



MANAGEMENT'S DISCUSSION AND ANALYSIS

FINANCIAL HIGHLIGHTS

(Expressed in thousands of dollars, except per share amounts)

	<u>For the 3 months ended December 31,</u>			<u>For the Years ended December 31,</u>		
	(Unaudited)			(Audited)		
	2006	2005	% Change	2006	2005	% Change
Revenue - continuing operations	\$17,173	\$13,493	27%	\$62,312	\$29,401	112%
Operating costs	10,775	8,163	32%	39,445	18,703	111%
Gross margin	6,398	5,330	20%	22,867	10,698	114%
Gross margin %	37%	40%	-6%	37%	36%	1%
General & administrative expenses	2,231	1,563	43%	8,347	3,850	117%
EBITDAS - continuing operations ⁽¹⁾	4,167	3,767	11%	14,520	6,848	112%
Per share diluted	0.11	0.10	10%	0.38	0.21	81%
Net earnings - continuing operations	672	1,064	-37%	3,107	1,447	115%
Per share diluted	0.02	0.03	-33%	0.08	0.05	60%
Net earnings (loss)	(111)	1,025	-111%	2,090	2,153	-3%
Per share diluted	(0.01)	0.03	-133%	0.05	0.07	-29%
Number of shares outstanding						
Basic	38,017,080	37,386,922	2%	37,731,038	31,467,865	20%
Diluted	38,152,032	37,887,914	1%	38,273,784	31,968,857	20%

(1) Refer to the "NON-GAAP MEASURES" section for further details.

This Management's Discussion and Analysis (MD&A) focuses on key statistics from the consolidated financial statements of IROC Systems Corp. (unless the context indicates otherwise, a reference in this MD&A to "IROC", the "Corporation", "we", "us", or "our" means IROC Systems Corp. and includes direct and indirect subsidiaries of IROC and partnership interests held by IROC and its subsidiaries) for the year ended December 31, 2006 as compared to the year ended December 31, 2005, and pertains to known risks and uncertainties relating to our business. This MD&A should not be considered all-inclusive, as it excludes changes that may occur in general economic, political and environmental conditions. This MD&A of the financial condition and results of operations for the year ended December 31, 2006 should be read in conjunction with the annual audited consolidated financial statements for the year ended December 31, 2006 and related notes and material contained in other parts of this report as well as the Corporation's Annual Information Form ("AIF"). Additional information relating to IROC, including IROC's AIF, may be found on SEDAR at www.sedar.com. This MD&A was prepared effective March 23, 2007. All amounts are expressed in Canadian dollars unless otherwise noted.

This MD&A contains forward-looking statements which reflect management's expectations regarding IROC's future growth, results of operations, performance and business prospects and opportunities. Wherever possible, words such as "may", "will", "believe", "expect", "potential", "continue", "view" and similar expressions have been used to identify these forward-looking statements. These statements reflect management's current beliefs and are based on information currently available to management. Forward-looking statements involve significant risk, uncertainties and assumptions. A number of factors could cause actual results, performance or achievements to differ materially from the results discussed or implied in the forward-looking statements. Although the forward-looking statements contained in this report are based upon what management believes to be reasonable assumptions, the Corporation cannot assure readers that actual results will be consistent with these forward-looking statements. Some of the risks, uncertainties, and factors include, but are not limited to: certain economic risks, most important of which are a slowdown in the general economy or reduced oil and natural gas drilling; changes to governmental regulations; prevailing interest rates; currency exchange rates; customer relationships; labor disruption; accidents and costs of liability insurance; and fuel prices. Given these risks and uncertainties, the reader should not place undue reliance on these forward-looking statements. See additional discussion under "Business Risks".

FOURTH QUARTER HIGHLIGHTS

During the fourth quarter of fiscal 2006 the overall activity level of many oil and gas service companies was negatively impacted as a result of continued softening of oil and gas commodity prices, particularly the price of natural gas. The reduction in commodity prices was primarily driven by the concerns over high storage levels of these commodities in North America. This caused oil and gas exploration and production companies to scale back or adjust their drilling programs, leading to major reductions in natural gas exploration in shallow wells, with the focus on deeper natural gas well or oil wells which generally derived higher profitability in the continuing high cost service environment. The shift in focus towards oil and deeper gas pools was positive for certain areas of IROC's operations, specifically the well servicing and lease construction businesses. The softening trend through 2006 did impact certain of our smaller service lines, including the safety, monitoring, and communications service lines as well as our environmental consulting and remediation business.

This persistent impact on the operating results led management to make the decision to discontinue the operations of the remediation and environmental consulting businesses of our Envirocore division. These two services were not considered to be significant in size for management to continue to focus efforts on growth initiatives with returns well below internal requirements. As a result of this decision, management began the necessary steps to discontinued operations of these services including offering for sale certain fixed assets of the remediation business. Management expects to complete this sale process by the end of the first quarter of fiscal 2007. The assets identified for disposal contained certain inventory utilized in the provision of environmental consulting services. The inventory related to the environmental consulting services was written down by \$0.9 million to net realizable value of nil at December 31, 2006 as management determined there is no foreseeable market for the disposal of this inventory. After the discontinuation of these services, management will focus the Envirocore division entirely on its lease construction business in Northeastern BC, which continues to contribute positively to the overall results of IROC. Throughout the remainder of this MD&A amounts are presented on a continuing operations basis to more accurately reflect the ongoing basis in which IROC intends to operate.

IROC's revenue from continuing operations for the fourth quarter ended December 31, 2006 increased 27%, from \$13.5 million to \$17.2 million compared to the same period in 2005. Revenue from continuing operations for the year ended December 31, 2006 increased 112% from \$29.4 million to \$62.3 million year over year. The increases in both the three and twelve months were achieved by increased equipment capacity from internal growth initiatives, business acquisitions completed in fiscal 2005 and price increases and high utilization of equipment in certain divisions. Improvements in overall operating results reflect the impact of strategic growth plans initiated in fiscal 2005 and that continued through 2006 to expand the services offered by IROC. Significant growth and expansion throughout the past year within the well servicing division, communication and monitoring division, the addition of the downhole tools subsidiary and the establishment of a rental division has resulted in a changing mix of revenues, costs and margins for IROC for fiscal 2006 as compared to fiscal 2005.

EBITDAS from continuing operations for the three months ended December 31, 2006 was \$4.2 million or \$0.11 per share, an 11% increase as compared to \$3.8 million, or \$0.10 per share, in the same period of 2005. The increase in EBITDAS is a result of the substantial growth in revenue as noted above. EBITDAS as a percentage of revenue was 24.3% and 27.9% for the three months ended December 31, 2006 and 2005, respectively.

The Corporation recorded net earnings from continuing operations of \$0.7 million, or earnings of \$0.02 per share, for the three months ended December 31, 2006 compared to net earnings of \$1.1 million, or earnings of \$0.03 per share, for the comparable period for 2005. The improvement in operating results is evidenced in the year to date numbers as net earnings from continuing operations increased to \$3.1 million in 2006 from \$1.4 million in the comparable period of 2005 an increase of 115% year over year.

These strong results were delivered in a market where the number of wells drilled in the quarter decreased substantially, and drilling rig utilization declined slightly as compared to 2005. Lower natural gas prices due to concerns over high gas inventory levels negatively impacted the industry during the fourth quarter of 2006. The decline in natural gas prices along with continued high storage levels have prompted oil and gas producers to reduce their capital programs, particularly in areas of shallow gas drilling, resulting in lower than expected utilization in our safety, monitoring and communications product line.

The Corporation's fourth quarter financial results reflect the growth initiatives that IROC implemented during the past few quarters. We are confident that our financial performance will continue to improve as the efficiencies associated with more equipment reaching the field are realized. Our capital expenditure program for 2006 continued through the quarter focused primarily in Eagle Well Servicing and Aero Rentals based upon continued demand for our products and services, the benefits of which will continue to be seen in the coming months. IROC continues to perform well financially and management is keenly aware of the environment that it operates in and continues to monitor the market as it affects IROC, its competitors and its customers. The erosion in pricing of natural gas in particular and the October 31, 2006 announcement from the federal government regarding the taxation of trusts could have significant effects upon our businesses going forward, the extent of which cannot be estimated accurately at this time.

OVERALL PERFORMANCE

Revenue from continuing operations after effecting the impact of the discontinued operations was \$62.3 million an increase of 112% compared to the \$29.4 million generated in fiscal 2005 from continuing operations. As a result of the discontinued operations discussed above, net earnings after the effect of discontinued operations for the year ended December 31, 2006 was \$2.1 million or \$0.05 per share compared to \$2.2 million or \$0.07 per share for the prior fiscal year representing a decrease of 3% in net earnings overall. The Corporation recorded net earnings from continuing operations of \$3.1 million, or \$0.08 per share, for the year ended December 31, 2006 compared to net earnings of \$1.4 million, or \$0.05 per share, for the comparable period of 2005. The increase in the year was achieved by additional equipment capacity from internal growth initiatives, business acquisitions completed in late fiscal 2005 and price increases and higher utilization of equipment in certain divisions. Improvements in overall operating results reflect the impact of strategic growth plans initiated in fiscal 2005 and that continued through 2006 to expand the services offered by IROC. Significant growth and expansion throughout the past year with additional service rigs, the acquisition of Canada Tech subsidiary and the establishment of a rental and fishing tools division has resulted in a changing mix of revenues, costs and margins for IROC for fiscal 2006 as compared to fiscal 2005.

EBITDAS from continuing operations for the year ended December 31, 2006 was \$14.5 million or \$0.38 per share, a 112% increase as compared to \$6.8 million, or \$0.21 per share, in the same period of 2005. The increase in EBITDAS is a result of the substantial growth in revenue as noted above. EBITDAS as a percentage of revenue was 23.3% for both the years ended December 31, 2006 and 2005, respectively.

IROC's operations are reported in two segments. The Drilling and Production Services segment includes well servicing, oilfield rental equipment and lease building and road construction product lines. The Technology Services segment includes safety, communications, monitoring and downhole tool product lines. The following is a discussion of the reporting segments in which IROC operates.

DRILLING AND PRODUCTION SERVICES

The Drilling and Production Services segment earned revenue from continuing operations for the fiscal year ended December 31, 2006 of \$41.8 million or 67% of total revenue as compared to the corresponding period in 2005 of \$18.5 million or 63% of total revenue. The \$23.3 million or 126% increase in revenue over the same period in 2005 was the result of capital additions during fiscal 2006 coupled with higher utilization and improved pricing, particularly in the well servicing portion of this segment. For the fiscal year ended December 31, 2006, the Drilling and Production Services segment generated positive EBITDAS of \$13.8 million compared to \$5.4 million in the same period of 2005 an increase of 154%. The increase is a direct result of the substantial growth in revenue from increased pricing, capital additions completed over the past year as well as continued focus on controlling costs in the current operating environment.

Eagle Well Servicing ("Eagle"), which comprises a significant portion of the Drilling and Production Services segment, finished the 2006 year with a fleet of 23 service rigs, an increase of 8 service rigs from the end of fiscal 2005. All 23 rigs are actively working during the first quarter of 2007 with the 24th rig delivered in early March. Eagle experienced solid equipment utilization throughout fiscal 2006 bolstered by record demand for services early in 2006, and good weather in July and August in Western Canada and hampered in part by wet weather in the latter half of September which impacted activity. Eagle plans to build 7 additional service rigs by the end of 2007 to bring its total fleet of service rigs to 30 by the end of 2007. Our original estimate of 28

rigs by fiscal year end 2006 was not achieved due to delays and constraints in the manufacturing process. The 5 rigs from 2006 that were not completed have been rescheduled in the capital build program for fiscal 2007. To date Eagle continues to meet its targeted numbers during the first quarter of 2007 and expects this trend to continue as the additional rigs are deployed to the field throughout the remainder of 2007 and into 2008.

Aero Rentals commenced commercial operations late in the third quarter of fiscal 2006. Aero Rentals provides rental equipment for surface pressure control in drilling and workover operations and tubular handling equipment in the workover, re-entry and completion areas. Late in the third quarter IROC acquired all of the assets and operations of Fast Oilfield Rentals Ltd. ("Fast"), a business involved in similar operations to that which Aero Rentals has been developing in Central Alberta. The acquisition of the assets from Fast provides the Corporation with strategic geographic locations in Northern Alberta and allows the Corporation to meet the growing demand for equipment and services by customers within this service line. The results of operations for 2006 were considered nominal to the overall growth in 2006. We expect that during fiscal 2007 Aero Rentals should generate a stable revenue and earnings stream and we will continue to execute an organic capital growth plan within the Aero division for 2007 with approximately \$4.7 million of planned capital expenditures. For the twelve months ended December 31, 2006, this division acquired capital assets totalling approximately \$4.6 million, including the assets acquired from Fast. Revenue from Aero for the fiscal year ended December 31, 2006 was \$1.2 million. Management expects that the organic growth model employed by Aero will provide favourable year over year comparisons in fiscal 2007 as much of the infrastructure costs have already been incurred in fiscal 2006.

The Envirocore division continues to focus on internally generated growth initiatives to grow its lease construction business. As mentioned previously in this MD&A, during the fourth quarter of fiscal year ended December 31, 2006, management identified the remediation and consulting operations, included in the Envirocore division, to be disposed of and shut down as a result of poor financial and operational performance and the need for management to focus on the continuing growth areas of operations of the Corporation. These two services were not considered to be significant in size for management to continue to focus efforts on growth initiatives with returns well below internal requirements. As a result of this decision, management began the necessary steps to discontinue operations of these services including offering for sale certain fixed assets of the remediation business. The assets identified for disposal consisted of trucks and trailers used in remediation work and certain inventory utilized in the provision of environmental consulting services. Management expects to complete the sale of the equipment by the end of the first quarter of fiscal 2007. The inventory related to the environmental consulting services was written down by \$0.9 million to net realizable value of nil at December 31, 2006 as management determined there is no foreseeable market for the inventory. After the discontinuation of these services, management will focus entirely on its lease construction efforts within the Envirocore division which continue to contribute positively to the results of IROC.

TECHNOLOGY SERVICES

The Technology Services segment generated revenue of \$20.5 million or 33% of the Corporation's total revenue for the fiscal year ended December 31, 2006, compared to \$10.9 million or 37% of total revenue in fiscal 2005. The \$9.6 million or 88% increase in revenue over the same twelve month period of 2005 was primarily the result of the acquisition of Canada Tech (Downhole tools) on October 31, 2005, and as such, fiscal 2006 was the first full year of results for Canada Tech, which contributed \$9.3 million of the total increase. The remainder of the increase was the result of some equipment additions and improved equipment utilization in our communications and monitoring services.

Canada Tech is a developer, manufacturer and marketer of a wide line of technologically advanced tools and systems that measure pressures and temperatures in the downhole and surface environment of oil and gas wells. Canada Tech has performed as expected for the first twelve months of 2006 contributing revenue of approximately \$11.3 million. Canada Tech does not generally experience the seasonal impact that the other businesses that IROC operates in due to international exposure and can therefore be looked to for consistent EBITDAS returns from quarter to quarter. EBITDAS for Canada Tech for the year ended December 31, 2006 was \$1.6 million compared to \$0.7 million in 2005 representing an increase of 129% year over year. We continue to invest in capital to increase manufacturing capacity and capabilities and expect to spend approximately \$1.0 million in capital expenditures during fiscal 2007.

Oricomm, our communications and monitoring division, continues with the development of communication technology and infrastructure combined with the advancements and the build out of additional equipment in fiscal 2006 focused on high end remote communications technology. While this division did not perform to our expectations during fiscal 2006, resulting in a negative impact on EBITDAS, there is a continued focus on marketing efforts in these services to develop new revenue sources from additional customers and increase revenues from existing customers. Additionally, our expertise in this area has allowed for the advancement of communication related projects in our other operating segments.

IROC Safety, which provides state-of-the-art safety equipment using certain of the latest technology available to the oil and gas service industry and has inventory that includes safety trailers, personal gas monitors and wireless gas detection devices. IROC Safety performed to expectations during fiscal 2006 and we expect similar performance from this division for fiscal 2007 with a focus on plant turnaround projects and drilling and completion operations providing expert personnel creating a full spectrum of services to our customers in the oil and gas industry. Lower natural gas prices due to concerns over high gas inventory levels negatively impacted the industry late in the third quarter of 2006 and continued through the end of fiscal 2006. The decline in natural gas prices along with high storage levels have prompted many oil and gas producers to reduce their capital programs, particularly in areas of shallow gas drilling, resulting in lower than expected utilization in our safety, monitoring and communications product line.

Much of our business is derived from production related activities which helped to negate some of the effects of the reduced drilling activity in the industry, leading to strong results for fiscal 2006. The significant growth and improved results during the year were delivered in a market where the number of wells drilled in the year remained relatively flat compared to the prior year, and drilling rig utilization declined slightly as compared to 2005. The success of fiscal 2006 can be attributed to increased demand for our services from customers, increased pricing and the significant expansion of our fleet of equipment available during 2006.

SELECTED ANNUAL FINANCIAL INFORMATION

Selected annual financial information derived from the audited consolidated financial statements for the three most recently completed financial years is set forth below and is prepared in accordance with Canadian generally accepted accounting principles (“GAAP”).

(Expressed in thousands of dollars, except per share amounts)

	2006	2005	2004
Revenue - continuing operations	\$62,311,741	\$29,400,910	\$9,134,591
Income before discontinued operations and extraordinary items	3,106,844	1,446,813	291,374
Per share:			
Basic	0.08	0.05	0.01
Diluted	0.08	0.05	0.01
Net earnings	2,089,785	2,153,471	206,134
Per share:			
Basic	0.05	0.07	0.01
Diluted	0.05	0.07	0.01
Total assets	89,626,786	65,771,709	19,666,746
Total long-term financial liabilities (excludes current portion and future taxes)	8,152,786	9,124,363	313,758

Revenue increased in 2006 by 112% as compared to 2005 and was 582% higher than 2004. This increase is a result of internal capital equipment growth predominantly in the Drilling and Production Services operating segment (service rig fleet increased from 15 rigs to 23 rigs in 2006), the acquisition of Canada Tech Corp completed in late fiscal 2005 significantly expanded our Technology Services operating segment with a full year of operations being included in 2006, and coupled with strong utilization and slightly higher pricing in 2006 compared to 2005. The increase in 2005 as compared to 2004 is a result of internal capital growth coming from the expansion of the service rig fleet in 2005 increasing to 15 rigs at the end of 2005 from 6 rigs at the end of 2004, equipment additions in safety, monitoring and communication service lines, as well as the acquisition of Canada Tech at the end of 2005 that contributed positively to the results for 2005.

Income from continuing operations in 2006 increased by 115% compared to 2005 and increased 966% compared to 2004. The increases in both 2006 and 2005 are consistent with the increases noted above on revenue coming from growth through internal capital build plans supplemented by the acquisition of Canada Tech Corp. completed in 2005 which contributed two months to the results in 2005 and having a full year of impact in fiscal 2006.

Net earnings decreased in 2006 by 3% as compared to 2005 and was 914% higher than 2004. The decrease in 2006 was the result of the \$0.9 million write down of inventory within discontinued operations during fiscal 2006 as further discussed herein. The increase since 2004 reflects the capacity growth of IROC driven by a total of approximately \$42.1 million in capital expenditures over the past three years and strategic acquisitions completed in 2005 and 2006. This substantial growth has led to significant net earnings improvement in the past three years. As previously noted in the MD&A, management identified that the remediation and consulting operations, included in the Drilling and Production Services segment, was to be disposed of and shut down. As a result the inventory related to the environmental consulting services was written down to a net realizable value of nil at December 31, 2006, which reduced net earnings by \$0.9 million for 2006.

The Corporation's total assets have increased substantially since 2004. This reflects the internal capital expenditures noted above as well as acquisitions in 2005 and 2006. The increase of 356% in total assets since December 31, 2004, reflects the Corporation's strategy of using its funds from operations, debt and new equity to finance growth.

RESULTS OF OPERATIONS

Revenue

For the year ended December 31, 2006, IROC recorded revenue from continuing operations of \$62.3 million compared to \$29.4 million in the same period of 2005, an increase of 112%. The year over year increase is due to the effect of significant capital expenditures on equipment in both 2006 and 2005 coupled with increased activity in all product lines and the acquisition of Canada Tech Corp in October of fiscal 2005 now contributing a full year of results in 2006. Despite an overall decrease in industry activity during the second half of fiscal 2006 as a result of depressed commodity prices for natural gas, revenue from continuing operations increased 27% in the quarter compared to the prior year quarter. The increase is a result of the continued capital expenditures on equipment, predominantly in the Drilling and Production Services segment as evidenced by the increase in our fleet of service rigs to 23 at the end of 2006 from 15 at the end of the prior year.

A summary of the Corporation's mix of revenues from our operating segments is shown in the following table and demonstrates the changes that have occurred in revenue sources:

	<u>Three months December 31,</u>		<u>Twelve months December 31,</u>	
	<i>(Unaudited)</i>		<i>(Audited)</i>	
	2006	2005	2006	2005
REVENUE SOURCE				
Drilling and Production Services	75%	61%	67%	63%
Technology Services	25%	39%	33%	37%
TOTAL	100%	100%	100%	100%

We expect the allocation of revenues for fiscal 2007 will continue to follow much the same pattern with approximately 70% from Drilling and Production Services and 30% from Technology Services.

Operating Costs and Gross Margin

For the three months ended December 31, 2006 operating costs of continuing operations were \$10.8 million (63% of revenue) as compared to \$8.2 million (60% of revenue) in the comparable period of 2005. Operating costs of continuing operations for the twelve months ended December 31, 2006 were \$39.4 million (63% of revenue) as compared to \$18.7 million (64% of revenue) in the corresponding period of 2005. Gross margin was slightly lower when comparing the fourth quarter of 2006 and the comparable quarter of 2005 moving to 37% in 2006 versus 40% for the corresponding period in 2005. Gross margin of continuing operations for the fiscal year 2006 was 37% compared to 36% in the comparable period of 2005. We anticipate margins for fiscal 2006 should estimate in the range of 34% to 35% overall, impacted by pricing pressure from oil and gas producers and competitors.

Significant growth and expansion through the increases in the service rig fleet, development of the rental services and communication services divisions and the acquisition of Canada Tech has resulted in a substantially different mix of revenues, costs and margins for the IROC group of companies in 2006 as compared to the same period of 2005. Given the increased cost structure overall to conduct business in the oil and gas services industry, IROC has managed to contain costs as compared to revenues despite the fact that labour, fuel, equipment and many other operating costs have escalated. An increase in pricing on service rigs was implemented effective October 1, 2006 and contributed positively to gross margins during the fourth quarter of fiscal 2006 and has continued into the first quarter of fiscal 2007. The price increase was partially offset by increases in wages commensurate with the increase in pricing. We continue to focus on operating cost efficiencies in all areas of our business.

General and Administrative Expenses

General and administrative expenses ("G&A") for the three month period ended December 31, 2006 were \$2.2 million (13% of revenue) compared to \$1.6 million (11.6% of revenue) in the comparable period of 2005. G&A increased from \$3.9 million (13.1% of revenue) for the twelve months ended December 31, 2005 to \$8.3 million (13.4% of revenue) for the same period in 2006. The year over year increase of \$4.5 million is primarily attributable to our continued investment in the overall infrastructure costs in IROC to appropriately support and manage the growth of our businesses which includes additional capital equipment in all services, the establishment of a new business line, Aero Rentals as mentioned previously and continued expansion of our manufacturing capabilities in Canada Tech. There has been an overall head count increase consistent with the growth of IROC in the past two years, coupled with higher employee compensation costs to remain competitive in the industry and increased consulting costs to address the immediate demands of our business. We also incurred higher than anticipated professional fees due to the conversion to a partnership structure during the 2006 fiscal year, which provides for a more favourable income tax structure that fits the chosen growth strategy. All of these increases in G&A negatively impact the operating results of the Corporation in the immediate term as revenue related to these growth initiatives takes time to develop positive contributions. Additionally, management feels some of the costs described above are considered one-time in nature. Costs continue to be incurred related to the growth of the Corporation's infrastructure and we continue to review all areas for reductions where appropriate.

Stock-based Compensation Expense

Stock-based compensation expense totaled \$1.1 million for the twelve months ended December 31, 2006 compared to \$0.8 million in the comparable period of 2005. The Corporation utilizes a stock option plan as part of its incentive compensation arrangements for key employees. The increase in stock-based compensation expense can be attributed to the increase in stock options granted during fiscal 2006 as a result of new employees being granted stock options as part of their incentive compensation to remain competitive in the industry. The impact of stock-based compensation expense has a non-cash impact on the operating results of the Corporation and the amount expensed represents the estimated fair value of the stock options granted using various assumptions using the Black-Scholes option pricing model, and is an estimate of the compensation expense dependant upon certain conditions existing at the time of granting of the related stock options.

Depreciation and Amortization

For the year ended December 31, 2006 depreciation expense and amortization of intangible assets from continuing operations totalled \$6.2 million, an overall increase of 95% compared to \$3.2 million of depreciation and amortization in the corresponding period of 2005. The increase is a direct result of the Corporation's prior business acquisitions and increases in the depreciable asset base from internal capital build programs. For the year ended December 31, 2006 and 2005, depreciation and amortization of continuing operations was 10% and 10.9% of revenues respectively demonstrating the immediate effect of increased revenue from new equipment additions. The value of assets subject to depreciation and amortization increased 42% year over year.

Interest Expense

Interest expense increased by \$1.7 million for the year ended December 31, 2006 compared to the same period in 2005. The increase is due in part to the issue of \$7 million of three year 8% unsecured debentures in the third quarter of fiscal 2005 as well as an increased level of debt being carried in 2006 compared to 2005, arising from the Corporation's investment in internal capital expenditures and acquisitions during fiscal 2005 and 2006. Interest has also increased as a result of increased interest rates over the past year as much of the debt has variable interest rates tied to the prime rate of interest. The Canadian prime bank rate changed from 5.0% at December 31, 2005 to 6.0% at December 31, 2006.

Loss/Gain on disposal of Property and Equipment

For the year ended December 31, 2006, the loss on disposal of property and equipment was \$40,527 compared to a gain of \$257,800 for the prior year. The current year loss relates to the sale or disposal of service equipment, primarily vehicles, during fiscal 2006.

Income taxes

The total income tax expense for the year ended December 31, 2006 totalled \$1.6 million as compared to \$0.9 million in the corresponding period of 2005. At the expected combined income tax rate of 32.49%, net earnings before income taxes from continuing operations for the year ended December 31, 2006 of \$4.8 million would have resulted in an income tax provision of approximately \$1.5 million compared to the actual provision booked of \$1.6 million. There was a reduction of approximately \$0.2 million for announced reductions in the federal and provincial corporate tax rates, a reduction of \$0.4 million for income tax effects of discontinued operations, offset by a provision of \$0.5 million for non-deductible items for income tax purposes and further offset by differences between the prior year income tax provision and the actual tax returns filed for fiscal 2005 totalling \$0.2 million. The increase in the future income tax expense year over year is also impacted by the conversion to a partnership structure resulting in the deferral of income tax to future periods. The current income tax expense relates entirely to Canada Tech which is currently taxable and is not included in the partnership structure at this time.

SUMMARY OF QUARTERLY RESULTS

The following table presents the unaudited selected financial data for each of the last eight quarters of the Corporation ended December 31, 2006.

(Expressed in thousands of \$'s, except per share amounts – "Unaudited")

	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
	2006	2006	2006	2006	2005	2005	2005	2005
Revenue-continuing operations	17,173	16,359	11,203	17,577	13,493	7,350	3,356	5,202
Net earnings (loss) from continuing operations	672	972	(539)	2,001	1,064	542	(627)	469
Per share – basic	0.02	0.03	(0.02)	0.05	0.03	0.02	(0.02)	0.02
Per share - diluted	0.02	0.03	(0.02)	0.05	0.03	0.02	(0.02)	0.02
Net earnings (loss)	(111)	934	(781)	2,048	1,025	992	(428)	564
Per share – basic	(0.01)	0.03	(0.02)	0.05	0.03	0.03	(0.01)	0.02
Per share - diluted	(0.01)	0.03	(0.02)	0.05	0.03	0.03	(0.01)	0.02

Seasonality and Weather

The majority of the Corporation's operations are carried on in Western Canada. The ability to move heavy equipment in the Canadian oil and natural gas fields is dependent on weather conditions. As warm weather returns in the spring, the winter's frost comes out of the ground rendering many secondary roads incapable of supporting the weight of heavy equipment until they have thoroughly dried out. The duration of this "spring breakup" has a direct impact on the Corporation's activity levels. In addition, many exploration and production areas in northern Canada are accessible only in winter months when the ground is frozen enough to support equipment. The timing of freeze up and spring breakup affects the ability to move equipment in and out of these areas. As a result, late March through May is traditionally the Corporation's slowest time, and as such the operating results of the Corporation will vary on a quarterly basis.

LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2006 the Corporation had negative working capital of \$11 million as compared to the positive working capital at December 31, 2005 of \$ 1.8 million. The reason for the reduction in the working capital is a result of the callable features that are attached to the debt facilities. Under Canadian GAAP any debt that contains a demand feature is required to be classified as a current liability. During the year ended December 31, 2006 the Corporation utilized its existing credit facilities to acquire capital assets under its previously announced capital budget which has increased the total current liabilities as at December 31, 2006. The entire amount of the callable debt of \$19.9 million is under an interest only payment facility as described below and if not for the demand feature would be reclassified in part as a long-term obligation. The adjusted working capital if the debt were reclassified in part as a long-term obligation would have been positive at \$6.7 million.

On July 21, 2006, the Corporation executed a \$35 million credit facility agreement. The facility consists of a demand operating credit line of \$10 million, an extendible revolving capital asset acquisition facility of up to \$20 million to finance corporate and internal growth and a \$5 million lease line. The extendible revolving capital asset acquisition facility of up to \$20 million requires no principal payments during the term and the facility expires on July 20, 2007 renewable at the lenders option, for an additional 364 day period. If not renewed, the facility is repayable over a period of three years. Upon entering into this agreement all of the outstanding callable term debt was refinanced under the extendible revolving capital asset acquisition facility. This has allowed the Corporation more flexibility with its cash flow and to continue to execute its organic growth plans. All covenants of the credit facility were satisfied at December 31, 2006. The Corporation does not anticipate any covenant issues restricting its future operating, investing or financing activities.

Future cash requirements will be met through funds from operations, additional bank financing or the issuance of equity as available. The Board of Directors, in conjunction with management, will determine the appropriate course of action as conditions dictate. Management considers the resources available sufficient to fund IROC's existing commitments and working capital requirements for at least the next year.

IROC may require additional financing in the future to implement its strategies and business objectives. It is possible that such financing will not be available, or if available, will not be available on favourable terms. If IROC issues any shares in the future to finance its operations or implement its strategies, the current shareholders of IROC will suffer a dilution of their interest.

IROC's contractual financial obligations are summarized as follows:

Contractual Obligations	Payments Due by Period				
	Total	Next 12 months	1-3 years	4-5 years	After 5 years
Long-term debt	\$ 6,361,120	\$ -	\$ 6,361,120	\$ -	\$ -
Obligations under capital lease	\$ 2,642,769	\$ 851,103	\$ 1,618,584	\$ 173,082	
Operating leases(1)	\$ 5,656,346	\$ 1,749,783	\$ 1,938,017	\$ 841,046	\$ 1,127,500
Total contractual obligations	\$14,660,236	\$ 2,600,887	\$ 9,917,721	\$1,014,128	\$ 1,127,500

(1) Operating leases relate primarily to buildings and lands leased in operations and service vehicles used in day to day operating activities.

CAPITAL EXPENDITURES

Capital expenditures of continuing operations for the year ended December 31, 2006 were \$22.9 million, which includes property and equipment purchases related to business acquisitions of \$2.5 million. These expenditures were financed using cash generated from operations and debt financing with the addition of several small capital leases. The following is summary of the various capital expenditures incurred during fiscal 2006:

- \$14.2 million for service rigs and related equipment;
- 4.6 million for rental services equipment;
- 0.5 million for heavy equipment in lease construction services segment ;
- 1.1 million for downhole tools manufacturing capacity expansion and development;
- 0.7 million for safety, communication and monitoring assets; and
- 1.8 million for other ancillary operating equipment and infrastructure costs.
\$22.9 million

The largest expenditures were for the continued acquisition and construction of service rigs and related equipment. Capital expenditures were also incurred for the continued development of communication assets in our communications group as demand grows for these services. The start up of Aero Rentals division continued with assets being purchased during fiscal 2006 totaling \$2.1 million plus \$2.5 million from asset additions related to business acquisitions. Additions continue in Canada Tech Corp. for the continuing research and development of their products and expanded manufacturing capabilities. The remainder of the capital costs incurred was spread over an array of support equipment.

As noted previously, from unanticipated delays by suppliers in the manufacturing of rig related equipment a portion of the 2006 capital build program will be carried over into fiscal 2007 and will form part of a revised internal capital build program as we continue to focus on internal growth initiatives to expand equipment offered in each of our service lines. As a result of our strategy to organically grow our capital asset base, IROC's capital assets, as a whole, are in new or like new condition. Our service rigs that have been deployed to the field during the past two years represent a large percentage of the Corporation's overall fixed assets.

The Corporation has recently approved a capital budget of \$23.8 million for fiscal 2007. The vast majority of the capital budget relates to growth capital driven by the continued demand for the Corporation services as well as the strategy of developing its services through internal growth. The 2007 capital expenditure program will be financed from internally generated funds from operations and additional credit facilities or equity financing as required. It should be noted that management has the ability to adjust this plan quickly depending on conditions of the industry and equipment utilization levels.

The 2007 capital expenditure program will consist of the following:

- \$16.0 million for service rigs and related equipment;
- 4.7 million for continued build out of rental services equipment;
- 0.5 million for heavy equipment in lease construction services segment ;
- 1.0 million for downhole tools manufacturing capacity expansion and development;
- 0.6 million for safety, communication and monitoring equipment; and
- 1.0 million for other ancillary operating equipment and infrastructure costs.
\$23.8 million

STRATEGIC ACQUISITIONS

On September 1, 2006, IROC closed the purchase of the operating assets of Fast Oilfield Rentals Ltd. ("Fast"), a business involving oilfield rental assets for approximately \$2.8 million which was paid with cash using the debt facilities entered into during the third quarter. The acquisition is complimentary to the start-up of Aero Rentals and provides important geographic diversity for our fleet of assets within Northern Alberta as a result of it operating bases in Grande Prairie, AB and Valleyview, AB.

SUBSEQUENT EVENT

On February 16, 2007 the Corporation successfully completed the acquisition of four drilling rigs from JMAC Drilling Ltd. ("JMAC") for total consideration of approximately \$33.95 million. The consideration for the assets consisted of 6,200,000 common shares of the Corporation issued at a price of \$2.25 per share and a five year secured promissory note in the amount of \$20 million. The promissory note will bear interest at a rate of 9% per annum for the first year and will increase to 10% thereafter. Security for the promissory note has been granted in the specific assets purchased until the note is satisfied. The Corporation will pay interest only on a quarterly basis until March 31, 2008. On April 1, 2008, the Corporation will begin making equal quarterly principal payments plus interest until December 31, 2011. The drilling rigs consist of three telescopic doubles, each with depth capacity of 3400 meters, and one single with depth capacity of 1800 meters. Two of the doubles and the single were delivered on closing, with the third double scheduled for delivery by March 31, 2007. Management intends to deploy the drilling rigs through its newly created drilling division, Mission Drilling, which will be included in the Drilling and Production Services operating segment.

OUTSTANDING SHARE DATA

Balance at January 1, 2007	38,017,080
Issued on acquisition of equipment	6,200,000
Balance at March 22, 2007	44,217,080

OFF BALANCE SHEET ARRANGEMENTS

IROC has not entered into any off-balance sheet arrangements.

TRANSACTIONS WITH RELATED PARTIES

There were no significant or material transactions with related parties during the year ended December 31, 2006.

CRITICAL ACCOUNTING ESTIMATES

The Corporation prepares its consolidated financial statements in accordance with Canadian generally accepted accounting principles ("GAAP"). In preparing its financial statements, management is required to make various estimates and judgments in determining the reported amounts of assets and liabilities, revenues and expenses, as well as the disclosure of commitments and contingencies. Management bases its estimates and judgments on its own experience and various other assumptions believed to be reasonable at the time and under the circumstances in existence when the financial statements were prepared. Anticipating future events cannot be done with certainty; therefore, these estimates may change as new events occur, more experience is acquired or the Corporation's operating environment changes. The accounting estimates believed by management to require the most difficult, subjective or complex judgments and which are material to the Corporation's financial reporting results are set out below.

Allowance for Doubtful Accounts Receivable

The Corporation periodically evaluates its accounts receivable on an individual and overall customer basis. This process consists of a review of historical collection experience, current aging status of the customer accounts and other factors. Based on its review of these factors, it establishes or adjusts allowances for specific customers. This process involves a high degree of judgment and estimation. Accordingly, the Corporation's results of operations can be affected by adjustments to the allowance due to actual write-offs that differ from estimated amounts.

Impairment of Long-Lived Assets

Long-lived assets are tested for impairment annually, or more frequently as circumstances require. An impairment loss is recognized when the carrying amount of a long-lived asset exceeds the sum of the undiscounted cash flows expected to result from its use and eventual disposition. Estimates of undiscounted future net cash flows are calculated using estimated future revenues, operating expenses and other costs. These estimates are subject to risk and uncertainties, and it is possible that changes in estimates could occur which may affect the expected recoverability of the Corporation's long-lived assets.

To test for and measure impairment, long-lived assets are grouped at the lowest level for which identifiable cash flows are largely independent. The lowest asset groupings for which identifiable cash flows are largely independent are the well servicing division, the environmental services division, the rentals division, the safety, monitoring and communications division and the downhole tools division or reporting units within the Drilling and Production Services and Technology Services segments.

Based on management's expectations for continued demand for the Corporation's services, the assumptions utilized to determine the future recoverability of long-lived assets resulted in no indication as at December 31, 2006 that the carrying value of the long-lived assets would not be recoverable in the future.

Goodwill Impairment

Goodwill represents the excess of purchase price for a company acquired over the fair market value of the acquired company's net assets. Goodwill is allocated as of the date of the business combination to the Corporation's reporting units that are expected to benefit from the synergies of the business combination. Goodwill is tested for impairment at least 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 performance of the second step of the impairment test is unnecessary. The second step compares the implied fair value of the reporting unit's goodwill with its carrying amount to measure the amount of the impairment loss, if any.

Assumptions utilized to determine the fair market value of each reporting unit are estimated future revenues, operating expenses and other costs. These estimates are subject to risk and uncertainties, and it is possible that changes in estimates could occur which may affect the impairment of goodwill.

Based on management's expectations for continued demand for the Corporation's services, the assumptions utilized to test for goodwill impairment resulted in no indication as at December 31, 2006 that the carrying value of the goodwill was impaired.

Depreciation and Amortization of Property, Plant and Equipment and Intangible Assets

Depreciation and amortization is calculated using either the straight-line or declining balance method over the estimated useful life of the asset. Management bases the estimate of the useful life and salvage value of equipment on expected utilization, technological change and effectiveness of maintenance programs. Although management believes the estimated useful lives and salvage values of the Corporation's equipment are reasonable, they can not be certain that depreciation and amortization expense measures with precision the true reduction in value of assets over time.

Income Taxes

The Corporation follows the liability method of accounting for income taxes. Under this method, the Corporation records future income taxes for the effect of any difference between the accounting and income tax basis of an asset or liability, using the substantively enacted tax rates. Valuation allowances are established to reduce future tax assets when it is more likely than not that some portion or all of the future tax asset will not be realized. Estimates of future taxable income and the continuation of ongoing prudent tax planning arrangements have been considered in assessing the utilization of available tax losses. Changes in circumstances and

assumptions may require changes to the valuation allowances associated with the Corporation's future tax assets.

CHANGES IN ACCOUNTING POLICIES

During the year ended December 31, 2006, the Corporation established a new business, Aero Rentals, a division of the IROC Energy Services Partnership. IROC continued to build out the rental inventories through the end of fiscal 2006 and commenced active operations during the latter part of the third quarter of 2006. Accordingly the Corporation has capitalized the pre-operating expenditures related to the start up of the new business, net of incidental revenues. These expenditures are deferred and amortized over a period of five years upon commencement of commercial operations.

ACCOUNTING PRONOUNCEMENTS

The CICA has issued two new accounting standards: Section 3855, Financial Instruments – Recognition and Measurement; and Section 1530 – Comprehensive Income. The Corporation will adopt these standards effective January 1, 2007, which are summarized below:

Section 3855, Financial Instruments – Recognition and Measurement describes the standards for recognizing and measuring financial instruments on the balance sheet and the standards for reporting gains and losses in the financial statements. Financial assets classified as loans and receivables and financial liabilities classified as other liabilities have to be measured initially at fair value. Management will be reporting on and recording the net impact resulting from the adoption of this accounting standard in the 2007 first quarter.

Section 1530, Comprehensive Income incorporates the addition of a statement entitled “Consolidated Statement of Comprehensive Income” to the Corporation’s Consolidated Statement of Income and Retained Earnings. Comprehensive Income consists of net income plus “other comprehensive income”. Other comprehensive income will include gains or losses resulting from the adoption of Section 3855 as outlined above. Accumulated other comprehensive income will be presented separately in shareholders’ equity.

FINANCIAL INSTRUMENTS

IROC’s financial instruments consist of accounts receivable, an operating line of credit, long-term debt and accounts payable and accrued liabilities. There are no significant differences between the carrying values of these financial instruments and their estimated fair values. Of IROC’s financial instruments, only its accounts receivable represents credit risk. Management views the credit risks with its customers as normal for the industry.

NON-GAAP MEASURES

The financial statements have been prepared in accordance with GAAP. Certain supplementary information and measures not recognized under GAAP are provided where Management believes they assist the reader in understanding IROC’s results. These measures include:

1. EBITDAS - EBITDAS is defined as earnings before interest, taxes, depreciation and amortization, stock-based compensation expense, foreign exchange gains and losses and gains or losses on disposal of property and equipment. EBITDAS and EBITDAS per share are not recognized measures under GAAP. Management believes that EBITDAS is provided as a measure of operating performance without reference to financing decisions, income tax impacts and non-cash expenses, which are not controlled at the operating management level. Accordingly, management believes EBITDAS is a useful measure for prospective investors in evaluating the financial performance of the Corporation, and specifically, the ability of the Corporation to service the interest on its indebtedness. Investors should be cautioned that EBITDAS should not be construed as an alternative to net income determined in accordance with GAAP as an indicator of the Corporation’s performance. IROC’s method of calculating EBITDAS may differ from those of other companies, and accordingly, EBITDAS may not be directly comparable to measures used by other companies.

The following is a reconciliation of EBITDAS to net income from continuing operations:

	<u>Three months ended December 31,</u>		<u>Years ended December 31,</u>	
	<i>("Unaudited")</i>		<i>("Audited")</i>	
<i>(in thousands of dollars)</i>	2006	2005	2006	2005
Net earnings - continuing operations	\$672	\$1,064	\$3,107	\$1,447
Add:				
Depreciation and amortization	1,933	906	6,219	3,194
Interest on debt	767	30	1,414	366
Interest and accretion on debentures	235	329	943	329
Stock based compensation expense	332	671	1,138	824
Foreign exchange loss (gain)	(25)	20	15	20
Loss (gain) on disposal of equipment	77	(76)	41	(258)
	3,991	2,944	12,877	5,922
Income taxes:				
Current (recovery)	(67)	199	381	199
Future reduction	243	624	1,262	727
EBITDAS - continuing operations	4,167	3,767	14,520	6,848

BUSINESS RISKS

Certain activities of the Corporation are affected by factors that are beyond its control or influence, some of which are summarized below. Additional risks and uncertainties that management may be unaware of, or that they determine to be immaterial may also become important factors which affect the Corporation. The general risk factors associated with IROC's business and operations are as follows:

OPERATIONAL RISKS OF THE OIL AND GAS INDUSTRY

Demand and prices for IROC's products and services depend upon the level of activity in the Canadian oil and gas exploration and production industry which in turn depends on the level of oil and gas commodity prices, expectations about future oil and gas commodity prices, the cost of exploring for, producing and delivering oil and gas, the discovery rate of new oil and gas reserves, available pipeline and other oil and gas transportation capacity, worldwide weather conditions, political, military, regulatory and economic conditions and the ability of oil and gas companies to raise capital. The level of activity in the Canadian oil and gas exploration and production industry has been volatile. No assurances can be given that current levels of oil and gas exploration and production activities will continue or that demand for the Corporation's services will continue to reflect the level of activity in the industry generally. Industry conditions will continue to be influenced by numerous factors over which the Corporation will have no control. Prices for oil and gas are expected to continue to be volatile and to affect the demand for and pricing of the Corporation's products and services. A material decline in oil or gas prices or Canadian industry activity could have a material adverse affect on the Corporation's business, results or operations and prospects.

The Corporation's operations are subject to hazards inherent in the oilfield service industry, such as explosions, fires and spills that can cause personal injury or loss of life, damage to or destruction of property, equipment and the environment and suspension of operations. In addition, claims for loss of oil and gas production, damage to formations, damage to facilities and business interruptions can occur. While the Corporation maintains insurance coverage that it believes to be adequate and customary in the industry there can be no assurances that insurance proceeds will be available or sufficient or that IROC will be able to maintain adequate insurance in the future at rates considered reasonable. The single occurrence of a significant uninsured claim or a claim in excess of the insurance coverage limits maintained by the Corporation could have a material adverse effect on the Corporation's business, results of operation and prospects.

ENVIRONMENT

All phases of IROC's business could be affected by changes to environmental legislation and regulations in the various jurisdictions in which the Corporation operates. While the Corporation expects that environmental

legislation is evolving in a manner, which will enhance the value of the Corporation's products and services, there can be no assurances that such changes to existing legislation will occur.

COMPETITION

The oilfield service industry is highly competitive and there are a number of other oilfield service companies, which have greater technical ability and greater financial resources than IROC. There are no assurances that IROC will be able to compete with these other companies.

FOREIGN OPERATIONS

A portion of the Downhole Tools operating segment revenues are to customers with international operations. International sales are subject to inherent risk, including variations in local economies, fluctuating exchange rates, greater difficulty in collection of accounts receivable, changes in tariffs and other trade barriers, adverse foreign talks, tax consequences and burdens of complying with a variety of foreign laws. Canada Tech may also encounter exchange rate risk in the event that international sales are denominated in currency other than Canadian dollars.

The Corporation's financial results are reported in Canadian dollars. A portion of the Downhole Tools segment revenue and accounts receivables are frequently denominated in currencies other than the Canadian dollar. Fluctuations in the exchange rate between these other currencies and the Canadian dollar could reduce the Corporation's reported revenue, increasing the Corporation's costs or give rise to a change related to foreign currency transactions, all of which could materially effect operating results.

DISCLOSURE CONTROLS

In accordance with Multilateral Instrument 52-109 - *Certification of Disclosure in Issuers' Annual and Interim Filings*, the Corporation's President and Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") have designed, or have caused to be designed under their supervision, disclosure controls and procedures. The CEO and the CFO, after evaluating the effectiveness of the Corporation's disclosure controls and procedures as at December 31, 2006, have concluded that the Corporation's disclosure controls and procedures provide reasonable assurance that (i) information required to be disclosed by the Corporation in its annual filings, interim filings or other reports filed or submitted by it under provincial and territorial securities legislation is recorded, processed, summarized and reported within the time periods specified in the provincial and territorial securities legislation; and (ii) material information relating to the Corporation is accumulated and communicated to the Corporation's management, including the CEO and the CFO, in a timely manner. It should be noted that while the Corporation's CEO and CFO believe that the Corporation's disclosure controls and procedures provide a reasonable level of assurance that they are effective, they do not expect that the disclosure controls and procedures will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objective of the control system is met.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

Internal control over financial reporting is designed to provide reasonable assurance regarding the design and preparation of financial statements in accordance with Canadian GAAP and the reliability of financial reporting. Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Corporation. IROC's management, including the CEO and CFO, have evaluated the design of the Corporation's internal control over financial reporting using the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") framework and criteria.

Using the COSO framework, management has documented the business processes and internal controls over financial reporting and has concluded that such controls have been designed effectively as of December 31, 2006 except for the exceptions further discussed herein. As with many companies of a similar size, the Corporation has control deficiencies within the accounting and finance department over segregation of duties and user access. None of the segregation of duty control deficiencies has resulted in a misstatement to the financial statements as management has other compensating controls in place. Management has identified and

Consolidated Financial Statements of

IROC SYSTEMS CORP.

Years ended December 31, 2006 and 2005



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AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of IROC Systems Corp. as at December 31, 2006 and 2005 and the consolidated statements of earnings and retained earnings and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation 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.

KPMG LLP

Chartered Accountants
Calgary, Canada
March 22, 2007

IROC SYSTEMS CORP.

Consolidated Balance Sheets

December 31, 2006 and 2005

	2006	2005
Assets		
Current assets:		
Cash	\$ 700	\$ 700
Accounts receivable	16,941,616	12,139,074
Inventory	4,026,716	873,110
Prepaid expenses and deposits	1,026,082	752,739
Income taxes recoverable	–	177,743
Assets of discontinued operations (note 17)	905,326	2,876,704
	<u>22,900,440</u>	<u>16,820,070</u>
Property and equipment (note 5)	51,866,949	34,667,965
Intangible assets (note 4)	6,314,468	6,297,219
Goodwill	7,621,211	7,050,484
Assets of discontinued operations (note 17)	923,718	935,971
	<u>\$ 89,626,786</u>	<u>\$ 65,771,709</u>

Liabilities and Shareholders' Equity

Current liabilities:		
Operating loan (note 6)	\$ 6,094,515	\$ 1,265,722
Accounts payable and accrued liabilities	6,511,023	5,089,120
Income taxes payable	434,653	–
Callable debt (note 7)	19,915,042	6,945,608
Current portion of long-term debt (note 8)	851,103	1,012,394
Liabilities of discontinued operations (note 17)	130,470	681,813
	<u>33,936,806</u>	<u>14,994,657</u>
Long-term debt (note 8)	1,791,666	3,146,583
Non-convertible debentures (note 8)	6,361,120	5,977,780
Deferred revenue	–	216,276
Future income taxes (note 10)	2,960,148	1,089,582
Shareholders' equity:		
Share capital (note 9)	37,584,718	36,118,511
Warrants (note 9 (d))	828,415	1,150,000
Contributed surplus (note 9 (e))	1,823,781	827,973
Retained earnings	4,340,132	2,250,347
	<u>44,577,046</u>	<u>40,346,831</u>
Commitments and contingencies (notes 11 and 16)		
Subsequent event (note 18)		
	<u>\$ 89,626,786</u>	<u>\$ 65,771,709</u>

See accompanying notes to consolidated financial statements.

Approved on behalf of the Board:

“Thomas M. Alford” Director

“Brian Neeland” Director

IROC SYSTEMS CORP.

Consolidated Statements of Earnings and Retained Earnings

Years ended December 31, 2006 and 2005

	2006	2005
Revenue	\$ 62,311,741	\$ 29,400,910
Expenses:		
Operating	39,444,647	18,703,373
General and administrative	8,346,662	3,849,520
Stock-based compensation	1,137,667	824,274
Depreciation and amortization	6,219,412	3,193,815
Interest on callable debt and long-term debt	1,414,199	366,112
Interest and accretion on debentures	943,340	328,883
Loss (gain) on disposal of property and equipment	40,527	(257,800)
Foreign exchange loss	14,888	19,631
	57,561,342	27,027,808
Earnings before income taxes from continuing operations	4,750,399	2,373,102
Income taxes (note 10):		
Current	381,458	199,526
Future	1,262,097	726,763
	1,643,555	926,289
Net earnings from continuing operations	3,106,844	1,446,813
Net earnings (loss) from discontinued operations (note 17)	(1,017,059)	706,658
Net earnings	2,089,785	2,153,471
Retained earnings, at beginning of year	2,250,347	96,876
Retained earnings, at end of year	\$ 4,340,132	\$ 2,250,347
Earnings per share from continuing operations (note 9(f)):		
Basic	\$ 0.08	\$ 0.05
Diluted	\$ 0.08	\$ 0.05
Earnings (loss) per share from discontinued operations (note 9(f)):		
Basic	\$ (0.03)	\$ 0.02
Diluted	\$ (0.03)	\$ 0.02
Earnings per share (note 9(f)):		
Basic	\$ 0.05	\$ 0.07
Diluted	\$ 0.05	\$ 0.07
Weighted average number of shares outstanding (note 9(f)):		
Basic	37,731,038	31,467,865
Diluted	38,273,784	31,968,857

See accompanying notes to consolidated financial statements.

IROC SYSTEMS CORP.

Consolidated Statements of Cash Flows

Years ended December 31, 2006 and 2005

	2006	2005
Cash flows from operating activities:		
Net earnings from continuing operations	\$ 3,106,844	\$ 1,446,813
Items not affecting cash:		
Depreciation and amortization	6,219,412	3,193,815
Future income taxes	1,262,097	726,763
Stock-based compensation	1,137,667	824,274
Non-cash accretion on debentures	383,340	130,875
Deferred revenue received	–	216,277
Loss (gain) on disposal of property and equipment	40,527	(257,800)
	<u>12,149,887</u>	<u>6,281,017</u>
Changes in non-cash working capital balances (note 13)	(8,261,062)	(7,019,321)
	<u>3,888,825</u>	<u>(738,304)</u>
Discontinued operations (note 17):		
Funds provided by discontinued operations	75,203	789,050
Changes in non-cash working capital balances of discontinued operations	518,228	(1,891,919)
	<u>4,482,256</u>	<u>(1,841,173)</u>
Cash flows from investing activities:		
Purchase of property and equipment – continuing operations	(20,354,749)	(14,042,676)
Business acquisitions, net of cash acquired (note 3)	(2,868,400)	(4,529,682)
Intangible asset expenditures (note 4)	(771,998)	–
Proceeds on disposal of property and equipment	532,042	424,793
Purchase of property and equipment – discontinued operations	(140,460)	(985,242)
Change in non-cash working capital balances (note 13)	1,911,527	(363,600)
	<u>(21,692,038)</u>	<u>(19,496,407)</u>
Cash flows from financing activities:		
Issue of callable debt	19,915,042	5,487,833
Repayment of callable term debt	(6,945,608)	(1,498,043)
Operating loan advances	4,828,794	1,265,722
Repayment of long-term debt	(2,230,540)	(281,878)
Issue of common shares	1,031,541	10,011,934
Issue of long-term debt	714,331	–
Deferred financing costs (note 4)	(75,000)	(40,000)
Share issue costs	(28,778)	(657,859)
Issue of non-convertible debentures	–	7,000,000
	<u>17,209,782</u>	<u>21,287,709</u>
Decrease in cash during the year	–	(49,871)
Cash, beginning of year	700	50,571
Cash, end of year	<u>\$ 700</u>	<u>\$ 700</u>

See accompanying notes to consolidated financial statements.

IROC SYSTEMS CORP.

Notes to Consolidated Financial Statements

Years ended December 31, 2006 and 2005

1. Structure of the Corporation:

IROC Systems Corp. (the "Corporation") is a Canadian corporation supplying equipment and personnel to oil and gas contractors and producers. The Corporation's common stock is traded on the TSX.

2. Significant accounting policies:

These financial statements are expressed in Canadian dollars and have been prepared by management in accordance with accounting principles generally accepted in Canada. 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, liabilities, revenues and expenses and disclosure of contingent assets and liabilities. The most significant of these are the valuation of accounts receivable, the estimated useful lives of property and equipment, the valuation of intangible assets and goodwill and the provision for income taxes. Actual results may differ from these estimates. The financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the significant accounting policies described below:

(a) Principles of consolidation:

These consolidated financial statements include the accounts of the Corporation and its subsidiaries all of which are wholly owned.

(b) Inventory:

Inventory consisting of operating supplies, parts and finished goods are stated at the lower of cost, determined on a weighted average basis, and net realizable value.

(c) Property and equipment:

Property and equipment are recorded at cost less accumulated depreciation. Depreciation is provided taking into consideration the estimated useful lives of the assets and their residual values using the following annual rates and methods:

Rig equipment	Straight-line with 20% residual	10%
Trailers	Declining balance with 25% residual	15%
Heavy equipment	Declining balance	15%
Field equipment	Declining balance	20% - 50%
Other equipment	Declining balance	20% - 100%
Data acquisition centre	Declining balance	20%
Leasehold improvements	Straight-line, over the term of the lease	5 – 10 years

IROC SYSTEMS CORP.

Notes to Consolidated Financial Statements, page 2

Years ended December 31, 2006 and 2005

2. Significant accounting policies (continued):

(d) Long-lived assets:

Long-lived assets consist of property and equipment and intangible assets. On a periodic basis, management assesses the carrying value of long lived assets for indications of impairment. Indications of impairment include items such as an ongoing lack of profitability and significant changes in technology. When an indication of impairment is present, the Corporation tests for impairment by comparing the carrying value of the asset to its net recoverable amount. If the carrying amount is greater than the net recoverable amount, the asset is written down to its estimated fair value.

(e) Intangible assets:

Intangible assets, consisting of primarily of proprietary software and tool development related to patents and trademarks and customer relationships as well as deferred financing costs and pre-operating expenditures related to the start-up of a new business, are recorded at cost, which is equal to the fair value, and are amortized by the straight-line method over their useful lives ranging from 3 to 10 years.

(f) Goodwill:

Goodwill is the residual amount that results when the purchase price of an acquired business exceeds the sum of the amounts allocated to the assets acquired, less liabilities assumed, based on their fair values. Goodwill is allocated as of the date of the business combination to the Corporation's reporting segments that are expected to benefit from the business combination.

Goodwill is not amortized and is tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test is carried out in two steps. In the first step, the carrying amount of the reporting segment is compared to its fair value. When the fair value of a reporting segment exceeds its carrying amount, goodwill of the reporting segment is considered not to be impaired and the second step of the impairment test is unnecessary. The second step is carried out when the carrying amount of the reporting segment's goodwill exceeds its fair value, in which case the implied fair value of the reporting segment'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 the goodwill is determined in a business combination described in the previous paragraph, using the fair value of the reporting segment as if it was the purchase price. When the carrying amount of the reporting segment's goodwill exceeds the implied fair value of the goodwill, an impairment loss is recognized in an amount equal to the excess.

IROC SYSTEMS CORP.

Notes to Consolidated Financial Statements, page 3

Years ended December 31, 2006 and 2005

2. Significant accounting policies (continued):

(g) Income taxes:

The Corporation follows the asset and liability method of accounting for income taxes. Temporary differences between the tax basis of an asset or liability and its carrying amount on the balance sheet are used to calculate future income tax assets or liabilities. Future income tax assets and liabilities are measured using enacted or substantively enacted tax rates and laws expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in earnings in the period that includes the enactment or substantive enactment date.

(h) Stock-based compensation:

The Corporation has equity incentive plans, which are described in note 9(c). The fair value of common share purchase options is calculated at the date of grant using the Black-Scholes option pricing model and that value is recorded as compensation expense over the grant's vesting period with an offsetting credit to contributed surplus. Upon exercise of the share purchase option, the associated amount is reclassified from contributed surplus to share capital. Consideration paid by employees upon exercise of share purchase options is credited to share capital.

(i) Revenue recognition:

The Corporation's services are generally sold based upon purchase orders or contracts with customers that include fixed or determinable prices based upon daily, hourly, or job rates. Customer contract terms do not include provisions for significant post-service delivery obligations. Revenue is recognized when services and equipment rentals are rendered and only when collectability is reasonably assured.

(j) Per share amounts:

Basic per share amounts are calculated using the weighted average number of common shares outstanding during the year. Diluted per share amounts are calculated following the treasury stock method assuming that proceeds obtained upon exercise of the options, warrants and the conversion of convertible debentures would be used to purchase common shares at the average market price during the period.

(k) Research and development costs:

The Corporation invests resources in the development of improved and new products, which are expensed in the year incurred. These expenditures qualify for research and development investment tax credits. These credits are estimated annually and are reflected as a reduction of product development expenses.

(l) Comparative figures:

Certain comparative figures have been reclassified to conform with the presentation adopted for the current year.

IROC SYSTEMS CORP.

Notes to Consolidated Financial Statements, page 4

Years ended December 31, 2006 and 2005

3. Acquisitions:

(a) Fast Oilfield Rentals:

On September 1, 2006, the Corporation purchased substantially all of the operating assets of Fast Oilfield Rentals Ltd. ("Fast"), a business involved in oilfield rentals and services. The purchase price of \$2,868,400 was paid by way of \$2,836,400 in cash, plus transaction costs of \$32,000. Earnings of Fast are included from September 1, 2006.

The purchase price of \$2,836,400 has been allocated based on the fair value of assets as follows:

Inventory	\$ 61,933
Property and equipment	2,508,077
Intangible assets	298,390
	<hr/>
	\$ 2,868,400

(b) Global Atmospheric Sensoring Inc.:

On March 22, 2005, the Corporation acquired all of the issued and outstanding shares of Global Atmospheric Sensoring Inc. ("Global"). The total purchase price of \$1,198,460 was paid by way of \$75,000 in cash, 607,473 common shares of the Corporation with an ascribed value of \$1.81 per share, plus transaction costs of \$23,934. Earnings of Global are included from March 22, 2005.

The purchase price of \$1,198,460 including transaction costs of \$23,934 has been allocated to Global's net assets and liabilities as follows:

Cash	\$ 259,455
Accounts receivable	201,557
Other assets	450
Future income taxes	6,279
Property and equipment	247,248
Intangible assets	350,000
Goodwill	431,924
Accounts payable	(176,235)
Long-term debt	(43,689)
Income taxes payable	(78,529)
	<hr/>
Net assets acquired	\$ 1,198,460
	<hr/>
Consideration:	
Cash, including costs	\$ 98,934
Common shares	1,099,526
Total consideration	<hr/> \$ 1,198,460

IROC SYSTEMS CORP.

Notes to Consolidated Financial Statements, page 5

Years ended December 31, 2006 and 2005

3. Acquisitions (continued):

(c) Canada Tech Corp.:

On October 31, 2005 the Corporation acquired all of the issued and outstanding shares of Canada Tech Corp. ("Canada Tech") for \$5,417,487 in cash and 2,328,452 common shares of IROC at the fair value of \$2.827 per share, plus transaction costs of \$117,760.

Additional contingent consideration of up to \$8,000,000 is based on Canada Tech meeting certain revenue and earnings targets for a 24 month period. Earnings of Canada Tech are included from November 1, 2005. Goodwill was adjusted by \$570,727 in fiscal 2006 for additional future income tax liabilities associated with the acquisition.

The purchase price of \$12,117,781 including transaction costs of \$117,760 has been allocated to the fair value of Canada Tech's net assets and liabilities as follows:

Cash	\$ 904,686
Accounts receivable	1,886,031
Inventory	675,583
Other assets	533,903
Property and equipment	1,512,778
Intangible assets	6,050,000
Goodwill	5,849,716
Accounts payable	(1,882,850)
Corporate taxes payable	(119,774)
Long term debt	(877,538)
Future income taxes	(2,414,754)
Net assets acquired	\$ 12,117,781
<hr/>	
Consideration:	
Cash, including costs	\$ 5,535,247
Common shares	6,582,534
Total consideration	\$ 12,117,781

IROC SYSTEMS CORP.

Notes to Consolidated Financial Statements, page 6

Years ended December 31, 2006 and 2005

4. Intangible assets:

Intangible assets consist of the following:

2006	Cost	Accumulated amortization	Net book value
Intangible assets	\$ 6,699,870	\$ 1,170,523	\$ 5,529,347
Pre-operating expenditures	770,517	51,368	719,149
Deferred financing costs	115,000	49,028	65,972
	\$ 7,585,387	\$ 1,270,919	\$ 6,314,468

2005	Cost	Accumulated amortization	Net book value
Intangible assets	\$ 6,484,372	\$ 222,709	\$ 6,261,663
Deferred financing costs	40,000	4,444	35,556
	\$ 6,524,372	\$ 227,153	\$ 6,297,219

The deferred financing costs consist of commissions paid in connection with the issue of non-convertible debentures during fiscal 2005 which is being amortized over three years, representing the term of the debentures, and a fee paid in connection with the credit facility agreement entered into in 2006 (note 7 and 8) which is being amortized over twelve months, representing the term of the credit facility.

The pre-operating expenditures relate to the start-up of a new business and are recorded at cost, net of incidental revenues. These expenditures are deferred and amortized over a period of five years upon commencement of commercial operations of the related business venture. The corporation began amortization of the pre-operating expenditures related to the rental and fishing tools division in September 2006 when commercial operations commenced.

IROC SYSTEMS CORP.

Notes to Consolidated Financial Statements, page 7

Years ended December 31, 2006 and 2005

5. Property and equipment:

2006	Cost	Accumulated depreciation	Net book value
Rig equipment	\$ 41,228,445	\$ 4,698,588	\$ 36,529,857
Heavy equipment	6,294,024	1,328,143	4,965,881
Rental equipment	4,560,032	252,512	4,307,520
Field equipment	6,467,985	2,822,610	3,645,375
Other equipment	1,869,596	970,689	898,907
Trailers	1,870,826	1,009,771	861,055
Leasehold improvements	670,801	157,241	513,560
Data acquisition centre	353,500	208,706	144,794
	\$ 63,315,209	\$ 11,448,260	\$ 51,866,949

2005	Cost	Accumulated depreciation	Net book value
Rig equipment	\$ 27,348,456	\$ 2,076,019	\$ 25,272,437
Heavy equipment	3,679,699	135,116	3,544,583
Field equipment	5,229,277	2,140,967	3,088,310
Other equipment	2,354,941	856,232	1,498,709
Trailers	1,807,572	933,856	873,716
Leasehold improvements	301,578	95,649	205,929
Data acquisition centre	357,020	172,739	184,281
	\$ 41,078,543	\$ 6,410,578	\$ 34,667,965

Included in property and equipment at December 31, 2006 is certain equipment under capital lease with a cost of \$3,786,219 (2005 – \$5,272,292) and a net book value of \$3,156,855 (2005 – \$4,913,454). This equipment is classified as heavy equipment and other equipment and is depreciated on the same basis as other heavy equipment and other equipment.

6. Operating loan:

The Corporation has access to a \$10,000,000 extendible demand revolving operating credit facility. Drawings bear interest at the bank's prime rate plus 0.75%. The facility is secured by a general security agreement covering all of the assets of the Corporation. The effective interest rate at December 31, 2006 was 6.75%. At December 31, 2006, \$6,094,515 (December 31, 2005 - \$1,265,722) was drawn on the facility.

IROC SYSTEMS CORP.

Notes to Consolidated Financial Statements, page 8

Years ended December 31, 2006 and 2005

7. Callable debt:

	2006	2005
Extendible demand revolving capital asset acquisition facility of up to \$20,000,000 requiring no principal payments during the term, secured by a general assignment of book debts and a security arrangement covering all assets of the Corporation. Drawings bear interest at the bank's prime rate plus 1.0%. The effective interest rate at December 31, 2006 was 7.0%. The facility expires on July 20, 2007 and is renewable at the lenders option, for an additional 364 day period. If not renewed, the facility is repayable over a period of three years.	\$ 19,915,042	\$ -
Term demand loans, repayable in monthly installments of \$114,054 including interest at the bank's prime rate plus 1.0%	\$ -	\$ 5,122,807
Term demand loans, repayable in monthly installments of \$75,165 including interest at the bank's prime rate plus 1.0%	-	1,822,801
	<u>\$ 19,915,042</u>	<u>\$ 6,945,608</u>

Assuming that existing obligations are not called, minimum principal repayments on callable debt for the next five fiscal years, are as follows:

2007	\$ 2,212,782
2008	6,638,347
2009	6,638,347
2010	4,425,566
	<u>\$ 19,915,042</u>

IROC SYSTEMS CORP.

Notes to Consolidated Financial Statements, page 9

Years ended December 31, 2006 and 2005

8. Long-term debt and debentures:

	2006	2005
Unsecured non-convertible debentures, interest at 8% payable quarterly, principal repayable on September 12, 2008 The debentures are non-transferable.	6,361,120	5,977,780
Obligations under capital leases, repayable in monthly instalments totalling \$83,832 plus interest at rates varying from 3.8% to 12.2%, secured by the specific equipment	2,642,769	4,158,977
	9,003,889	10,136,757
Less current portion	851,103	1,012,394
	<u>\$ 8,152,786</u>	<u>\$ 9,124,363</u>

Minimum principal repayments on long-term debt and debentures for the next five fiscal years are as follows:

2007	\$ 851,103
2008	\$ 7,251,787
2009	\$ 727,917
2010	\$ 173,081

The obligations under capital leases are repayable in blended monthly installments including interest at a weighted average rate of 6.87%. At the end of each lease the Corporation has a purchase option to acquire the leased assets. Estimated payments under the leases are as follows:

2007	\$ 1,005,983
2008	985,819
2009	768,312
2010	178,557
	2,938,671
Less amount representing interest	295,902
	<u>\$ 2,642,769</u>

IROC SYSTEMS CORP.

Notes to Consolidated Financial Statements, page 10

Years ended December 31, 2006 and 2005

8. Long-term debt and debentures (continued):

On September 12, 2005 the Corporation completed the private placement of \$7.0 million of three year 8% unsecured non-convertible debentures, which included 1,050,000 warrants to purchase common shares of the Corporation (note 9(d)). Each warrant is exercisable into one common share of the Corporation at a price of \$2.50 for the first two (2) years and at a price of \$2.70 for the third year of the warrant. The debentures are non-transferable. A commission in the amount of \$40,000 was paid in connection with the offering.

The fair value of the warrants was \$1,150,000 and has been included in shareholders' equity. The fair value of \$5,850,000 that has been allocated to the non-convertible debentures and is being accreted using the straight line method over the term of the debentures. In the event the debentures are retired prior to maturity, the difference between the carrying amount of the debenture and the face value of the debentures will be charged to earnings. For the fiscal year ended December 31, 2006 \$383,340 (2005 – \$127,780) of accretion expense has been recorded.

9. Share capital:

(a) Authorized:

Unlimited number of voting common shares without nominal or par value

(b) Issued:

	Number	Amount
Balance at December 31, 2004	25,734,342	13,246,030
Issued on acquisition of service rig equipment	4,313,463	5,362,067
Issued on acquisition of Global Atmospheric Sensing Inc.	607,473	1,099,526
Issued on acquisition of Canada Tech Corp.	2,328,452	6,582,534
Issued on private placement	3,600,000	9,900,000
Issued on exercise of options	206,000	118,858
Issued on conversion of debenture	600,000	322,947
Share issue costs, net of income tax benefits	–	(513,451)
Balance at December 31, 2005	37,389,730	36,118,511
Issued on exercise of options	335,000	442,525
Issued on exercise of warrants	292,350	1,052,460
Share issue costs, net of income tax benefits	–	(28,778)
Balance at December 31, 2006	38,017,080	\$ 37,584,718

IROC SYSTEMS CORP.

Notes to Consolidated Financial Statements, page 11

Years ended December 31, 2006 and 2005

9. Share capital (continued):

(c) Stock option plan:

The Corporation has a stock option plan for its directors, officers and key employees whereby options to a maximum of ten percent of the issued and outstanding common shares may be granted subject to certain terms and conditions. Under this plan, the exercise price of each option equals the market value of the common shares on the date of grant and an option's maximum term is five years. Stock option vesting ranges from two to three years from the date of grant as employees or directors render continuous service to the Corporation. Changes in the number of common shares under option during the years ended December 31, 2006 and 2005 are summarized as follows:

	2006		2005	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Balance, beginning of year	1,515,666	1.95	630,000	\$ 0.67
Granted	1,075,000	3.49	1,180,000	2.32
Forfeited	(450,833)	3.17	(88,334)	1.04
Exercised	(335,000)	.90	(206,000)	0.54
Balance, end of year	1,804,833	2.75	1,515,666	1.95
Options exercisable	883,164		695,668	

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

Exercise price	Options outstanding			Options exercisable	
	Number of options	Weighted average remaining contractual life (years)	Weighted average exercise price	Number exercisable at December 31, 2006	Weighted average exercise price
\$ 0.35	84,000	1.26	\$ 0.35	84,000	\$ 0.35
0.89 - 0.95	100,000	2.45	0.92	100,000	0.92
1.30	8,333	3.05	1.30	-	-
2.05 - 2.25	400,000	3.48	2.11	266,666	2.11
2.60 - 2.88	425,000	4.40	2.74	66,666	2.85
3.25 - 3.99	787,500	4.04	3.59	365,832	3.52
\$ 0.35 - 3.99	1,804,833	3.78	\$ 2.75	883,164	\$ 2.45

IROC SYSTEMS CORP.

Notes to Consolidated Financial Statements, page 12

Years ended December 31, 2006 and 2005

9. Share capital (continued):

(c) Stock option plan (continued):

The fair value of common share options is estimated as at the grant date using the Black-Scholes option pricing model, with the following weighted average assumptions:

Risk free interest rate (%)	4.08%
Expected lives (years)	5.0
Expected volatility (%)	44.98%
Dividend per share	—

The weighted average fair value of the options issued is \$1.87. For the year ended December 31, 2006, stock-based compensation costs included in net earnings totaled \$1,137,667 (2005 - \$824,274).

(d) Warrants:

At December 31, 2006 there were 757,650 (2005 – 1,050,000) warrants outstanding entitling holders to purchase common shares of the Corporation at an exercise price of \$2.50 per share exercisable until September 12, 2007 and \$2.70 per share thereafter until maturity. The value of the warrants was reduced and share capital was increased by \$321,585 (2005 – nil) for warrants converted during the year ended December 31, 2006 representing the fair value assigned to the warrants at the date of issue.

(e) Contributed surplus:

Contributed surplus represents the cost of the stock-based compensation payments relating to the compensation expense for stock options granted to employees, directors and officers.

The following tables summarize information regarding contributed surplus:

	2006	2005
Balance, beginning of year	\$ 827,973	\$ 10,623
Stock-based compensation expense	1,137,667	824,274
Reclassification to common shares upon the exercise of options	(141,859)	(6,924)
Balance, end of year	\$ 1,823,781	\$ 827,973

(f) Earnings per share:

The weighted average number of shares outstanding during the year was 37,731,038 (2005 - 31,467,865). In computing diluted earnings per share for 2006, 542,746 shares (2005 – 500,992) were added to the average number of common shares outstanding to give effect to stock options and warrants.

10. Income taxes:

IROC SYSTEMS CORP.

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Years ended December 31, 2006 and 2005

The provision for income taxes differs from that which would be expected by applying statutory rates. A reconciliation of the difference is as follows:

	2006	2005
Earnings before income taxes – continuing operations	\$ 4,750,399	\$ 2,373,102
Combined federal and provincial income tax rate	32.49%	33.62%
Expected income taxes	1,543,405	797,837
Increase (decrease) resulting from:		
Non-deductible items	176,417	52,380
Income tax effect of income tax rate change	(249,539)	–
Non-taxable portion of capital gains	–	(9,090)
Reversal of valuation allowance	–	(355,137)
Stock based compensation	369,628	277,121
Income tax effect of discontinued operations	(357,036)	215,592
Other	160,680	(52,414)
	\$ 1,643,555	\$ 926,289

The future income tax (liability) asset is comprised of:

	2006	2005
Future tax assets:		
Income tax losses	\$ 5,168,717	\$ 893,300
Share issue costs	208,166	275,300
Investments	–	28,400
	5,376,883	1,197,000
Future tax liabilities:		
Property and equipment	\$ (3,121,480)	\$ (452,227)
Intangible assets	(2,037,756)	(1,834,355)
Operations of a partnership with a different tax year	(3,177,795)	–
	(8,337,031)	(2,286,582)
Net future income tax liability	\$ (2,960,148)	\$ (1,089,582)

IROC SYSTEMS CORP.

Notes to Consolidated Financial Statements, page 14

Years ended December 31, 2006 and 2005

10. Income taxes (continued):

The Corporation has loss carry-forwards for income tax purposes totaling \$16,117,684 which are available for application against future taxable income until:

2008	\$	975
2009	\$	55,839
2010	\$	1,500
2014	\$	309,706
2015	\$	2,395,236
2016	\$	13,354,428

11. Commitments:

The Corporation has entered into agreements to lease equipment and premises with varying expiration dates requiring future minimum payments of \$5,656,346. The minimum annual payments are as follows:

2007	\$	1,749,783
2008	\$	1,152,137
2009	\$	785,880
2010	\$	472,546
2011	\$	368,500
Beyond five years	\$	1,127,500

12. Financial instruments:

(a) Fair value of financial assets and liabilities:

The Company's financial instruments recognized in the balance sheet consists of cash, accounts receivable, accounts payable and accrued liabilities, operating and callable debt. The fair value of these financial instruments approximates their carrying amounts due to their short terms to maturity. The fair value of the callable debt and operating loan facility approximates their carrying value as it bears interest at floating rates. The fair value of long-term debt and debentures included in the consolidated balance sheet does not materially differ from their carrying values.

(b) Interest rate risk:

The Corporation manages its exposure to interest rate risk through a combination of fixed and floating rate borrowings.

(c) Credit risk:

Accounts receivable includes balances from a large number of customers primarily operating in the oil and gas industry. The Corporation assesses the credit worthiness of its customers on an ongoing basis as well as monitoring the amount and age of balances outstanding. Accordingly, the Corporation views the credit risk on these amounts as normal for the industry.

IROC SYSTEMS CORP.

Notes to Consolidated Financial Statements, page 15

Years ended December 31, 2006 and 2005

13. Supplemental cash flow information:

	2006	2005
Interest paid	\$ 1,974,199	\$ 568,448
Income taxes paid	\$ 240,011	\$ 15,884
Changes in non-cash working capital components of continuing operations:		
Accounts receivable	\$ (4,802,542)	\$ (7,373,920)
Inventory	(3,091,673)	(151,003)
Prepaid expenses	(47,243)	(151,699)
Income taxes recoverable	177,743	173,433
Accounts payable and accrued liabilities	(932,000)	483,868
Income taxes payable	434,653	-
	\$ (8,261,062)	\$ (7,019,321)
Changes in non-cash working capital items in investing activities	1,911,527	(363,600)
Changes in non-cash working capital items	\$ (6,349,535)	\$ (7,382,921)

14. Related party transactions:

During the year ended December 31, 2005, the Corporation purchased six service rig packages from Key Energy Services Inc. ("Key"). At December 31, 2006, Key, a U.S. public company, holds 23% (2005 – 23%) of the Corporation's issued and outstanding shares. The purchase price for the equipment was \$917,400 US, (\$1,144,089 CDN dollars). The purchase price was paid by way of issuance of 547,411 common shares of the Corporation at an issuance price of \$2.09 per share. Key has two members on the board of directors of the Corporation.

IROC SYSTEMS CORP.

Notes to Consolidated Financial Statements, page 16

Years ended December 31, 2006 and 2005

15. Segmented information:

As at December 31, 2006 the Corporation operates in two main segments, which are substantially in one geographic region. Drilling and production services includes service rigs and related equipment, oilfield rental equipment and services, and lease construction and road building services all of which assist oil and gas companies and contractors in drilling and production activities in oil and gas wells. Technology services includes remote communications products and services, safety and air monitoring services and equipment, and manufacturing and distribution of downhole pressure and temperature measurement tools all of which provide technology based solutions to assist oil and gas companies in the production of oil and gas.

Year ended December 31, 2006	Drilling and Production Services	Technology Services	Corporate	Total
Revenue	\$ 41,803,856	\$ 20,507,885	\$ –	\$ 62,311,741
Depreciation and amortization	3,578,025	2,289,923	351,464	6,219,412
Interest on callable and long-term debt	–	–	1,414,199	1,414,199
Interest and accretion on debentures	–	–	943,340	943,340
Net earnings (loss) – continuing operations	10,229,222	896,585	(8,018,963)	3,106,844
Intangible assets	997,646	5,250,850	65,972	6,314,468
Goodwill	1,339,571	6,281,640	–	7,621,211
Property and equipment	44,818,670	5,964,576	1,083,703	51,866,949
Capital expenditures*	17,931,402	1,955,166	468,181	20,354,749

* Excludes property and equipment acquired on business acquisitions

Year ended December 31, 2005	Drilling and Production Services	Technology Services	Corporate	Total
Revenue	\$ 18,481,857	\$ 10,919,053	\$ –	\$ 29,400,910
Depreciation and amortization	1,788,062	1,274,881	130,872	3,193,815
Interest on callable and long-term debt	–	–	366,112	366,112
Interest and accretion on debentures	–	–	328,883	328,883
Net earnings (loss) – continuing operations	3,638,729	1,777,187	(3,969,103)	1,446,813
Intangible assets	–	6,261,663	35,556	6,297,219
Goodwill	1,339,571	5,710,913	–	7,050,484
Property and equipment	28,985,669	5,118,860	563,436	34,667,965
Capital expenditures*	11,950,582	1,838,640	253,454	14,042,676

* Excludes property and equipment acquired on business acquisitions

IROC SYSTEMS CORP.

Notes to Consolidated Financial Statements, page 17

Years ended December 31, 2006 and 2005

16. Contingencies:

- (a) A legal action seeking damages and compensation of \$821,000 plus \$50,000 for punitive damages has been filed against the Corporation. Four parties have been named. The claim seeks damages and compensation for non-performance in regard to a 1996 agreement. The claim has been responded to by the Corporation and a counterclaim has been filed in the amount of \$220,241 for failure to perform pursuant to the 1996 agreement, plus all amounts currently outstanding. No liability in respect of these actions has been included in these consolidated financial statements as management intends to vigorously defend the matter and believes the outcome will be in its favor. Any amounts awarded as a result of these actions will be reflected in the year the amounts become reasonably estimable.
- (b) A legal action seeking \$5.0 million plus general, special and punitive damages has been filed against IROC Systems Corp. Management believes that the suit is completely unfounded and without merit, and management intends to vigorously defend the matter and believes that the outcome will be in its favor. Any amounts awarded as a result of this action will be reflected in the year the amounts become reasonably estimable.
- (c) A legal action seeking compensation for wrongful dismissal damages has been filed against the Corporation. Management has indicated that it intends to vigorously defend the matter and believes the outcome will be in its favor. Any amounts awarded as a result of this action will be reflected in the year the amounts become reasonably estimable.

17. Discontinued operations:

During the fiscal year ended December 31, 2006, management identified the remediation and consulting operations, included in the Drilling and Production Services segment, to be disposed of and shut down as a result of financial and operational performance and the need to focus on the continuing operations of the Corporation. The disposal group consisted of certain fixed assets consisting of trucks and trailers used in remediation work and certain inventory utilized in the provision of environmental consulting services. On February 22, 2007 the Corporation entered into a letter of intent to sell the property and equipment of the remediation business and expects to complete this sale during the first quarter of fiscal 2007. The inventory related to the environmental consulting services was written down to a net realizable value of nil at December 31, 2006 as management determined there is no foreseeable market for the disposal of this inventory.

	2006	2005
Revenue from discontinued operations	\$ 3,657,070	\$ 4,504,542
Net earnings (loss) from discontinued operations before taxes	(979,317)	739,779
Income taxes – future	(37,742)	(33,121)
Net earnings (loss) from discontinued operations	\$ (1,017,059)	\$ 706,658

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17. Discontinued operations (continued):

The following table provides additional information with respect to amounts included in the balance sheet as assets and liabilities of discontinued operations:

	2006	2005
Inventory	\$ –	\$ 901,807
Accounts receivable	905,326	1,974,897
	905,326	2,876,704
Property and equipment	923,718	935,971
Total assets of discontinued operations	\$ 1,829,044	\$ 3,812,675
Liabilities of discontinued operations	\$ 130,470	\$ 681,813

The following table provides additional information with respect to amounts included in the statement of cash flows related to discontinued operations:

	2006	2005
Net earnings (loss) from discontinued operations	\$ (1,017,059)	\$ 706,658
Items not affecting cash:		
Depreciation and amortization	152,713	49,271
Write down of inventory	901,807	–
Future income taxes	37,742	33,121
Funds provided by discontinued operations	\$ 75,203	\$ 789,050
Components of change in non-cash working capital balance of discontinued operations:		
Accounts receivable	\$ 1,069,571	\$ (1,312,962)
Inventory	–	(901,807)
Accounts payable and accrued liabilities	(551,343)	322,850
	\$ 518,228	\$ (1,891,919)

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18. Subsequent event:

On February 16, 2007 the Corporation successfully completed the acquisition of four drilling rigs from JMAC Drilling Ltd. ("JMAC") for total consideration of approximately \$33,950,000. The consideration for the assets consisted of 6,200,000 common shares of the Corporation issued at a price of \$2.25 per share and a five year secured promissory note in the amount of \$20,000,000. The promissory note will bear interest at a rate of 9% per annum for the first year and will increase to 10% thereafter. Security for the promissory note has been granted in the specific assets purchased until the note is satisfied. The Corporation will pay interest only on a quarterly basis until March 31, 2008. On April 1, 2008, the Corporation will begin making equal quarterly principal payments plus interest until December 31, 2011. The drilling rigs consist of three telescopic doubles, each with depth capacity of 3400 meters, and one single with depth capacity of 1800 meters. Two of the doubles and the single were delivered on closing, with the third double scheduled for delivery by March 31, 2007. Management intends to deploy the drilling rigs through its newly created drilling division, Mission Drilling, which will be included in the drilling and production services operating segment.