Company can attract additional financing. The financial statements do not include any adjustments relating to the recoverability and classification of recorded assets or the amounts of and classification of liabilities that might be necessary in the event the Company cannot continue in existence.

Interim Financial Statements

The interim financial statements included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading.

These statements reflect all adjustments, consisting of normal recurring adjustments, which in the opinion of management, are necessary for fair presentation of the information contained therein. It is suggested that these interim financial statements be read in conjunction with the audited financial statements of the Company for the year ended August 31, 2005 included in the Company s 10-KSB Annual Report. The Company follows the same accounting policies in the preparation of interim reports.

Results of operations for the interim periods are not indicative of annual results.

Revenue Recognition

Revenue from the sale of products is recognized when products are shipped, the title and risk of loss has passed to the customer, the sales price is fixed or determinable and collectibility is reasonable assured. Revenue generated through the provision of consulting services is recognized as the services are provided.

Stock Option Compensation

The Company has adopted SFAS No. 123, Accounting for Stock-Based Compensation to account for stock options granted to non-employees using the fair value based method prescribed in SFAS 123. Stock option compensation for non-employees is re-measured on each balance sheet date until options vest.

The Company has elected to continue to measure compensation cost for employees under Accounting Principles Board (APB) Opinion No. 25, including interpretations provided in Interpretation (FIN) No. 44. Generally, under APB No. 25, compensation expense is recognized for options granted to employees and directors (for their services as directors) only if the option price is less than the market price of the underlying common stock on the date of the grant.

SFAS No. 123 requires the Company to provide pro forma information regarding net loss and loss per share as if compensation cost for the Company s stock options granted to employees had been determined in accordance with the fair value based method prescribed in SFAS 123.

The Company has not adopted the fair value method of accounting under SFAS No. 148 for stock-based compensation to employees. Consequently, related pro forma information as required under SFAS No. 123 has been disclosed below in accordance with SFAS No. 148.

	Three Months Ended May 31,		**Nine Months Ended May 31,**	
(in thousands, except per share data)	**2006**	**2005**	**2006**	**2005**
Net loss, as reported	$ (312)	$ (839)	$ (4,055)	$ (2,716)
Deduct: Stock-based employee compensation expense determined under fair value based method	(506)	(844)	(1,726)	(2,107)
Pro forma, net loss	$ (818)	$ (1,683)	$ (5,781)	$ (4,823)
Basic and diluted loss per share:				
As reported	$ (0.01)	$ (0.03)	$ (0.17)	$ (0.12)
Pro forma	$ (0.03)	$ (0.07)	$ (0.23)	$ (0.20)

During the nine month period ended May 31, 2006 the Company granted 1,360,000 options to fourteen employees at a weighted average exercise price of $1.48 per option. Of these options granted, 20,000 were forfeited subsequent to the date of grant but prior to May 31, 2006. The options expire between December 1, 2010 and December 26, 2010. The weighted average fair value of the options granted was $1.54 per option estimated using the Black Scholes option pricing model with the following assumptions: dividend yield of 0%, expected volatility of 186%, risk free rate of 5.0% and an expected life of 5 years. Such amount is being amortized on a straight-line basis over the vesting periods of 36 months.

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The weighted average fair value of the options granted during the previous year ended August 31, 2005 to employees was $1.60 per option estimated using the Black-Scholes option pricing model with the following assumptions: dividend yield of 0%, expected volatility of 186%, risk-free rate of 4.18% - 4.40% and an expected life of 5 years. Such amount is being amortized on a straight-line basis over the vesting periods ranging from 10 to 36 months.

New Accounting Pronouncements

On December 16, 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004), Share-Based Payment. SFAS No. 123(R) would require the Company to measure all employee stock-based compensation awards using a fair value method and record such expense in its consolidated financial statements. In addition, SFAS No. 123(R) will require additional accounting related to the income tax effects and additional disclosure regarding the cash flow effects resulting from share-based payment arrangements. For public entities that file as a small business issuer, SFAS No. 123(R) is effective for the first annual reporting period beginning after December 15, 2005.

In February 2006, FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments - an Amendment of FASB Statements No. 133 and 140. Among other things, SFAS No. 155 permits the election of fair value remeasurement for certain hybrid financial instruments that would otherwise require bifurcation under Statement 133, Accounting for Derivative Instruments and Hedging Activities. These hybrid financial instruments would include both assets and liabilities. SFAS No. 155 is effective for fiscal years beginning after September 15, 2006.

In September 2005, the FASB ratified the consensus reached by the Emerging Issues Task Force (EITF) on Issue 05-7 (EITF 05-7), Accounting for Modifications to Conversion Options Embedded in Debt Instruments and Related Issues. According to EITF Issue 96-19, Debtor s Accounting for a Modification or Exchange of Debt Instruments, an exchange of debt instruments having substantially different terms (or a substantial modification of the terms of existing debt) is deemed tantamount to a debt extinguishment.

In EITF 05-7, the Task Force provides the following additional guidance in the application of EITF 96-19. In determining whether a substantial modification has been made to a convertible debt instrument (and thus whether an extinguishment has occurred), the change in fair value of the related embedded conversion option should be included in the EITF 96-19 analysis, with such change calculated as the difference between the fair values of the option immediately before and after the modification. The modification of a convertible debt instrument should affect subsequent recognition of interest expense with respect to changes in the fair value of the embedded conversion option. A new beneficial conversion feature should not be recognized nor should an existing one be reassessed upon modification to a convertible debt instrument (i.e., the only value associated with the modification of the embedded conversion option to be accounted for should be the change in its fair value). The foregoing consensus is effective for future modifications of debt instruments beginning in the first interim or annual reporting period commencing after December 15, 2005, with early application permitted.

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN No. 48), which clarifies the accounting for uncertainty in tax positions. FIN No. 48 requires that the Company recognize in its financial statements, the impact of a tax position, if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The provisions of FIN No. 48 are effective as of the beginning of its 2007 fiscal year, with the cumulative effect, if any, of the change in accounting principle recorded as an adjustment to opening retained earnings. The Company is currently evaluating the impact of adopting FIN No. 48 on the financial statements.

The Company has not yet determined the effect of future implementation of these new standards on its consolidated financial statements.

3. **Recapitalization**

In November 2003, the Company closed an agreement with the stockholders of Bulldog BC and Bulldog Nevada (companies under common control) whereby the Company acquired the issued and outstanding shares of Bulldog BC and Bulldog Nevada on a one-for-one basis in exchange for 710,000 and 9,081,500 shares of the Company s common stock, respectively. At the acquisition date, all of Bulldog Nevada s shares had been exchanged while 695,800 of Bulldog BC s common shares had been exchanged leaving 14,200 common shares of Bulldog BC still to be exchanged. As of May 31, 2006, only 2,000 shares still had to be exchanged.

The acquisition was accounted for using the purchase method of accounting as applicable to reverse acquisition because the former stockholders of Bulldog BC and Bulldog Nevada controlled approximately 51% of the Company s common stock immediately upon conclusion of the transaction and the continuing business is that of Bulldog BC and Bulldog Nevada. Under reverse acquisition accounting, the post-acquisition entity is accounted for as a recapitalization of Bulldog BC and Bulldog Nevada.

4. Comprehensive Income or Loss

SFAS No. 130, Reporting Comprehensive Income, establishes standards for the reporting and displaying of comprehensive income or loss and its components in the consolidated financial statements. Comprehensive income (loss) is the total of net income (loss) and all other non-owner changes in equity including such items as unrealized holding gains (losses) on securities classified as available-for-sale, foreign currency translation, adjustments and minimum pension liability adjustments. During the three and nine months ended May 31, 2006 and 2005, the Company s only item of other comprehensive income or loss was a result of the effect of foreign currency translation.

	Three Months Ended May 31		**Nine Months Ended May 31,**	
	2006	**2005**	**2006**	**2005**
Net loss	$ (312)	$ (839)	$ (4,055)	$ (2,716)
Other comprehensive income (loss)	(126)	(28)	(240)	239
Comprehensive loss	$ (438)	$ (867)	$ (4,295)	$ (2,477)

5. Short-term Investments

Short-term investments consist of amounts held under guaranteed investment certificates of the Royal Bank of Canada and bearing interest at rates ranging from 3.6% to 4.1% per annum, maturing on various dates through June 2006.

6. Inventory

Inventory consisted of the following:

	May 31, 2006	**August 31, 2005**
Components	$ 198	$ 154
Work in progress		64
Finished goods	136	111
	$ 334	$ 329

7. Bank Loan

The Company had a demand operating line of credit of approximately $386 (CDN$450) (August 31, 2005 - $379 (CDN$450)) which bore interest at 5% per annum and was payable monthly. The Company s line of credit agreement was collateralized by short-term investments. The Company had not previously used this credit facility. In January 2006, the Company terminated the operating line of credit.

8. Related Party Transactions

Related party transactions not disclosed elsewhere in the consolidated financial statements are as follows:

The Company entered into agreements with two directors for services commencing November 17, 2003 whereby the Company agreed to issue an aggregate of 275,000 shares of common stock vesting monthly of which 23,000 shares were issued in November 2003 and 69,000 shares were issued in June 2004. The

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remaining 183,000 shares were issued during the nine month period ended May 31, 2005. During the three and nine month periods ended May 31, 2005 the Company recorded $Nil and $102, respectively, as compensation expense related to the shares earned by the directors under these agreements based on the quoted market price of $1.50 per share of common stock on the agreement date. As of May 31, 2005, all common shares had been issued to the directors of the Company pursuant to this agreement and the Company had no further obligations in respect of this arrangement.

Related party transactions were recorded at the exchange amount, being the amount established and agreed to by the related parties.

9. Convertible Notes

August 2005 Convertible Notes

In August 2005, the Company entered into an agreement with four (4) accredited investors (the August 2005 Investors) to sell an aggregate of $2,100 of 6% convertible notes (the August 2005 Notes) which entitle the investors to convert all or any part of the principal outstanding under the convertible notes into common shares at $1.06 per share, subject to adjustment according to the terms of the note agreement. In connection with the February 2006 Notes, as further described herein, the conversion price was reduced to $1.00 per share pursuant to the anti-dilution provisions of the August 2005 Notes. In September 2005, the Company received net proceeds from this transaction of approximately $1,883, net of transaction costs for placement agents, legal and accounting of approximately $217. The interest payable on the principal amount outstanding under the convertible notes is payable quarterly in cash or common shares, at the option of the Company, with the number of shares to be determined by dividing the interest payable by the market price as defined in the August 2005 Notes agreement. The Company may elect to make the quarterly interest payments in shares of common stock at a conversion price equal to the then current market price, which is equal to the closing sale price of our Company s common stock (or if no closing sale prices are reported, the average of the closing bid and ask prices) for the 20 day period immediately prior to the date of the interest payment. The August 2005 Notes will mature on August 29, 2010.

In connection with the issuance of the August 2005 Notes, each investor also received detachable share purchase warrants. Each share purchase warrant entitles the investor to purchase one share of common stock and is exercisable for a period of five (5) years, at an exercise price per warrant of $1.25, subject to adjustment in accordance with the terms of the warrant. In connection with the February 2006 Notes, as further described herein, the exercise price was reduced to $1.15 per warrant pursuant to the anti-dilution provisions of the August 2005 Notes. The Company issued 792,453 warrants to the August 2005 Investors in September 2005 and an additional 166,415 warrants to a placement agent on the same terms.

In accordance with the Registration Rights Agreement executed in connection with the Securities Purchase Agreement dated August 29, 2005 (See Note 10), the Company was required to use its best efforts to file and cause the registration statement of the Company s common stock to be declared effective under the Securities Act of 1933, as amended, as promptly as possible, but in any event, no later than the earlier of the 90th calendar day following the closing date of the agreement and the fifth (5th) trading day following the date on which the Company is notified by the Securities and Exchange Commission that the registration statement will not be reviewed or is no longer subject to further review and comments (the Effective Date). The Company is also required to keep the registration statement continuously effective for a period of two (2) years from the Effective Date in respect of the August 2005 Notes agreement.

Consequently, the warrants issued in connection with these private placements are deemed to require net-cash settlement and are classified as liabilities in accordance with Emerging Issues Task Force (EITF) Issue No. 00-19. Accordingly, the Company initially recorded the fair value of these warrants as a liability. Subsequently, such amount is being re-measured on each balance sheet date based on the then fair value of the warrants with the adjustment charged to the Consolidated Statement of Operations.

The proceeds of the convertible notes have been allocated to the notes, warrants and beneficial conversion option in accordance with EITF 00-27, Application of Issue No. 98-5 to Certain Convertible Instruments (EITF 0027). Accordingly, $448 was allocated to the notes and $836 was allocated to the embedded conversion option and $816 was originally allocated to the detachable warrants. The issuance cost of the convertible notes amounted to $388 (inclusive of the fair value of $171 related to 166,415 warrants issued to the

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placement agent, the agent fees paid in cash and the legal and accounting expenses incurred as described above) is recognized in the Consolidated Balance Sheet as deferred financing costs and is amortized on a straight-line basis over the term of debt. The amount allocated to the embedded conversion option is also amortized on a straight-line basis over the term of debt. The fair value of the warrants was calculated as described in Note 10.

As a result of the February 28, 2006 change in conversion price noted above, an additional amount had been allocated to the embedded conversion option of $125.

February 2006 Convertible Notes

On February 24, 2006, the Company entered into an agreement with ten (10) investors to sell an aggregate of $2,000 of convertible notes (the February 2006 Notes) which entitle the investors to convert all or any part of the principal outstanding under the convertible notes into common shares at $1.00 per share, subject to adjustment according to the terms of the February 2006 Notes agreement. The February 2006 Notes bear interest on the outstanding principal amount until the February 2006 Notes are paid in full at an annual rate of the greater of six percent (6%) or LIBOR plus 300 basis points (8.12% at May 31, 2006). Pursuant to the terms of the February 2006 Notes agreement, the February 2006 Notes are convertible into shares of our common stock. The total principal of $2,000 is to be repaid in 14 monthly instalments commencing on June 24, 2006. These repayments may be payable in cash or in shares of common stock at the market price, as further defined in the February 2006 Notes agreement. Interest accrues on the unpaid balance of the principal amount of each note, is payable on a quarterly basis commencing on March 31, 2006 and may be payable in cash or in shares of common stock at the market price at the option of the Company. Market price is defined in the note to equal 90% of the volume weighted average trading price per share for the 20 day period immediately prior to the date the principal repayment or the interest payment is due. The Company may not make a principal repayment or interest payment in shares of common stock unless the closing price on the day the principal repayment or interest is due, as the case may be, is greater than the volume weighted average trading price for the 20 trading days preceding such principal repayment or interest payment date. All principal and interest on the February 2006 Notes shall be due on August 24, 2007.

On June 24, 2006, the Company paid in cash its first monthly principal amortization and quarterly interest payment of $143 and $41, respectively, on the February 2006 Notes.

In connection with the February 2006 Notes, the Company received aggregate proceeds of $1,874 through fundings in February 2006 and March 2006, net of legal and placement agent fees of $126. In February 2006, eight (8) investors provided the initial $1,500 portion of the February 2006 Notes and the balance of $500 was funded by two (2) investors in March 2006.

In connection with the issuance of the February 2006 Notes, each investor also received detachable share purchase warrants. Each share purchase warrant entitles the investor to purchase one share of common stock and is exercisable for a period of five (5) years, at an exercise price per warrant of $1.15, subject to adjustment in accordance with the terms of the warrant. The Company issued 1,500,000 share purchase warrants to the eight (8) investors in February 2006 and the remaining 500,000 share purchase warrants to the other two (2) investors in March 2006.

In consideration of the August 2005 Investors agreement to participate in the February 2006 Notes financing, the Company agreed to issue to the August 2005 Investors an additional 1,307,547 share purchase warrants, pro rated based on the principal amount of notes held by the respective investor on February 24, 2006. The warrants have an exercise price of $1.15, subject to adjustment in accordance with the terms of the warrant and are exercisable for a period of five (5) years.

As a result of the execution of a registration rights agreement, with terms and conditions similar to the August 2005 Notes, the warrants issued in connection with the February 2006 Notes require net-cash settlement and are classified as liabilities in accordance with EITF Issue No. 00-19.

The proceeds of the February 2006 Notes of $2,000, of which $1,500 was received in February 2006 and $500 was received in March 2006, have been allocated to the notes, warrants and beneficial conversion option in accordance with EITF 00-27. Accordingly, $Nil was allocated to the notes and $789 was allocated to the embedded conversion option and $1,211 was allocated to the 2,000,000 detachable warrants. The issuance cost of the convertible notes which amounted to $1,646 (inclusive of the fair value related to the 1,307,547 additional warrants of $1,520, the agent fees, legal and accounting expenses incurred as described above) is

recognized on the Consolidated Balance Sheet as deferred financing costs and is amortized on a straight line basis over the term of debt. The amount allocated to the embedded conversion option is also amortized on a straight-line basis over the term of debt. The fair value of the warrants was calculated as described in Note 10.

The convertible notes are summarized as follows:

		Convertible Debt Allocations			
	Convertible Debt (Fair Value)	**Convertible Debt per the Balance Sheet**	**Allocated Face Value Convertible Debt**	**Beneficial Conversion Option**	**Original Warrant Valuation**
August 2005 Note issuance	$ 2,100	$ 448	$ 1,284	$ 836	$ 816
Conversion of Notes:					
November 2005 conversion	(225)	(48)	(137)	(89)	
December 2005 conversion	(350)	(79)	(214)	(135)	
Amortization of August 2005 Note beneficial conversion option		102		(102)	
Incremental increase to beneficial conversion option		(125)		125	
February 2006 Note issuance	2,000		789	789	1,211
March 2006 conversion	(229)	(35)	(140)	(105)	
Amortization of February 2006 Note beneficial conversion option		139		(139)	
	$ 3,296	$ 402	$ 1,582	$ 1,180	$ 2,027

In connection with the August 2005 Note and February 2006 Note (the Notes), the Company incurred aggregate transaction costs of $2,033, which have been recorded as deferred financing costs in the balance sheet and are being amortized on a straight-line basis over the term of the respective Notes. As of May 31, 2006, deferred financing costs was $1,701. For the three and nine month periods ended May 31, 2006, amortization of deferred financing costs was $294 and $332, respectively.

As collateral for payment and satisfaction of all of Company s obligations under the notes issued on February 24, 2006 and August 2005, the Company granted a continuing first priority security interest in and to all of its assets (presently owned and those that are to be acquired in the future) to the holders of the notes.

10. Capital Stock

April 2004 Private Placement of Shares and Warrants

In April 2004, the Company completed a private placement and issued 2,219,611 units for gross proceeds of approximately $4,994 (the April 2004 Financing). Each unit consisted of one (1) common share, 1/4 Series A share purchase warrant, and 1/2 Series B share purchase warrant. The Company issued 554,902 Series A share purchase warrants exercisable at $3.50 per share for a period of five (5) years, which were subsequently repriced to $1.25 in September 2005 in connection with certain anti-dilution provisions as a result of a convertible note issuance in August 2005 (See Note 9). The Company also issued 1,109,806 Series B share purchase warrants in connection with the April 2004 Financing, which were exercisable at $2.25 per share until the earlier of fourteen (14) months after April 14, 2004 or eight (8) months after a registration statement is declared effective. The registration statement was declared effective by the SEC on June 2, 2004. In connection with the April 2004 Financing, the Company paid a placement fee of approximately $300. Additionally, the Company has accrued and paid six percent (6%) of any monies received on the exercise of these warrants. The Series B share purchase warrants expired on February 2, 2005.

On November 5, 2004, holders of the Series B share purchase warrants exercised 309,806 of those warrants for gross proceeds of approximately $589. The Company paid a placement fee in cash of approximately $35, or 6% of the gross proceeds, as required under the original private placement agreement to the placement agent who originally identified the investors in April 2004. As an inducement to early exercise, the Company temporarily reduced the exercise price of the Series B share purchase warrants to $1.90 per share if exercised on

or before November 5, 2004. All other terms and conditions of the warrants remained unchanged. As of November 5, 2004, approximately $293 was recorded as additional paid-in capital on revaluation of the liability for warrants subject to registration rights. This balance represented the prorated amount of the liability on the exercise date of November 5, 2004. The fair value of the warrants was estimated using the Black-Scholes option pricing model at that date with the following assumptions: dividend yield of 0%, expected volatility of 186%, risk-free interest rate of 3.51% and an expected life of 10 months for the exercised Series B warrants.

In accordance with the Registration Rights Agreement executed in connection with the Securities Purchase Agreement dated April 2004, the Company was required to use its best efforts to file and cause the registration statement of the Company s common stock to be declared effective under the Securities Act of 1933, as amended, as promptly as possible, but in any event, no later than the earlier of the ninetieth (90th) calendar day following the closing date of the agreement and the fifth (5th) trading day following the date on which the Company is notified by the Securities and Exchange Commission that the registration statement will not be reviewed or is no longer subject to further review and comments (the Effective Date). The Company is also required to keep the registration statement continuously effective for a period of two (2) years from the Effective Date.

Consequently, the warrants issued in connection with April 2004 Financing are deemed to require net-cash settlement and are classified as liabilities in accordance with Emerging Issues Task Force (EITF) Issue No. 00-19. Accordingly, the Company initially recorded the fair value of these warrants as a liability. Subsequently, such amount is being re-measured on each balance sheet date based on the then fair value of the warrants with the adjustment charged to the Consolidated Statement of Operations.

As of May 31, 2006, the Company has 4,808,817 (Note 11) share purchase warrants outstanding composed of the following: (i) Series A warrant exercisable into 542,402 shares of the Company s common stock at $1.25 per share, (ii) August 2005 Notes detachable warrants exercisable into 958,868 shares of the Company s common stock at $1.15 per share, and (iii) February 2006 Notes detachable warrants exercisable into 3,307,547 shares of the Company s common stock at $1.15 per share. As of May 31, 2006 the liability for the fair value of the warrants recorded on the balance sheet was $2,843 (August 31, 2005 - $499). For the three and nine month periods ended May 31, 2006, the Company recorded a gain on revaluation of liability for warrants subject to registration rights of approximately $2,092 and $1,372, respectively. For the three and nine month periods ended May 31, 2005, the Company recorded a gain on revaluation of liability for warrants subject to registration rights of approximately $126 and $537, respectively.

The fair value of the warrants was estimated using the Black-Scholes option pricing model with the following weighted average assumptions:

	Three Months Ended May 31,		**Nine Months Ended May 31,**	
	2006	**2005**	**2006**	**2005**
Dividend yield	None	None	None	None
Expected volatility	186%	186%	186%	186%
Risk-free interest rate	4.14% - 4.72%	3.39% - 3.88%	4.14% - 4.72%	3.39% - 3.88%
Expected life	3.10 to 5.00 years	3.88 years	3.10 to 5.00 years	3.88 years

Upon the exercise, cancellation or lapsing of obligations under the Registration Rights Agreement, a pro-rata amount of the liability will be reclassified to Stockholders Equity using the Black-Scholes value as of that date.

Other Capital Stock

On May 4, 2004, the Company entered into an employment agreement with an employee, to issue 150,000 shares of the Company s common stock as compensation, of which 75,000 shares were issued on November 29, 2004 and another 75,000 shares were issued to him on March 11, 2005. The value attributed to the common stock issued to the employee was $324 based on the quoted market value of the Company s common stock of $2.16 per share on the agreement date of May 4, 2004. At May 31, 2006 prepaid expenses includes $36 (August 31, 2005 - $90) in respect of common shares issued to the employee but not yet earned by the employee under this agreement based on the quoted market price of $2.16 per share of common stock on the agreement date.

In July 2004, the Company entered into a six (6) month service agreement to issue 5,000 shares per month for a total of 30,000 shares. Upon expiry of the service agreement the Company extended the original agreement on a month-to-month basis under the original terms. During August 2004, the Company issued 15,000 shares pursuant to the agreement. The value attributed to the common stock was approximately $25 based on the quoted market price of the Company s common stock of $1.69 per share at the agreement date. The Company issued a an additional 30,000 shares of common stock during the year ended August 31, 2005 based on the weighted average market price of $1.24 for services rendered up to the date of termination of the contract. The agreement was terminated during the 2005 fiscal year.

In November 2005 and December 2005, certain holders of convertible notes (See Note 9) converted an aggregate of $575 of convertible notes into 562,264 shares. Of the 562,264 shares issued, 212,264 shares were converted at $1.06 per share and 350,000 shares were converted at $1.00 per share.

On December 7, 2005, an investor exercised Series A warrants at the exercise price of $1.25 per share to purchase 12,500 shares of our common stock for net proceeds of $16.

On December 13, 2005, the Company issued 3,200 shares to a supplier as part-settlement of a debt. The value attributed to the common stock was $3 based on the quoted market price of the Company s common stock of $1.07 per share at the settlement date.

On December 1, 2005, the Company issued 30,007 common shares to the holders of the convertible notes as payment for interest. The value attributed to the common stock was $42 based on the quoted market price of the Company s common stock of $1.39 per share at the settlement date.

On March 1, 2006, we issued 20,499 shares of common stock to four (4) accredited investors as interest payments on convertible notes issued on August 29, 2005. The value attributed to the common stock was $23, or $1.12 per share, based on the average of the quoted market price for the twenty (20) day period prior to the March 1, 2006 settlement date.

On March 3, 2006, we issued 100,000 shares of common stock to an investor upon the investor s conversion of $100 of a $600 convertible note.

On March 8, 2006, we issued 129,000 shares of common stock to an investor upon the investor s conversion of $129 of a $600 convertible note.

11. **Stock Options and Warrants**

Stock Option Plan

In March 2004, the Board of Directors approved the Company s 2004 Stock Option Plan (the 2004 Plan). The 2004 Plan provides for the granting of stock options to key employees, directors and consultants to purchase up to 5,000,000 common shares of the Company. Under the 2004 Plan, the granting of incentive and non-qualified stock options, exercise prices and terms are determined by the Board of Directors. For incentive options, the exercise price shall not be less than the fair market value of the Company s common stock on the grant date. In the case of options granted to an employee who owns stock possessing more than ten percent (10%) of the voting power of all classes of the Company s stock on the date of grant, the option price must not be less than 110% of the fair market value of the common stock on the grant date. Options granted may be exercised over a term not to exceed ten (10) years from the date of grant (five (5) years in the case of an incentive stock option granted to a holder of ten percent (10%) or more of the voting power of all classes of the Company s common stock), subject to the terms of the 2004 Plan. Unless otherwise specified by the Board of Directors, stock options shall vest at the rate of 25% per year starting one year following the granting of options.

The 2004 Stock Option Plan was amended and, effective November 17, 2004, authorized the issuance of a maximum of 7,000,000 shares of common stock to eligible employees, directors, officers and employees of the Company or its subsidiaries.

Stock Options

The Company follows SFAS No. 123, Accounting for Stock-Based Compensation , which requires compensation costs associated with stock options granted to non-employees to be recognized based on the fair value of the stock options using the Black-Scholes option pricing model. Stock-based compensation for non-

employees is re-measured on each balance sheet date until such options vest. Compensation expense is recognized immediately for past services and pro-rata for future services over the option-vesting period. Unvested stock options are re-measured on each balance sheet date for the purpose of determining stock option compensation, and are amortized on a straight-line basis over the vesting period of 10 months.

As of May 31, 2006 and 2005, the fair value of these options using the Black-Scholes option pricing model was based on the following weighted average assumptions:

	2006	**2005**
Dividend yield	None	None
Expected volatility	186 %	186 %
Risk-free interest rate	5.00 %	3.53 %
Expected life	5 years	5 years

The compensation expense arising from options issued to consultants in fiscal 2006 and 2005 is amortized over the vesting period of the options. For the three and nine month periods ended May 31, 2006, the Company recorded compensation expense in connection with options issued to consultants of $59 and $123, respectively. For the three and nine month periods ended May 31, 2005, the Company recorded compensation expense in connection with options issued to consultants of $53 and $279, respectively.

The following table summarizes the stock option transactions and the weighted average exercise prices thereof:

	Number of Options	**Weighted Average Exercise Price**
Outstanding at August 31, 2005	6,065,000	$ 1.60
Granted		
Forfeited	(1,590,000)	$ 1.62
Outstanding at November 30, 2005	4,475,000	$ 1.58
Granted	1,560,000	$ 1.46
Forfeited	(500,000)	$ 1.50
Outstanding at February 28, 2006	5,535,000	$ 1.57
Granted		
Forfeited	(756,667)	$ 1.59
Outstanding at May 31, 2006	4,778,333	$ 1.56
Exercisable at May 31, 2006	2,629,987	$ 1.58
Exercisable at August 31, 2005	2,056,667	$ 1.59

During the nine months ended May 31, 2006, the Company granted 1,360,000 options to fourteen (14) employees at a weighted average exercise price of $1.48 per option. The options expire between December 1, 2010 and December 26, 2010. The Company granted a further 100,000 stock options to a director at an exercise price of $1.30 per share, and granted 50,000 stock options each to two (2) advisory board members at an exercise price of $1.25 per share. The options expire on December 6, 2010, October 19, 2010 and December 20, 2010, respectively. The weighted average fair value per option granted based on the value determined at the respective grant dates was $1.57.

On June 19, 2006, the Company terminated six (6) employees in connection with a restructuring plan initiated by management in June 2006. Five (5) of these terminated employees had been granted a total of 855,000 options at a weighted average exercise price of $1.45 per option. As a result of the termination, a total of 534,170 options, representing the unvested portion of the options previously granted to these employees, and having a weighted average exercise price of $1.41 per option were cancelled as of June 19, 2006. Pursuant to the terms of the termination, four (4) of the terminated employees may exercise up to 45,831 shares at a weighted average exercise price of $1.67 for a period of three (3) months from the termination date; and one (1) terminated employee may exercise up to 274,999 shares at a weighted average exercise price of $1.47 for a period of six (6) months from the termination date.

A summary of the common share options exercisable and outstanding at May 31, 2006 was as follows:

Number of options outstanding	Exercise price		Expiry date	Number of options exercisable
125,000	$	0.50	February 25, 2009	125,000
150,000	$	2.20	May 4, 2009	150,000
50,000	$	2.20	May 14, 2009	50,000
50,000	$	2.42	July 16, 2009	50,000
1,943,333	$	1.60	May 8, 2009	1,255,833
50,000	$	1.64	August 5, 2009	50,000
400,000	$	1.60	December 16, 2009	241,667
100,000	$	1.60	December 22, 2009	100,000
340,000	$	1.70	January 25, 2010	141,666
50,000	$	1.15	March 14, 2010	50,000
50,000	$	1.25	October 19, 2010	40,000
460,000	$	1.25	December 1, 2010	113,331
795,000	$	1.60	December 1, 2010	165,824
60,000	$	1.30	December 6, 2010	60,000
45,000	$	1.60	December 12, 2010	5,000
30,000	$	1.60	December 19, 2010	3,333
50,000	$	1.25	December 20, 2010	25,000
30,000	$	1.60	December 26, 2010	3,333
4,778,333				2,629,987

No compensation expense was recorded for options granted to employees under the intrinsic method of accounting in the reporting periods as the exercise prices equal or exceed the fair market values of the Company s common stock on the respective dates of grant.

Warrants

The following table summarizes the fully exercisable warrant transactions during the nine months ended and as of May 31, 2006:

	Number of Warrants		Weighted Average Exercise Price	
Warrants outstanding at August 31, 2005	554,902		$	1.25
Series A warrants exercised (Note 10)	(12,500	)	$	1.25
Warrants issued in connection with August 2005 convertible note financing (Note 9)	958,868			