Fans first. ***Pushing the limits of the fan experience.***

Kangaroo Media Inc. / 2005 Annual Report

Profile

Kangaroo Media Inc. gives fans the superstar experience by letting them create their own live-action sporting event. Our on-site broadcast technology delivers video, audio and data in real-time to each fan's hand-held KTV. Our content-rich invention conceals proprietary, patented technology. Fan-tested and approved, the result is breathtaking!

We want to be the leader in developing and commercializing innovative, personalized audio-visual solutions for on-site events. We don't want to change the way the game is played, but how it is experienced. KTV is an incomparable medium for targeted advertising, merchandising, market surveying and branding. With KTV, sports owners, sponsors and promoters have access to powerful new ways of reaching audiences and maximizing returns.

Headquartered near Montreal, Kangaroo Media is also present in New York and London. Kangaroo Media Inc. was listed on the TSX Venture Exchange until April 13, 2006. On April 18, 2006, under the KTV symbol, it was listed on the Toronto Stock Exchange TSX on a consolidated basis.

Kangaroo Media Inc. and its wholly-owned subsidiary Kangaroo.TV Inc. may from time to time be referred to in this report as Kangaroo. KTV refers to the product.

Kangaroo Media adheres to strong core values, including:

Fans first
We push the limits of the fans' experience with each new generation of product based on the content they want and what they tell us in ongoing testing.

Always first to market
We own a great idea, content and product, acclaimed by everyone in touch with it. As such, we are in the process of acquiring rights, one sport at a time, in a multi-billion dollar market where we are the only player.

Good governance and leadership
We ensure our business practices enhance shareholder value according to regulatory requirements and ethical behaviour. We show leadership by appointing high-calibre independent and objective members to the Board; and we employ the best people.

Creating value
Each of our target audiences – fans, shareholders, sports and series owners, promoters, sponsors, advertisers, partners, employees, suppliers – invests time, money, interest and effort in what we do, and deserves value in return.

Passion
Our enthusiasm for the extraordinary KTV is contagious – as soon as fans try it, they want it.

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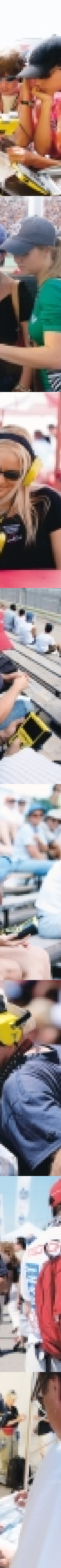


*“ **It’s the coolest thing they’ve come up with since putting cars on the track.”***
Raymond Tucker

*“ **I don’t think we have ever been more impressed with a new gadget. This just added a whole new dimension to attending a race. We’ve used scanners several times, but I always had trouble hearing the announcers and programming the frequencies. With the FanView, the headsets were 100 percent better. I actually had to lower the volume.”***
John and Debra Craig

*“ **Seriously though, I tried the Kangaroo device at the Molson Indy a couple of years ago in Toronto. It’s WAY cool for race fans. I have been attending at least one NASCAR race per year for the past 15 years, and I must say this looks to be a whole lot better than a regular scanner.”***
Meri

*“ **I rented one at the California Speedway this weekend and for the real die-hard fan who wants to see the replays, stats, and hear commentary, it is awesome!!! It beats scanners! If you have been to a race, and are not sitting in a suite, there is lots of stuff you miss...Give it a try!”***
Roger Beebe

" My son and I enjoyed your product so much at the Homestead truck races this past weekend that we want to be put on the waiting list for the purchase of this product."
Don Dallman

" It's great fun and with a gadget like this, it will only make it more fun. NASCAR is a sport that truly is always searching for bigger and better ways to get race info out to the fan. I can't wait to get my hands on this item. I say the more gadgets we have, the better."
Big D

" It's a 'must-have' device. I tried the KangarooTV (same as the FanView by Nextel) at a ChampCar race and it's really incredible. I suggest everybody rents one. I just wish everybody could have one!"
Nick Bouchard

We don’t want to change the way the game is played, but how it is experienced.

From an original idea in 2001 to full commercial production and major market acceptance in 2005, we've come a long way in a short time. In line with our promise in the 2004 Annual Report, we announced a major agreement in the North American motorsport sector. The signing with Sprint Nextel – the title sponsor of the NASCAR NEXTEL Cup Series – is a natural fit with far-reaching potential for KTV.

This consecration of our product development and marketing efforts of the past several years demonstrates our ability to meet the strategic priority of acquiring rights and expanding into a variety of sporting events. NASCAR is North America's most popular motorsport and Sprint Nextel is a leading provider of wireless communications on the largest all-digital wireless network in the U.S.

Under the five-year agreement, we will supply Sprint Nextel with multimedia KTVs and related products, equipment and services. While the minimum amount for the first year of the five-year term was expected to be US $10 million in revenue, this amount could increase significantly, since already as of mid-April 2006, orders in excess of US $13.8 million have been received.

New generation

Also in 2004, we said we would launch a new system generation. Effectively, during the final ten races of the 2005 season, Kangaroo jointly field tested and certified its KTV Generation II technology with NASCAR and Sprint Nextel. The Generation II product received rave reviews by fans and NASCAR constituents alike. With these commercial partners, we participated in weekly surveys and focus groups to help perfect content and production, while optimizing the user friendliness of the interface for NASCAR fans.

Branded NASCAR NEXTEL FanView™ by Sprint Nextel and NASCAR, the KTV Generation II is the first device of its kind in any major sport. Available on a rental basis, thousands of fans took advantage of hand-held KTVs during the end-of-season races to see how they could produce their own multimedia experience on site. Subsequently, Generation II technology had a sold-out commercial launch at the Daytona 500, the first race of the 2006 season, and it continues to sell out at every race. Our partners report an unheard of 99% level of acceptance by the customer base.

Business development

In 2005, Kangaroo vigorously pursued approaches to major sports leagues further to the agreement with TWI Interactive (a subsidiary of IMG, the world's largest independent producer of sports programming, including Wimbledon and the Olympic Games). TWII helps Kangaroo develop new partnerships with sports organizations and other rights holders, such as broadcasters and teams; define market strategies; and tailor content for specific sports.

Kangaroos' unique value proposition makes us the only player in this untapped market. As such, our strategy is to capture on-site broadcasting rights with major sports properties by developing strong relationships with leagues, promoters and sponsors and demonstrating the benefits of the KTV value proposition for the on-site fan experience. Current targets include motorsports, football, golf, baseball, and the Olympics.

In line with our core value "Always first to market", we focus on having the best device for the best fan experience, including device sophistication, extraordinary content, and functional add-ons. We believe in the importance of adding value so KTV is consistently the right product in each of its environments.

Creating value

Kangaroo's priority for generating revenue is to acquire licensing rights to sporting series, thereby creating value for shareholders and partners. Our business model covers the full spectrum of possibilities from master franchises to full-service providers. Agreements are characterized by exclusive licensing, long-term agreements, manufacturing and supply of KTVs, content and services. Maximum flexibility and adaptability in any context is what we offer to best penetrate target markets.

The heart of our one-of-a kind proposition is the ability to resell unique content. We address this lucrative market with access to on-site broadcasting content, customized content for sports fans, by supplying packaged content to other rights owners, sponsors or mobile providers.

In the near future, advertising has significant revenue potential with a variety of possible applications. As our market penetration increases, advertisers will notice KTV's viability as a strong targeted advertising medium – we soon intend to take advantage of this opportunity.

Financial results

Revenues totaled $1.2 million in 2005 compared to $0.08 million in 2004, thanks in large part to initial deliveries of units and components to Sprint Nextel, under the August 2005 agreement.

Net losses in 2005 amounted to $5.1 million compared to $3.1 million in 2004, or respectively $0.07 and $0.06 per share (on a non-consolidated basis). As the Corporation continues to develop its product portfolio and intensify its business development efforts aimed at new sporting venues, operating expenditures increased to $5.2 million in 2005 from $2.7 million in 2004. We are confident the Sprint Nextel agreement will result in significant revenue growth in 2006.

In August 2005, we completed a private placement for $5 million followed by another in March 2006 for $20 million. The net proceeds of these offerings will provide capitalization for acquiring additional licensing rights of sporting series, infrastructure expenditures, and general working capital purposes.

Conclusion

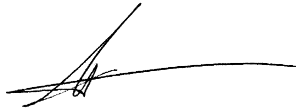
Looking forward to 2006-2007, we will be preparing the way for major agreements in the sport stadium and motorsport sectors and intend to maintain the initiative in our favour in this untapped multi-billion dollar market.

Our dedicated team of management and employees will grow with our business. We thank them for rising to meet the exciting challenges we face on a daily basis, with passion, innovative attitudes and flexibility.

You will find on the inside front cover our corporate profile and value statement, a result of the time we have taken to define who we are, where we are going and what we believe in as we move forward.

We welcome our new Chief Financial Officer Normand Chartrand, who brings 20 years of senior management experience to the position.

Pierre Boivin
Chairman of the Board



Marc Arseneau
President and Chief Executive Officer

Working with NASCAR, the second biggest spectator sport in the U.S. after the National Football League, Kangaroo is entering a 75-million-fan market with over seven-million spectators on site.

Commercial viability, rollout and infrastructure development

When Kangaroo President and CEO Marc Arseneau attended the 2005 FORMULA 1™ Sinopec Chinese Grand Prix in October 2005, he observed Bernie Ecclestone, President and CEO of Formula One Management. Ecclestone, to Arseneau's amazement, was demonstrating a hand-held KTV to several curious onlookers, with enthusiasm. When he spotted Arseneau, he hid his hand behind his back so only Arseneau could see – Ecclestone was giving Arseneau the thumbs-up sign.

This anecdote defines Kangaroo's activities in 2005. With the build-up through the year to the signing with Sprint Nextel in August, the firm had moved from three years of development to full-scale commercial rollout with a very imposing partner, the title sponsor of the NASCAR NEXTEL Cup Series.

The remarkable KTV invention had become commercially viable and was finding acceptance in the highest spheres of influence and most importantly, with the fans, without whom sporting events would simply not exist. The excitement Ecclestone showed in Shanghai is typical of how thousands of NASCAR fans renting the device respond once they interact with it.

In fact, the NASCAR fan renting the NASCAR NEXTEL FanView (the brand used for the KTV technology within the NASCAR property) can access, among other things, eight channels of live video content including seven in-car views, 44 live in-car and officials' audio communications, an electronic version of the series media guide, and live statistics, timing and scoring information.

With a view to ramping up its infrastructure in anticipation of future demand, in the second quarter of 2005, Kangaroo entered into a manufacturing agreement with Hong Kong-based VTech, a world-renowned electronics manufacturer. Currently, VTech owns and manages four manufacturing facilities in mainland China, of which two, near Shenzen, manufacture KTVs. The goal is to reduce production costs for KTV Generation II and allow seamless increases in manufacturing capacity as new markets come on stream.

During the course of 2005, aside from the negotiation and start of execution of the Sprint Nextel agreement, and appearances at some venues of Champ Car (its valued partner in developing KTV), Kangaroo aggressively approached leading sports leagues in the United States and Europe. These initiatives should produce results in 2006 with the signature of on-site rebroadcast agreements.

Alain Charette, Executive Vice President, Corporate Development, and Marc Arseneau, President and CEO, at Kangaroo's Daytona 500 (NASCAR) 2006 debut.

As we aggressively pursue our growth on all fronts, we are paying special attention to our financial and human resources as outlined in the Message to Shareholders. Revenue from the five-year contract with Sprint Nextel and the private placements will, among other uses, enable Kangaroo to continue strengthening its workforce in engineering, business development and administration.

The challenges of 2005 were to build commercially and financially on the significant milestones achieved in 2004, develop a thriving business to the benefit of sports fans and business partners, and increase value to shareholders. We believe we have met and even surpassed these goals.

In 2006, we are continuing to improve the KTV and content while focussing on surpassing the fans' experience. Most importantly, we will aggressively seek to acquire rights in other top tier sports markets as we build on the NASCAR success.

Kangaroo Media Inc.

Years ended December 31	**2005**	2004
(in thousands of dollars)	**$**	$
Consolidated results		
Revenues	**1,161**	77
Gross margin	**97**	(429)
Operating expenses	**5,196**	2,678
General and administrative expenses (including stock-based compensation)	**2,484**	1,179
Marketing and corporate development expenses	**1,250**	967
Research and development expenses	**817**	255
Depreciation, amortization and disposal of tangible assets	**454**	224
Financial expenses	**191**	53
Stock-based compensation	**317**	122
Operating loss (in thousands of dollars)	**(5,098)**	(3,107)
Basic and diluted loss per share	**0.07**	0.06
Weighted average number of outstanding shares	**71,858,102**	51,814,811
(in thousands of dollars)		
Consolidated balance sheet		
Cash and cash equivalents and short-term investments	**6,775**	3,566
Long-term assets	**870**	745
Total assets	**11,719**	4,624
Total liabilities	**5,353**	1,064
Equity	**6,366**	3,560
(in thousands of dollars)		
Consolidated cash flows		
Cash flows from operating activities	**(4,130)**	(3,242)
Cash flows from (used for) investment activities	**115**	(3,823)
Cash flows from financing activities	**7,794**	7,400
Market information (unaudited)		
As at December 31		
High	**1.25**	0.62
Low	**0.45**	0.23
Closing	**1.20**	0.61
Shares issued and outstanding – end of year	**84,524,863**	65,648,499
Warrants issued and outstanding – end of year	**21,687,652**	18,435,653
Stock options issued and outstanding – end of year	**9,078,333**	6,106,428

The following management's discussion and analysis of results of operations, financial position and cash flows must be read in conjunction with the audited consolidated financial statements and accompanying notes of Kangaroo Media Inc. for the years ended December 31, 2005 and 2004. Management prepared this report taking into account all available information as of March 29, 2006.

All financial information contained in this analysis and the financial statements have been prepared in accordance with the Canadian generally accepted accounting principles (GAAP). Unless otherwise indicated, all amounts are in Canadian dollars.

This management report may contain information and declarations on the future performance of Kangaroo Media Inc. that are by nature forward-looking. These declarations reflect management's expectations regarding future events based on assumptions and uncertainties that are subject to the risk factors identified in the Risks and Uncertainties section. Readers are hereby cautioned that actual results may differ materially from expectations.

This management report was submitted to the Audit Committee and approved by the Board of Directors of Kangaroo Media Inc.

Business profile

The Company was incorporated under the Canada Business Corporations Act on September 22, 2003. On April 14, 2004, Kangaroo Media Inc. closed a qualifying transaction with the shareholders of 3721477 Canada Inc. whereby Kangaroo Media Inc. purchased all issued and outstanding common shares of 3721477 Canada Inc. This transaction, considered as a reverse takeover, was accounted for as recapitalization of the resulting company.
On October 7, 2004, the Company changed its name from Kangaroo Capital Inc. to Kangaroo Media Inc. The resulting company ("Kangaroo" or "the Company") specialize in an onsite broadcasting technology that creates a unique content experience for spectators at live events. The Company also designs, manufactures and commercializes Kangaroo.TV, a unique portable audiovisual multi-function entertainment system that broadcasts on-site real-time audio, video and data content to spectators attending an event. Aside from a few appearances at Champ Car events in 2003 and 2004, Kangaroo.TV started commercial operations during the third quarter of 2005 through a five-year agreement with Sprint Nextel, the title sponsor of the NASCAR Nextel Cup Series.

In the second quarter of 2005, Kangaroo entered into a manufacturing agreement with Hong Kong-based VTech, a world-renowned electronics manufacturer. VTech currently owns and manages four manufacturing facilities in mainland China. Kangaroo devices are currently manufactured at two VTech facilities located in Donguan, near Shenzen, in southern China. This agreement's goal was to reduce the cost of manufacturing Kangaroo Generation II handsets and allow seamless increases in manufacturing capacity to rapidly address new markets.

In the third quarter of 2005, Kangaroo.TV unveiled its new Generation II digital broadband handheld technology. In conjunction with Sprint Nextel, Generation II devices were then certified in laboratory trials, successfully field tested and progressively commissioned at NASCAR Nextel Cup Series races during the fourth quarter of 2005.

Corporate Development

The NASCAR market

During the first and second quarters of 2005 and following an active test program with NASCAR in 2004, Kangaroo successfully negotiated and concluded an exclusive five-year agreement with Sprint Nextel. Sprint Nextel (formerly known as Nextel Communications) will be the title sponsor of the NASCAR Nextel Cup Series™ until the end of the 2013 season. Kangaroo.TV's five-year agreement will generate several distinct revenue streams for the Company. With this first significant contract, Kangaroo.TV is assured minimum revenues of US$10M during the first twelve months of the contract, starting August 8, 2005. As at December 31, 2005, cumulative orders from Sprint Nextel totaled US$7M.

During the third and fourth quarters of 2005 and following execution of the contract, Kangaroo jointly field tested and certified its Generation II technology with NASCAR and Sprint Nextel at the last ten races of 2005 season. Branded NASCAR Nextel FanView™ by Sprint Nextel and NASCAR, the Kangaroo Generation II device is the first of its kind to be used at a major sporting event. Thousands of units were distributed during these races, and this progressive integration of Generation II technology was designed to ensure a smooth commercial launch at the Daytona 500, the first race of the 2006 season.

Additional activities
In 2005, aside from the agreement with Sprint Nextel and appearances at some Champ Car venues, the Company continued its very aggressive marketing approach with leading sports leagues in the United States and Europe. These initiatives should produce results in 2006 with the signing of additional on-site rebroadcast agreements with major sports leagues.

Operations and human resources
In 2005, Kangaroo almost doubled its work force; staff was added in all areas of the Company, but mainly in engineering, business development and administration. Kangaroo's objective for 2006 is to aggressively reinforce its work force with dedicated and passionate talents, directly addressing one of the Company's main challenges: recruiting, training and motivating skilled personnel.

Moreover, in an effort to better serve its target markets, Kangaroo is expanding its work force in the United States as well as recruiting in Europe.

Operating results

Gross margin
Revenues for 2005 stood at $1.16M, as compared to $77,000 in 2004. This strong growth was due mainly to sales of $1.13M made under the agreement with Sprint Nextel. The gross margin is established at $97,000.

The costs of products and services includes the variable costs and operations expenses related to the Company's manufacturing activities. In the fourth quarter, the Company began large scale commercial production and the low business volume during the period explains the low gross margin. Any increase in business growth would have an important positive impact on future increases in the margin.

Operating expenses
Operating expenses totaled $5.20M in 2005, compared to $2.68M in 2004.

General and administrative expenses stood at $2.48M, as compared to $1.18M in 2004. This growth was the result of higher payroll expenses associated with a larger work force and greater operating expenses due to organizational development. Administrative expenses included stock-based compensation, which came to $317,000 in 2005 as compared to $122,000 in 2004.

Marketing and corporate development expenses amounted to $1.25M for the year, compared to $967,000 in 2004. These expenses consisted of staff compensation, advertising expenses and professional fees incurred in the negotiations of contractual agreements. They also include the cost of event participation in the development of new market strategy. The Company engaged in business development activities with potential partners and customers while continuing to build its brand.

Research and development expenses amounted to $817,000 in 2005, compared to $255,000 in 2004. This consisted mainly of the costs associated with development and final design of the Kangaroo.TV™ Generation II product and its associated accessories, which are intended mainly for the NASCAR market. This amount is net of estimated refundable income tax credits of $22,000 compared to $113,000 in 2004.

Financial expenses totaled $191,000, $138,000 more than in 2004. This included interest expense on term loans signed with Investissement Québec, issuance costs of credit facilities, lease financing contracts, and gains and losses on foreign currencies. The increase was due to interest expense on term debt and expenses related to the issuance of letters of credit and standby letters of credit to suppliers.

The depreciation expense for 2005 was $300,000, or $86,000 more than in 2004. Moreover, the Company wrote off the entire inventory of the first-generation Kangaroo.TV product which totaled $154,000.

Furthermore, the Company adopted a conservative position concerning the accounting of future income taxes and concluded that a valuation allowance equivalent to the total of future income tax assets should be accounted for.

The operating loss for 2005 was $5.10M, compared to $3.11M in 2004. The variation is essentially due to an increase in operating expenses incurred by the Company as it pursued its growth strategy.

The basic and diluted loss per share was $0.07 in 2005, compared to $0.06 in 2004. In 2005, the average number of shares outstanding was 71.9 million on a diluted basis, compared to 51.8 million in 2004. As at December 31, 2005, the share market price was higher than the exercise price of all outstanding options and warrants. The loss per common share is determined based on the weighted average number of common shares outstanding during the years. The warrants and stock option plan were not taken into account in the calculation of the diluted result per share because of the anti-dilutive effect in the years presented.

Quarterly performance

The selected financial information for the last eight quarters ended December 31, 2005 is disclosed as follows:

				2005
(in thousand of dollars)	**Q 1**	**Q 2**	**Q 3**	**Q 4**
Revenues	**–**	**–**	**389**	**772**
Net loss for the period	**(671)**	**(1,362)**	**(1,432)**	**(1,633)**
Basic and diluted loss per share	**(0.01)**	**(0.02)**	**(0.02)**	**(0.02)**

				2004
(in thousand of dollars)	Q 1	Q 2	Q 3	Q 4
Revenues	–	22	60	(5)
Net loss for the period	(435)	(1,088)	(952)	(632)
Basic and diluted loss per share	(0.01)	(0.02)	(0.02)	(0.01)

Financial position

As at December 31, 2005, the Company held $6.77M in cash and short-term investments, of which $2.53M (US$2.14M) was given in guarantee to allow the issuance of letters of credits in favour of various suppliers in order to finance its manufacturing activities in Asia. As of December 31, 2004, the Company had cash flows of $3.57M.

Accounts receivable totaled $1.93M as at December 31, 2005, an increase of $1.68M that was mostly due to accounts receivable from Sprint Nextel, which accounted for $1.5M on this date.

Standing at $1.97M, inventory consisted mainly of finished products and raw materials within the framework of orders concluded with Sprint Nextel. The Company sub-contracts the manufacturing and assembly of its products. However, in order to optimize its cost of manufacturing and within a strategic framework, the Company supplies a certain category of components directly.

Accounts payable, including provisions for vacations and bonuses, and trade accounts payable totaled $2.49M, compared to $424,000 in 2004. This increase was directly related to an increase in amounts payable to suppliers of components, parts and assembly services. The Company created a provision for guarantee expenses on delivered Kangaroo.TV™ units based on electronics industry standards and internal estimates which will be revised according to the future actual costs.

Deferred revenues of $1.96M consist of revenues in an amount of $542,000 related to sales of units which were accepted by the customer as of December 31, 2005 in accordance with the terms of the contract. The units were held in the Company's premises in order to facilitate delivery logistics to event sites. The units affected by this modification were partially paid at December 31, 2005. Deferred revenues also include invoices relating to an exclusive licence with Sprint Nextel and maintenance income for a total residual value of $1.41M at December 31, 2005. The licence income will be recognized on the basis of units sold to Sprint Nextel during the period of exclusivity whereas maintenance income will be recognized in 2006.

Cash flows from operating activities amounted to $4.13M was allocated to operating activities, compared to $3.24M in 2004.

The Company acquired capital assets, consisting mainly of computer hardware and production equipment in a total amount of $454,000, compared to $388,000 in 2004.

Financing activities generated $7.79M in 2005, compared to $7.40M in 2004. The Company issued shares and warrants for a net value of $4.88M, including $4.80M as part of a private placement made in the third quarter. Warrants were exercised in 2005 for total proceeds of $2.56M.

On March 21, 2006, the Company completed a private placement by a firm purchase of 17,393,000 shares at a price of $1.15 per share for a total gross cash proceed of $20,001,950. The proceeds will be used to finance the operations, acquire rights for broadcasting sporting events, finance capital expenditures and working capital.

In March 2006, the Company accepted an offer from a banking institution to establish short-term and long-term banking facilities totaling US$9M and $1.20M, respectively. The set-up of these facilities will be completed at the start of the second quarter of 2006. Obtaining these credits will allow the Company to finance its manufacturing operations without significantly impacting its liquidities.

In the normal course of its activities, the Company contracts certain obligations and commercial commitments in the form of, for example, letters of credit and others. The table below presents a summary of the Company's contractual obligations, that is to say the various components and expiries of the Company's long-term debt for the year ended December 31, 2005.

Contractual obligations

(in thousand of dollars)	2006	2007	2008	2009	2010	Total
Long-term debt	168.6	171.6	125.8	121.6	101.4	689.0
Capital leases	10.2	13.5	–	–	–	23.7
Lease agreements	67.9	34.0	–	–	–	101.9
Other long-term commitments	144.0	84.0	–	–	–	228.0
Total	**390.7**	**303.1**	**125.8**	**121.6**	**101.4**	**1,042.6**

The Company estimates that its available financial resources will allow it to meet its financial obligations.

Related party transactions

In the normal course of business, the Company signed a royalty agreement with two shareholders, one being a director and an officer, whereby the Company is committed to pay an annual amount equal to 10% of the earnings before interest, income taxes and amortization resulting from the marketing of products under the “Kangaroo” trademark, and all products resulting from the same technology, up to a total amount of $3.96M. In 2005, no amount was paid under the terms of this agreement.

As of December 31, 2005, in the normal course of its activities, an officer owed the Company $13,035 ($59,277 payable in 2004).

Risks and uncertainties

The operating history with which the Company could make an assessment of its business and outlook is limited. Any outlook must take into account the kinds of risks and uncertainties faced by a company in a new market. These forward-looking statements are based on estimates and assumptions made by the Company on the basis of its experience, market conditions and expected future developments. Several factors could cause actual results to differ from current expectations, including:

- The Company's ability to develop new markets and partnerships;
- The Company's dependence on a limited number of customers;
- The competitive landscape;
- Claims resulting from possible legal proceedings or litigation over the Company's intellectual property;
- The Company's ability to obtain patents for new products and technologies and acquire the related rights; and
- The fluctuations of exchange rates between the U.S. and Canadian dollar.

To limit these risks, among other things the Company must:

- Intensify efforts to market its innovative product in new markets;
- Recruit and motivate qualified staff;
- Continue to develop products that will maintain its technology-based competitive advantage;
- Reduce the product's manufacturing and operating costs;
- Improve distribution channels; and
- Establish a foreign currency hedge.

Outlook

The Company will pursue its main objective of signing long-term agreements with leading North American and European sports leagues for the content and broadcast rights of audio, video and data signals.

In addition, Kangaroo plans to enter into other strategic partnerships in order to ensure rapid future growth in its target markets.

Finally, the Company constantly seeks to make improvements to its current Kangaroo.TV™ device and develop new products that would improve the on-site experience for spectators.

Accounting policies and estimates

The preparation of consolidated financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the recorded amount of assets and liabilities and the reported amounts of contingent assets and liabilities at the date of the financial statements and the recorded amounts of income and expenses during the year. Actual results may differ from those estimates.

Inventory

Inventory consists of raw materials and finished products evaluated based on the lower of cost and replacement cost, cost being determined according to the first in, first out method. The cost of finished products includes raw material costs and subcontracting fees.

Revenue recognition

Certain contracts include multiple elements or deliverables. The accounting policies of the contracts including multiple elements require that the Company distribute the amounts of the contract between the various components of the contract on the basis of the fair value of each element and recognize the revenue for each element when the criteria for revenue recognition are satisfied. To determine the fair value of each element, the Company bases its assumptions on a variety of factors such as the requested price for an element when it is sold separately, price lists and any other information considered to be relevant by management.

Revenues from the sale of portable audiovisual entertainment systems are recognized when the systems are delivered and accepted by the customer.

Revenues from the sale of licences are recognized proportionally according to the number of units sold on the minimal contractual quantity order for the duration of the exclusivity period.

Revenues from the services of after-sales technical support and the services of support for the use of the audiovisual entertainment systems are recognized on a straight-line basis over the term of the contract.

Rental revenues are recognized when the use of the portable audiovisual entertainment systems are put to use.

The amounts received before delivery of the products or services are classified as deferred revenues.

Future changes to accounting standards

Financial instruments – recognition and measurement, hedges and comprehensive income

In January 2005, the ASB issued three new standards dealing with financial instruments: (i) Financial Instruments – Recognition and Measurement; (ii) Hedges; and (iii) Comprehensive Income. The new standards are based on the U.S. FASB Statement 133, *Accounting for Derivative Instruments and Hedging Activities,* and on the International Accounting Standards ("IAS") Board's new standard, IAS 39, *Financial Instruments – Recognition and Measurement.* These requirements will be applicable for the Company in the first quarter of fiscal 2007.

The Handbook Section 3855, *Financial Instruments – Recognition And Measurement* prescribes when a financial instrument is to be recognized on the balance sheet and the measurement method, using fair value or using cost-based measures. It also specifies how financial instrument gains and losses are to be presented.

New Handbook Section 3865, *Hedges* allows optional treatment providing that hedges be designated as either fair value hedges, cash flow hedges or hedges of a net investment in a self-sustaining foreign operation. For a fair value hedge, the gain or loss attributable to the hedged risk is recognized in net income in the period of change together with the offsetting loss or gain on the hedged item attributable to the hedged risk. The carrying amount of the hedged item is adjusted for the hedged risk. For a cash flow hedge or for a hedge of a net investment in a self-sustaining foreign operation, the effective portion of the hedging item's gain or loss is initially reported in other comprehensive income and subsequently reclassified to net income when the hedged item affects net income.

The ASB has issued new Handbook Section 1530, *Comprehensive Income,* and amended *Surplus,* Section 3250 to be renamed *Equity,* Section 3251. These standards require that an enterprise present comprehensive income and its components, as well as net income in its financial statements; and that an enterprise present separately changes in equity during the period, as well as components of equity at the end of the period, including comprehensive income.

The Company anticipates that these changes will not affect its results.

Continuous disclosure and disclosure controls

The Company files its Consolidated Financial Statements, Management's Discussion and Analysis, press releases and other required documents on the SEDAR database at www.sedar.com.

The Company's common shares are traded on the TSX Venture Exchange in Toronto, under the ticker KTV.

The Company's management, including its Chief Executive Officer and the Chief Financial Officer, have evaluated the effectiveness of the Company's disclosure controls and procedures. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in all material respects as of December 31, 2005.

Auditors' Report

To the Shareholders of
Kangaroo Media Inc.

We have audited the consolidated balance sheet of Kangaroo Media Inc. as at December 31, 2005 and the consolidated statements of earnings (loss) and deficit, contributed surplus and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit 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 Company as at December 31, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The financial statements for the year ended December 31, 2004 were audited by other auditors who expressed an opinion without reservation on those financial statements in their report dated February 11, 2005.

Chartered Accountants
March 9, 2006 (except for note 23 which is dated March 21, 2006)

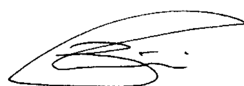
Kangaroo Media Inc.

Consolidated Balance Sheet

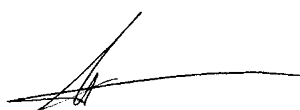
As at December 31, 2005	2005	2004
	$	$
Assets		
Current assets		
Cash and cash equivalents (Note 19 d)	**3,908,887**	130,727
Short-term investments, at cost (Notes 4 and 19 d)	**2,865,992**	3,435,000
Accounts receivable (Note 5)	**1,932,999**	257,815
Inventories (Note 6)	**1,966,481**	36,378
Prepaid expenses	**174,478**	19,455
	10,848,837	3,879,375
Property and equipment (Note 7)	**849,212**	721,574
Intangible assets (Note 8)	**20,744**	23,337
	11,718,793	4,624,286
Liabilities		
Current liabilities		
Bank loan (Note 9)	**193,190**	193,190
Accounts payable and accrued liabilities (Note 10)	**2,492,031**	423,507
Deferred revenues	**1,260,035**	–
Current portion of long-term debt (Note 11)	**178,763**	57,563
	4,124,019	674,260
Deferred revenues	**694,884**	–
Long-term debt (Note 11)	**534,019**	389,622
	5,352,922	1,063,882
Shareholders' Equity		
Capital stock and warrants (Note 12)	**14,718,131**	7,130,758
Contributed surplus	**1,220,954**	904,408
Deficit	**(9,573,214)**	(4,474,762)
	6,365,871	3,560,404
	11,718,793	4,624,286

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

Approved by the Board,



Director



Director

Kangaroo Media Inc.

Consolidated Statement of Earnings (Loss) and Deficit

For the year ended December 31, 2005	**2005**	2004
	$	$
Revenues	**1,160,643**	76,625
Cost of products and services	**1,063,404**	505,663
Gross margin	**97,239**	(429,038)
Operating expenses		
General and administrative expenses	**2,484,535**	1,178,898
Marketing and corporate development expenses	**1,249,801**	966,817
Research and development expenses (Note 15)	**816,668**	254,655
Financial expenses (Note 15)	**190,680**	52,667
Amortization, depreciation and write-off of property and equipment (Notes 7 and 8)	**454,007**	224,611
	5,195,691	2,677,648
Loss for the year	**5,098,452**	3,106,686
Deficit – beginning of year	**4,474,762**	1,368,076
Deficit – end of year	**9,573,214**	4,474,762
Basic and diluted loss per share	**0.07**	0.06
Weighted average number of shares outstanding	**71,858,102**	51,814,811

Consolidated Statement of Contributed Surplus

For the year ended December 31, 2005	**2005**	2004
	$	$
Balance – beginning of year	**904,408**	194,713
Stock-based compensation – employees (Note 13)	**51,064**	630,537
Stock-based compensation – non-employees (Note 13)	**265,482**	79,158
Balance – end of year	**1,220,954**	904,408

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

Kangaroo Media Inc.

Consolidated Statement of Cash Flows

For the year ended December 31, 2005	2005	2004
	$	$
Cash flows from		
Operating activities		
Loss for the year	**(5,098,452)**	(3,106,686)
Adjustments for		
Amortization and depreciation	**299,590**	214,252
Loss on disposal of property and equipment	**–**	10,359
Write-off of property and equipment	**154,417**	–
Stock-based compensation	**316,546**	121,889
Change in non-cash working capital items (Note 17)	**197,576**	(481,529)
	(4,130,323)	(3,241,715)
Investing activities		
Short-term investments	**569,008**	(3,435,000)
Property and equipment	**(454,218)**	(388,109)
	114,790	(3,823,109)
Financing activities		
Loans from shareholders	**(59,277)**	(71,408)
Bank loan	**–**	193,190
Repayment of bank loan	**–**	(320,000)
Long-term debt	**351,684**	330,000
Repayment of long-term debt	**(86,087)**	(206,095)
Issuance of capital stock and warrants (net of share issue costs)	**4,880,976**	4,785,534
Exercise of warrants	**2,558,531**	–
Exercise of stock options	**147,866**	–
Recapitalization (Note 3)	**–**	2,688,852
	7,793,693	7,400,073
Net increase in cash and cash equivalents for the year	**3,778,160,**	335,249
Cash and cash equivalents – beginning of year	**130,727**	(204,522)
Cash and cash equivalents – end of year	**3,908,887**	130,727
Cash and cash equivalents comprise:		
Cash	**3,484,029**	130,727
Short-term investments with initial terms of three months or less (Note 19 d)	**424,858**	–
	3,908,887	130,727

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

Notes to the Consolidated Financial Statements

1. Incorporation and nature of activities

The Company was incorporated under the Canada Business Corporations Act on September 22, 2003. On April 14, 2004, the Company closed a qualifying transaction with the shareholders of 3721477 Canada Inc., purchasing all issued and outstanding shares of 3721477 Canada Inc. (Note 3).

On October 7, 2004, the Company changed its name from Kangaroo Capital Inc. to Kangaroo Media Inc.

The Company manufactures and rents portable wireless audiovisual multi-functional entertainment systems that allow users to watch an event from several points of view, with audio content, real-time statistics and access to useful and informative material.

2. Accounting policies

Principles of consolidation

These consolidated financial statements include the accounts of Kangaroo Media Inc. and its wholly owned subsidiaries, 3721477 Canada Inc., 4121856 Canada Inc., Kangaroo.TV Inc. (formerly World Audio Visual Entertainment Systems ("W.A.V.E.S.") Inc.) and World Audio Visual Entertainment Systems ("W.A.V.E.S.") USA Inc.

Use of estimates

The preparation of the financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements, and reported amounts of revenues and expenses during the reporting period. Significant estimates include the evaluation of warrants and stock options as well as the valuation allowance with respect to future income taxes. Actual results could differ from those estimates.

Cash and cash equivalents

Cash and cash equivalents consist of cash and temporary investments with maturities of three months or less from the acquisition date.

Short-term investments

Short-term investments include money market instruments and commercial paper accounted for at cost or at market value, whichever is less, with maturities greater than three months from the acquisition date.

Inventories

Inventories consist mainly of raw materials and finished goods valued at the lower of the cost and replacement cost, cost being determined using the first-in, first-out method. The cost of finished goods includes the cost of raw materials and subcontracting fees.

Property and equipment

Property and equipment are recorded at cost less related depreciation. Depreciation of property and equipment is calculated using the straight-line method based on their estimated useful lives, as follows:

	Method	Period
Distribution and production equipment, research and development equipment and furniture and fixtures	Straight-line	3 to 5 years
Rental equipment, computer equipment and molds	Straight-line	3 years
Leasehold improvements	Straight-line	5 years

Impairment of long-lived assets
The Company recognizes an impairment loss for long-lived assets to be held and used when events or changes in circumstances cause its carrying amount to exceed the total undiscounted future cash flows expected from its use and eventual disposition. In this case, the impairment loss of the asset is the amount by which its carrying amount exceeds its fair value.

Intangible assets
Patents are recorded at cost and amortized using the straight-line method over their estimated useful lives of 10 years.

Share issue costs
Share issue costs are accounted for as a reduction of capital stock.

Stock-based compensation
The Company has a stock-based compensation plan for which it uses the fair value method. Under this method, the stock-based compensation expense is measured according to the fair value at the date of grant using an option pricing model and is recognized over the vesting period of the options.

The Company estimates the fair value of stock options using the Black-Scholes option pricing model. The Black-Scholes model was developed to estimate the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, valuation models usually require the input of subjective assumptions, including expected stock price volatility.

All considerations paid for stock options and the amount previously included for these stock options in the contributed surplus are credited to capital stock.

Revenue recognition
Certain contracts include multiple elements or deliverables. The accounting policies for contracts including multiple elements require the Company to allocate the value of the contract between the various elements of the contract based on the fair value of each element and recognize the revenue for each element when revenue recognition criteria are met. To determine the fair value of each element, the Company uses a variety of factors such as the requested price for an element when it is sold separately, price lists and any other information considered to be relevant by the management.

Revenues from the sale of portable audiovisual entertainment systems are recognized when the systems are delivered and accepted by the customer.

Revenues from the sale of licences are recognized proportionally according to the number of units sold over the minimal contractual quantity order for the term of the exclusivity period.

Revenues from after-sales technical support services and support services for the use of the audiovisual entertainment systems are recognized for on a straight-line basis over the term of the contract.

Rental revenues are recognized for at the time of use of the portable audiovisual entertainment systems.

The amounts received before the delivery of the products or the services are classified as deferred revenues.

Research and development costs and income tax credits
Research expenses are charged to expenses as incurred. Development expenses are charged to expenses as incurred unless they meet generally accepted accounting criteria for deferral and amortization. To date, no expenses have been deferred.

Research and development tax credits receivable have been estimated by management based on tax rules in effect at the date of preparation of the financial statements. These credits are subject to a subsequent revision by the tax authorities. The difference between the credits recorded and the credits granted, if any, will be recorded in the income statement in the year in which the difference arises.

Foreign currency translation
Monetary assets and liabilities in currencies other than the functional currency are translated at the exchange rates in effect at the balance sheet date. Non monetary assets and liabilities are translated at the exchange rate in effect at transaction dates. Revenues and expenses in foreign currencies are translated to the functional currency using the monthly average rate. Gains and losses on foreign currency translation are included in earnings (loss) for the year.

Income taxes
The Company uses the liability method to account for income taxes. Under this method, future income tax assets and liabilities are determined according to differences between the carrying amounts and the tax bases of assets and liabilities. They are measured using enacted or substantively enacted tax rates and laws expected to apply in years in which the temporary differences are expected to reverse.

The Company establishes a valuation allowance for future income tax assets if, according to the available information, it is more likely than not that a part of or all future income tax assets will not materialize.

Loss per share
The loss per common share is calculated on the weighted average number of shares outstanding during the year. All of the warrants and stock options described in Notes 12 and 13 were not included in the calculation of diluted loss per share because of their anti-dilutive effect in the years disclosed.

Future changes to accounting standards
Financial instruments – recognition and measurement, hedges and comprehensive income
In January 2005, the ASB issued three new standards dealing with financial instruments: (i) Financial Instruments – Recognition and Measurement; (ii) Hedges; and (iii) Comprehensive Income. The new standards are based on the U.S. FASB Statement 133, *Accounting for Derivative Instruments and Hedging Activities,* and on the International Accounting Standards ("IAS") Board's new standard, IAS 39, *Financial Instruments – Recognition and Measurement.* These requirements will be applicable for the Company in the first quarter of fiscal 2007.

The Handbook Section 3855, *Financial Instruments – Recognition and Measurement* prescribes when a financial instrument is to be recognized on the balance sheet and the measurement method, using fair value or using cost-based measures. It also specifies how financial instrument gains and losses are to be presented.

New Handbook Section 3865, *Hedges* allows optional treatment providing that hedges be designated as either fair value hedges, cash flow hedges or hedges of a net investment in a self-sustaining foreign operation. For a fair value hedge, the gain or loss attributable to the hedged risk is recognized in net income in the period of change together with the offsetting loss or gain on the hedged item attributable to the hedged risk. The carrying amount of the hedged item is adjusted for the hedged risk. For a cash flow hedge or for a hedge of a net investment in a self-sustaining foreign operation, the effective portion of the hedging item's gain or loss is initially reported in other comprehensive income and subsequently reclassified to net income when the hedged item affects net income.

The ASB has issued new Handbook Section 1530, *Comprehensive Income,* and amended *Surplus,* Section 3250 to be renamed *Equity,* Section 3251. These standards require that an enterprise disclose comprehensive income and its components, as well as net income in its financial statements; and that an enterprise disclose separately changes in equity during the period, as well as components of equity at the end of the period, including comprehensive income.

The Company does not expect these changes to have an effect on its results of operations.

3. Recapitalization

On April 14, 2004, the Company acquired all the issued and outstanding shares of 3721477 Canada Inc. in exchange for 30,000,000 of the Company's common shares, issued at a value of $6,000,000.

The control of the combined companies passed to the former shareholders of 3721477 Canada Inc., which is considered the acquirer. Consequently, the consolidated statements of earnings (loss) and deficit, contributed surplus and cash flows include 3721477 Canada Inc.'s consolidated statements of earnings (loss) and deficit, contributed surplus and cash flows from the date of inception (January 1, 2003) and Kangaroo Media Inc.'s results of operations and cash flows from April 14, 2004. The number of issued common shares is that of Kangaroo Media Inc. The acquisition, considered as a reverse takeover, was accounted for as a recapitalization of the Company.

At the date of acquisition, the fair value of the net assets of Kangaroo Media Inc. was as follows:

	$
Cash	2,688,852
Accounts receivable	268,520
Accounts payable	(151,489)
	2,805,883

4. Short-term investments, at cost

	2005	2004
	$	$
Certificates of deposit, bearing interest at rates varying from 1.30% to 3.25%, maturing at various dates from May 2006 to October 2006 (Note 19 d)	**2,865,992**	–
Money market investment fund	**–**	3,435,000
	2,865,992	3,435,000

5. Accounts receivable

	2005	2004
	$	$
Trade	**1,464,766**	–
Sales taxes receivable	**137,848**	39,240
Refundable research and development income tax credits	**239,127**	216,642
Other receivables	**91,258**	1,933
	1,932,999	257,815

6. Inventories

	2005	2004
	$	$
Raw material	**1,334,695**	36,378
Finished goods	**631,786**	–
	1,966,481	36,378

7. Property and equipment

			2005
	Cost $	**Accumulated Depreciation $**	**Undepreciated Cost $**
Distribution and production equipment	**408,559**	**105,787**	**302,772**
Rental equipment	**368,313**	**345,927**	**22,386**
Research and development equipment	**150,272**	**16,151**	**134,121**
Computer equipment	**157,239**	**60,055**	**97,184**
Molds	**134,907**	**57,637**	**77,270**
Furniture and fixtures	**68,767**	**9,344**	**59,423**
Leasehold improvements	**181,661**	**58,421**	**123,240**
Distribution and production equipment under a capital lease	**42,567**	**9,751**	**32,816**
	1,512,285	**663,073**	**849,212**

			2004
	Cost $	Accumulated Depreciation $	Undepreciated Cost $
Distribution and production equipment	250,331	35,317	215,014
Rental equipment	343,892	115,090	228,802
Research and development equipment	20,265	2,905	17,360
Computer equipment	69,998	18,279	51,719
Molds	43,820	14,023	29,797
Furniture and fixtures	25,962	1,621	24,341
Leasehold improvements	166,589	23,186	143,403
Distribution and production equipment under a capital lease	12,376	1,238	11,138
	933,233	211,659	721,574

The depreciation expense for the year ended December 31, 2005 was $296,997 ($211,659 in 2004).

During 2005, the Company wrote off rental equipment for rental with a net book value of $154,417. The Company does not anticipate selling or using any parts of this equipment.

8. Intangible assets

			2005
	Cost $	**Accumulated Amortization $**	**Unamortized Cost $**
Patents	**25,930**	**5,186**	**20,744**

			2004
	Cost $	Accumulated Amortization $	Unamortized Cost $
Patents	25,930	2,593	23,337

The amortization expense for the year ended December 31, 2005 was $2,593 ($2,593 in 2004).

9. Bank loan

On September 1, 2004, the Company signed an agreement for a loan of up to $239,500 secured by a first rank chattel mortage on existing and future receivables, including refundable research and development income tax credits. The loan bears interest at a monthly variable rate, as determined by the lender, plus 2%, or 8.50% as at December 31, 2005 (7.75% as at December 31, 2004). The loan is repayable upon receipt of the research and development income tax credits receivable and in any case no later than June 30, 2006. An amount of $193,190 was drawn against this facility as at December 31, 2005. Under the loan agreement, the Company has to maintain specific financial ratios. As at December 31, 2005, the Company met all the required financial ratios under the agreement.

During the year ended December 31, 2003, the Company signed a $750,000 operating bank facility bearing interest at the bank's base-rate plus 0.75%, renewable annually and secured by a director's personal guarantee. During the year ended December 31, 2004, all amounts drawn against this bank facility were repaid and the Company ended the facility.

10. Accounts payable and accrued liabilities

	2005	2004
	$	$
Accounts payable and accrued liabilities	**2,492,031**	364,230
Loans from shareholders, non-interest bearing	**–**	59,277
	2,492,031	423,507

11. Long-term debt

	2005	2004
	$	$
Loan, secured by the universality of property, bearing interest at a Canadian chartered bank base rate plus 3% (9.5% as at December 31, 2005; 7.25% as at December 31, 2004), redeemable by monthly instalments of $4,167, maturing in January 2008	**104,167**	154,167
Loan of a maximum of $700,000, secured by the universality of property, bearing interest at a weekly variable rate determined by the lender plus 4.5% (11.0% as at December 31, 2005; 10.25% as at December 31, 2004), redeemable by monthly capital instalments of $11,666, beginning in November 2005 and maturing in October 2010[a)]	**584,898**	286,737
Obligation under a capital lease, bearing interest of 17.42%, payable in monthly instalments of $1,028, maturing in February 2009	**23,717**	–
Obligation under a capital lease, bearing interest of 9%, payable in monthly instalments of $1,075, repaid in June 2005	**–**	6,281
	712,782	447,185
Less current portion	**178,763**	57,563
	534,019	389,622

a) On September 30, 2004, the Company signed a loan agreement to finance commercialization expenses for up to $700,000. As part of the agreement, the Company grants to the lender at the time of the disbursements an equivalent number of warrants representing 20% of each disbursement. The loan was recorded at the time of disbursement at its par value of $700,000 less the fair value of the related warrants issued, determined at $91,770 using the Black-Scholes pricing model.

Under the loan facility, the Company has to maintain specific financial ratios. As at December 31, 2005, the Company met all the required financial ratios under the facility.

The instalments on long-term debt for the next five years are as follows:

	Obligation under a capital lease $	Other long-term loans $
2006	10,184	168,579
2007	13,533	171,638
2008	–	125,805
2009	–	121,638
2010	–	101,405
	23,717	689,065

12. Capital stock and warrants

Authorized – unlimited number of common shares without par value

The following table sets forth a reconciliation of information on the Company's issued and outstanding common shares:

	Number	**Amount** **$**
Balance as at December 31, 2003[(1)]	30,000,000	83,884
Reverse takeover	22,259,833	1,949,088
Shares issued for cash (Note 12 a)	12,882,000	3,266,078
Shares issued following the exercise of warrants	406,666	82,080
Shares issued following the exercise of stock options	100,000	20,000
Balance as at December 31, 2004	65,648,499	5,401,130
Shares issued for cash (Note 12 b)	10,638,299	3,341,243
Shares issued following the exercise of warrants	7,532,835	3,248,856
Shares issued following the exercise of stock options	705,230	147,866
Balance as at December 31, 2005	**84,524,863**	**12,139,095**

(1) On the date of the reverse takeover, the Company issued 30,000,000 common shares in exchange for all the issued and outstanding shares of 3721477 Canada Inc.

Warrants

The following table sets forth a reconciliation of outstanding warrants:

	Number	**Amount** **$**
Balance as at December 31, 2003	–	–
Assumed during the reverse takeover	3,623,250	247,909
Issued during the year (Note 12 a)	14,812,403	1,481,719
Balance as at December 31, 2004	18,435,653	1,729,628
Issued during the year (Note 12 b)	10,784,834	1,539,733
Exercised during the year	(7,532,835)	(690,325)
Balance as at December 31, 2005	**21,687,652**	**2,579,036**

The following table sets forth information on outstanding and exercisable warrants as at December 31, 2005:

	Exercisable outstanding warrants	
Exercise price **$**	**Number**	**Weighted average contractual life (years)**
0.50	**10,775,895**	0.83
0.52	**273,458**	4.25
0.66	**10,638,299**	4.64
	21,687,652	2.62

a) On October 28, 2004, the Company completed a private financing for total proceeds of $4,704,534 in cash, net of a share issuance expense of $448,266, resulting from the issuance of 12,882,000 units for a cash consideration of $0.40 per unit, each unit containing one common share and one warrant, each warrant allowing its holder to acquire a common share at an exercise price of $0.50, for a two-year period following the issuance of the units. Pursuant to the Agency agreement with respect to the private financing, the Company also issued 901,740 non-transferable units at a price of $0.40, each unit allowing its holder to acquire a common share and one warrant, each warrant allowing its holder to acquire a common share at a price of $0.50, for a two-year period following the issuance of the units. The fair values of these warrants were estimated at $1,190,712 and $247,744, respectively, using the Black-Scholes pricing model with the following assumptions:

Risk-free interest rate	3.23%
Estimated life	2 years
Expected volatility	70%
Expected dividend yield	0%

On October 28, 2004, in accordance with the loan agreement of September 30, 2004 and following the first payment of $330,000, the Company issued 126,923 non-transferable warrants, each warrant allowing its holder to acquire one common share at a price of $0.52, for a five-year period following the issuance of the warrants. The fair value of these warrants was estimated at $43,263 using the Black-Scholes pricing model with the following assumptions:

Risk-free interest rate	3.92%
Estimated life	5 years
Expected volatility	70%
Expected dividend yield	0%

b) On March 30, 2005, in accordance with the loan agreement of September 30, 2004 and following the second disbursment of $370,000, the Company issued 146,535 non-transferable warrants, each warrant allowing its holder to acquire one common share at a price of $0.52, for a five-year period following the issuance of the warrants. The fair value of these warrants was estimated at $48,507 using the Black-Scholes pricing model with the following assumptions:

Risk-free interest rate	3.92%
Estimated life	5 years
Expected volatility	70%
Expected dividend yield	0%

On August 22, 2005, the Company completed a private financing for total proceeds of $4,832,469 in cash, net of a share issuance expense of $167,531, resulting in the issuance of 10,638,299 units for a cash consideration of $0.47 per unit, each unit containing one common share and one warrant, each warrant allowing its holder to acquire a common share at an exercise price of $0.66, for a five-year period following the issuance of the units. The fair value of these warrants was estimated at $1,491,226 using the Black-Scholes pricing model with the following assumptions:

Risk-free interest rate	3.35%
Estimated life	5 years
Expected volatility	70%
Expected dividend yield	0%

13. Stock option plan

a) On April 8, 2004, the Company introduced a stock-based compensation plan (the “Plan”), as amended on September 10, 2004 and August 11, 2005, available to its directors, officers, employees and consultants.

The Plan provides that the options granted will not exceed a five-year term, will be granted at a price which must not be less than the discounted market price on the last trading day of the listed shares before the date of the stock option grant, according to the terms set by the Company’s directors, the whole in accordance with the applicable regulatory policies.

According to changes made on August 11, 2005, the number of options that can be granted has been increased, subject to shareholders’ approval, to a maximum of:

- For beneficiaries, 5% of the issued and outstanding shares for any period of over 12 months;
- For consultants, 2% of the issued and outstanding shares; and
- For insiders, 10% of the issued and outstanding shares.

Any options granted must have a minimum 18-month vesting period, with a gradual and equal vesting period on at least a quarterly basis.

The following table summarizes stock option activities under the Plan for the year ended December 31, 2005:

	2005		2004	
	Number of stock options	**Weighted average exercise price $**	Number of stock options	Weighted average exercise price $
Outstanding, beginning of year	**6,106,428**	**0.27**	–	–
Granted	**3,850,000**	**0.65**	7,406,428	0.25
Exercised	**(705,230)**	**0.21**	(100,000)	0.20
Cancelled	**(172,865)**	**0.25**	(1,200,000)	0.15
Outstanding, end of year	**9,078,333**	**0.44**	6,106,428	0.27
Exercisable, end of year	**5,665,834**	**0.32**	4,453,698	0.20

	Outstanding stock options		**Exercisable stock options**	
Exercise price $	**Number**	**Weighted average remaining life (years)**	**Number**	**Weighted average remaining life (years)**
0.15	383,333	3.08	383,333	0.15
0.20	3,275,000	3.27	3,200,000	0.20
0.29	420,000	3.55	420,000	0.29
0.55	1,150,000	3.83	766,668	0.55
0.65	3,850,000	4.63	895,833	0.65
0.44	9,078,333	2.98	5,665,834	0.32

b) During the period preceding the reverse takeover, the Company granted 1,533,333 stock options at a price of $0.15 per common share and 4,150,000 stock options at a price of $0.20 per common share to Company directors, employees and consultants. The fair value of these stock options was estimated at $642,392 using the Black-Scholes pricing model with the following assumptions:

Risk-free interest rate	3.55% to 3.78%
Estimated life	5 years
Expected volatility	70%
Expected dividend yield	0%

From April 14, 2004 to December 31, 2004, the Company granted 1,690,230 stock options at prices varying from $0.285 to $0.55 per common share to directors and employees of the Company and 32,865 stock options at a price of $0.35 per common share to a consultant of the Company. The fair value of these stock options was estimated at $478,209 and $6,977, respectively, using the Black-Scholes option pricing model with the following assumptions:

Risk-free interest rate	3.78% to 3.93%
Estimated life	5 years
Expected volatility	70%
Expected dividend yield	0%

c) On August 11, 2005, the Company granted 800,000 stock options to a director of the Company and 3,050,000 stock options to officers of the Company. The exercise price of these shares is $0.65 per common share. The fair value of these stock options was estimated at $312,614 using the Black-Scholes option pricing model with the following assumptions:

Risk-free interest rate	3.92%
Estimated life	5 years
Expected volatility	70%
Expected dividend yield	0%

However, since the grant of these stock options remains subject to the approval of shareholders, they are not deemed authorized until such approval has been obtained. Therefore, no expense was recorded to the Company's earnings as at December 31, 2005.

d) For the year ended December 31, 2005, an amount of $51,064 was recorded as stock-based compensation expense for employees and $265,482 was recorded as stock-based compensation expense for non-employees.

For the year ended December 31, 2004, $630,573 was recorded as employees stock-based compensation expense and $79,158 as non-employees stock-based compensation expense, of which $575,675 and $12,131 were recorded respectively before April 15, 2004.

14. Related party transactions

On October 27, 2004, following an amendment to the agreement signed February 4, 2004, the Company committed to pay, starting January 1, 2004, an annual amount equal to 10% of the earnings before interest, income taxes, depreciation and amortization resulting from any products marketed under the “Kangaroo” trademark and any products using the same technology, to certain shareholders, one of which is a director and an officer, until these persons receive a total cumulative amount of $3,957,000. To date, no amount has been paid under the terms of this agreement.

During the year ended December 31, 2004, the Company paid a total amount of $344,166 in professional fees (of which $267,490 was accounted for as a reduction of equity and $76,676 as an expense) to a legal firm controlled by a director. These transactions took place in the normal course of business and were measured at the exchange amount, corresponding to the consideration established and accepted by the parties. No expenses were incurred towards this firm in the year ended December 31, 2005.

As at December 31, 2005 and in the normal course of business, the Company had $13,035 receivable from an officer ($59,277 payable in 2004).

15. Information on consolidated statement of earnings (loss) and deficit

Financial expenses

	2005	2004
	$	$
Bank charges and interest on bank loan	**63,708**	48,227
Interest on long-term debt	**146,731**	29,736
Interest income	**(91,881)**	(15,920)
Exchange loss (gain)	**72,122**	(9,376)
	190,680	52,667

Research and development expenses

Research and development expenses were respectively $839,153 and $367,928 during the years ended December 31, 2005 and December 31, 2004.

In addition, research and development income tax credits in the amounts of $22,485 for December 31, 2005 and $113,273 for December 31, 2004 were recorded against research and development expenses.

16. Income taxes

a) As at December 31, 2005, the Company had unused research and development expenses of $325,000 and $635,000 at the federal and provincial levels, respectively, that may be carried forward indefinitely to reduce future taxable income. The Company had available research and development income tax credits at the federal level in an amount of $50,000, which credits may be used until 2014 to reduce income taxes payable.

In addition, as at December 31, 2005, the Company had tax losses of $7,860,000 at the federal and provincial levels for which no income tax benefits have been recorded in the financial statements. These tax losses may be used in the following years:

	Federal	**Provincial**
	$	**$**
2007	1,000	1,000
2008	2,000	2,000
2009	357,000	357,000
2010	1,000,000	1,000,000
2014	2,750,000	2,750,000
2015	3,750,000	3,750,000
	7,860,000	7,860,000

b) The difference between the effective income tax rate and the statutory income tax rate is explained as follows:

	2005	2004
	%	%
Statutory income tax rate	**(34.0)**	(31.0)
Increase attributable to the following items		
Non-deductible stock-based compensation	**2.2**	1.2
Valuation allowance	**31.8**	29.8
	–	–

c) Future income taxes include the following items:

	2005	2004
	$	$
Non-capital loss carryforwards	**2,680,000**	1,234,539
Research and development expenses	**150,000**	133,963
Investment tax credits	**40,000**	49,033
Excess of tax value over the carrying value of property and equipment	**100,000**	61,330
Share issuance costs	**440,000**	261,539
	3,410,000	1,740,404
Valuation allowance	**(3,410,000)**	(1,740,404)
	–	–

17. Additional information on cash flows

Cash flows related to the changes in non-cash working capital items were as follows:

	2005	2004
	$	$
Accounts receivable	**(1,775,184)**	258,160
Inventories	**(1,930,103)**	11,851
Prepaid expenses	**(155,023)**	(17,568)
Accounts payable and accrued liabilities	**2,102,967**	(733,972)
Deferred revenues	**1,954,919**	–
	197,576	(481,529)
Additional information		
Interest paid	**117,139**	48,903
Acquisition of property and equipment included in accounts payable and accrued liabilities	**124,834**	–

18. Financial instruments

Fair value

The fair value of short-term financial assets and liabilities and of the obligations under a capital lease approximates their book value given that they will mature shortly.

The fair value of long-term borrowings is equivalent to their carrying values given that interest rates vary according to fluctuations in the market.

Credit risk

The financial instruments that subject the Company to potential credit risk consist of cash and cash equivalents, short-term investments and trade accounts receivable. To date, the Company has not incurred losses related to these instruments.

The Company allows relatively short payment terms and does not require guarantees. The Company carries out, on a continuing basis, assessments of its trade accounts receivable and maintains provisions for contingent losses on these accounts. To date, the Company has not incurred significant losses. Management believes that the financial risks associated with these financial instruments are minimal.

Foreign exchange risk

The Company realizes the major part of its revenue in foreign currencies, mainly in U.S. dollars. Its foreign currency risk is partially offset by purchases of capital assets and operating expenditures carried out in the same currency.

To date, the Company has not incurred significant losses related to foreign currency risk. The Company has not entered into foreign exchange contracts or other derivative financial instruments to mitigate this risk.

Interest rate risk

Cash and cash equivalents	Nil to 3.3%
Short-term investments	As indicated in Note 4
Accounts receivable	No interest
Sales taxes receivable	No interest
Refundable research and development income tax credits	No interest
Accounts payable and accrued liabilities	No interest
Long-term debt	As indicated in Note 11

19. Commitments

a) On March 23, 2004, the Company concluded a lease agreement ending in July 2007. The minimum lease payments for the remaining term of the agreement excluding property taxes and escalation clauses, totals $102,000. Minimum lease payments are $67,950 in 2006 and $34,050 in 2007. The agreement includes a renewal option for an additional two-year period.

b) On August 16, 2004, the Company signed a representation agreement providing assistance in business development and market positioning ending in July 2007. The minimum lease payments for the remaining term of the agreement totals $228,000 (US$190,000). Minimum payments for next years are $144,000 (US$120,000) in 2006 and $84,000 (US$70,000) in 2007. During the year, the Company incurred $197,126 ($50,843 in 2004) relating to this agreement.

c) The National Research Council of Canada has granted to one of the Company's subsidiaries, through its Industrial research assistance program, a grant of $250,000. This grant is repayable by annual instalments representing 2.89% of the prior year's revenues of the subsidiaries, from January 1, 2005 to December 31, 2015.The total amount repaid shall not exceed 150% of the contribution. If, following the expiry date, the balance is not entirely refunded, the Company will have no more obligations. Any refundable amounts under this program will be recorded in the Company's earnings in the same period as revenues are recognized. As at December 31, 2005, an accrual of $50,585 was recorded in research and development expenses ($2,000 in 2004).

d) As at December 31, 2005, the Company had issued letters of credit totalling US$2,143,842 to suppliers (none in 2004). These letters of credit were secured by short-term investments held by the Company.

20. Contingencies

In the normal course of business, the Company could be exposed to legal proceedings or litigation. Provisions are made when it is probable that the contingencies will create liabilities and that such liabilities are reasonably determinable. As at December 31, 2005, the Company had no such provisions.

21. Segmented information

The Company's activities are grouped under one reportable segment and all of the Company's long-lived assets are located in Canada.

a) Information by geographical segment is as follows:
Revenues are generated from customers residing in Canada and the United States. For 2005, the Company recognized revenues of:
- $28,270 from customers residing in Canada ($52,752 in 2004); and
- $1,132,373 from customers residing in the United States ($23,873 in 2004).

b) The Company's revenues for the year ended December 31, 2005 came essentially from a single customer which represented 99.9% of sales for the year (none in 2004).

22. Comparative figures

Certain comparative figures have been reclassified to conform with the presentation adopted in 2005.

23. Subsequent events

a) On March 21, 2006, the Company concluded a private placement on a firm underwriting basis for 17,393,000 of the Company's common shares, at a price of $1.15 per share, for gross proceeds of $20,001,950.
Proceeds from the placement take into account the exercise by the underwriters of their option on 2,610,000 shares at $1.15 per share. The underwriters will receive a total commission equal to 6.0% of gross proceeds from the sale of the shares.

b) In March 2006, the Company accepted a financing offer from a banking institution for a line of credit of a maximum amount of US$6,000,000, a financing in the form of an allowance on trade accounts receivable factoring in a maximum amount of US$3,000,000, and a term loan in a maximum amount of $1,200,000 for the acquisition of certain assets.

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Alain Charette
Executive Vice President,
Corporate Development

Jean Arseneau
Chief Technology Officer

Normand Chartrand
Chief Financial Officer

Stéphane Lambert
Director,
Production and Logistics

Board of Directors

Pierre Boivin
Chairman of the Board,
President, Club de hockey
Canadien and Bell Centre

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President and CEO,
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Jean-Denis Talon
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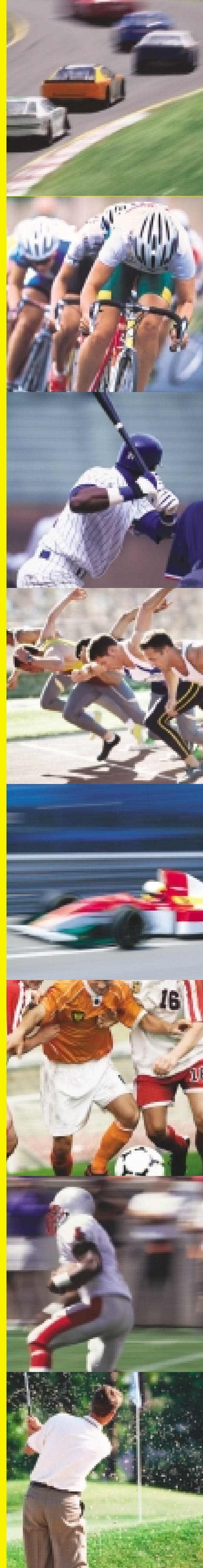

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