
Versatile Systems Inc.

(formerly Versatile Mobile Systems (Canada) Inc.)

Consolidated Financial Statements**December 31, 2005**

(Unaudited - Prepared by Management)

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Versatile Systems Inc.
Consolidated Balance Sheets
(Unaudited - Prepared by Management)

	December 31, 2005	June 30, 2005
	(unaudited)	
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 122,372	\$ 183,598
Accounts receivable	14,450,137	13,559,290
Current portion of deferred contract costs	5,046,345	3,415,850
Work in progress	43,461	216,066
Prepaid expenses	839,644	517,092
Inventory	1,214,537	1,552,906
	<u>21,716,496</u>	<u>19,444,802</u>
Deferred contract costs	548,345	381,375
Capital Assets	359,145	450,621
Intangible assets	3,420,491	4,076,042
Future income tax asset	1,419,255	-
Goodwill	12,595,561	12,595,561
	<u>\$ 40,059,293</u>	<u>\$ 36,948,401</u>
LIABILITIES		
Current Liabilities		
Line of credit	\$ 20,002	\$ 376,259
Bank Overdraft	829,084	144,367
Accounts payable and accrued liabilities	14,544,464	13,718,838
Current portion of deferred revenue	6,706,221	5,257,654
Bank term loan (note 3)	3,205,366	3,369,497
Promissory notes (note 4)	4,896,780	5,964,587
Current portion of capital lease obligations	6,613	6,952
	<u>30,208,530</u>	<u>28,838,154</u>
Bank Loan	204,033	214,480
Deferred Revenue	630,694	447,969
Capital Lease Obligations	10,356	13,689
	<u>31,053,613</u>	<u>29,514,292</u>
SHAREHOLDERS' EQUITY		
Common Shares (note 5)	59,696,239	59,779,153
Warrants (note 6)	360,111	458,715
Contributed surplus	3,119,201	2,481,183
Deficit	(54,003,513)	(54,716,914)
Foreign currency translation adjustment	(166,358)	(568,028)
	<u>9,005,680</u>	<u>7,434,109</u>
	<u>\$ 40,059,293</u>	<u>\$ 36,948,401</u>

APPROVED BY THE DIRECTORS:

DIRECTOR: *John Hardy*

DIRECTOR: *Fraser Atkinson*

See Notes to Consolidated Financial Statements

Versatile Systems Inc.
Consolidated Statements of Operations and Deficit

(Unaudited - Prepared by Management)

	Three months ended		Six months ended	
	December 31		December 31	
	2005	2004	2005	2004
	(unaudited)			
SALES	\$ 17,765,850	\$ 2,865,311	\$ 34,549,159	\$ 6,677,220
COST OF SALES	\$ 14,369,649	\$ 2,002,512	27,689,673	4,938,802
	3,396,201	862,799	6,859,486	1,738,418
EXPENSES				
General and administrative	1,171,137	480,602	2,501,121	1,164,579
Selling and marketing	1,461,146	639,560	3,092,336	1,231,969
Research and development	492,618	175,128	959,658	342,288
	3,124,901	1,295,290	6,553,115	2,738,836
NET EARNINGS (LOSS) BEFORE OTHER ITEMS	271,300	(432,491)	306,371	(1,000,418)
Interest	71,161	794	203,674	1,651
Amortization of capital assets	22,299	34,882	87,312	113,033
Amortization of intangible assets	332,027	23,854	658,580	14,772
Stock-based compensation	37,951	3,198	72,360	6,396
NET EARNINGS (LOSS) BEFORE INCOME TAXES	(192,138)	(495,219)	(715,555)	(1,136,270)
Current income tax expense	(13,175)	35	(16,390)	(1,011)
Future income tax benefit	959,757	-	1,445,346	-
NET EARNINGS (LOSS) FOR THE PERIOD	754,444	(495,184)	713,401	(1,137,281)
DEFICIT, BEGINNING OF PERIOD	(54,757,957)	(53,733,036)	(54,716,914)	(53,090,939)
DEFICIT, END OF PERIOD	(54,003,513)	(54,228,220)	\$(54,003,513)	\$(54,228,220)
NET EARNINGS (LOSS) PER SHARE:	\$0.01	(\$0.01)	\$0.01	(\$0.01)

See Notes to Consolidated Financial Statements

Versatile Systems Inc.
Consolidated Statements of Cash Flows

(Unaudited - Prepared by Management)

	Three months ended		Six months ended	
	December 31		December 31	
	2005	2004	2005	2004
CASH FLOWS FROM (USED IN) OPERATING ACTIVITIES				
Net earnings (loss) for the period	\$ 754,444	\$ (495,184)	\$ 713,401	\$(1,137,281)
Items not affecting cash				
Amortization of capital and intangible assets	354,326	58,736	745,892	127,805
Stock-based compensation	37,951	3,198	72,360	6,396
Future income tax benefit	(959,757)		(1,445,346)	-
Cash flow from(used in) operations before other items	186,964	(433,250)	86,307	(1,003,080)
Unrealized foreign exchange	(56,116)	(225,826)	401,670	(342,843)
Net change in non-cash working capital items	(473,634)	(71,466)	405,017	159,009
	(342,786)	(730,542)	892,994	(1,186,914)
CASH FLOWS FROM (USED IN) INVESTING ACTIVITIES				
Non-current Deferred contract costs	(187,041)		(166,970)	-
Additions to capital assets	(13,431)	(2,416)	(71,576)	(15,378)
	(200,472)	(2,416)	(238,546)	(15,378)
CASH FLOWS FROM (USED IN) FINANCING ACTIVITIES				
Proceeds from issuance of shares	-	6,667	411,500	6,667
Share issue costs	-	-	(4,560)	-
Proceeds (Repayment) of line of credit	20,002	-	(356,257)	-
Non-current Deferred revenue	206,300	-	182,725	-
Payment of Quarterly Payment	(80,660)	-	(163,254)	-
Payment of VAC Notes	(782,156)	-	(782,156)	-
Repayment of capital lease obligations	(1,185)	(2,691)	(3,672)	(6,429)
	(637,698)	3,976	(715,674)	238
Decrease in cash and cash equivalents	(1,180,956)	(728,982)	(61,226)	(1,202,054)
CASH and cash equivalents, beginning of period	1,303,328	1,557,176	183,598	2,030,248
CASH and cash equivalents, end of period	\$ 122,372	\$ 828,194	\$ 122,372	\$ 828,194
Supplementary information				
Cash paid for interest expense	77,150	1,281	154,514	\$ 2,652
Cash paid for income taxes	13,175	977	3,215	970
Non cash items				
Shares issued pursuant to Financial Services Agreement			-	27,450

See Notes to Consolidated Financial Statements

Versatile Systems Inc.**Notes to Consolidated Financial Statements****For the period ended December 31, 2005**

(Unaudited - Prepared by Management)

1. Consolidated financial statement presentation:

These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company's annual financial statements for the year ended June 30, 2005. These financial statements have not been audited or reviewed by the Company's auditors.

On November 16, 2005 the Company received Certificate of Continuance under the British Columbia Business Corporations Act effecting the change of the corporate jurisdiction of the Company from the Yukon to British Columbia and change in the name to Versatile Systems, Inc.

The ability of the Company to continue operations on an ongoing basis will be dependent on its ability to continue to generate sales at these levels, maintain profitable operations, maintain or increase margins, control operating expenses and pay its obligations as they become due.

2. Changes in accounting policies:

The accounting policies applied in these interim financial statements are consistent with those applied in the Annual financial statements. The following changes in accounting policies have been made in the past two years.

(a) Stock-based compensation:

Prior to July 1, 2003, the Company applied the intrinsic method of accounting prescribed by CICA Handbook Section 3870, "Stock-Based Compensation and Other Stock-Based Payments" ("HB 3870") to employee stock options. Under the intrinsic method, deferred stock-based compensation is recorded if, on the date of grant of the stock option to an employee, the current market value of the underlying common share exceeds the exercise price per share.

The CICA Accounting Standards Board has amended HB3870 to require entities to account for employee stock options using the fair value based method, beginning January 1, 2004. The Company has adopted the fair value method on a prospective basis for all grants made subsequent to June 30, 2003.

Under the fair value based method, compensation cost is measured at fair value at the date of each grant and is expensed over the award's vesting period. The Company has applied the fair value based method to all employee stock options granted on or after July 1, 2003. The quarterly results prior to January 1, 2004 were not amended, as the amounts were insignificant.

(b) Intangible assets:

Intangible assets acquired individually or with a group of assets are initially recognized and measured at cost. The cost of a group of intangible assets acquired in a transaction, including those acquired in a business combination that meet the specified criteria for recognition apart from goodwill, is allocated to the individual assets acquired based on their relative fair values.

Intangible assets with finite useful life relate to acquired software licenses and are amortized over their estimated useful life. The amortization methods and estimated useful lives of intangible assets are reviewed annually.

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(Unaudited - Prepared by Management)

During the 2005 fiscal year the Company reviewed the estimated useful lives of the intangible assets. After the review, the Company increased the estimated useful lives of the intangible assets from three years to four years.

3. Bank term loan

On April 26, 2005 the Company obtained a term loan in the amount of U.S. \$2,749,263 from the Commerce Bank. The term loan is repayable on April 26, 2006, bears interest at the State of New York prime rate plus 1% and is secured with a first charge on the company's assets. Monthly repayments consist of interest only with the principal due at the end of the term.

4. Promissory notes

On April 26, 2005, as part of the consideration for the acquisition of Perfect Order, the company issued unsecured promissory notes to pay U.S. \$1,000,000 bearing interest at the rate of 3% per annum and due within the current fiscal year (the "POAC Notes") and secured promissory notes to pay U.S. \$4,200,000 bearing interest at the rate of 3.1% per annum and due on April 25, 2006 (the "Promissory Notes"). The Company repaid U.S. \$333,333 of the POAC Notes on June 30, 2005 and the balance of \$666,667 on November 10, 2005. The Vendors may convert up to one-half of their Promissory Notes on or before February 25, 2006, into shares of Versatile at the rate of one common share for each \$0.425 (U.S. \$0.34) of the Promissory Note.

5. Common Shares

Authorized

500,000,000 common shares without par value

Issued and outstanding

Issued and outstanding - June 30, 2005

Shares issued pursuant to a private placement

Less share issue costs

Cancellation of the shares held in trust

Issued and outstanding - December 31, 2005

	Number	Amount
	96,187,926	\$59,779,153
	1,646,000	345,660
	-	(4,560)
	(690,000)	(424,014)
	97,143,926	\$59,696,239

On August 10, 2005, the Company completed a non-brokered private placement for 1,646,000 Units at a price of \$0.25 per Unit for gross proceeds of \$411,500. Each Unit consisted of one common share and one common share purchase warrant. Each common share purchase warrant entitles the holder to purchase one common share of the Company for a period of twenty-four months after the Closing Date at a price of \$0.30 per common share. The Company assigned a value of \$0.21 to each common share and \$0.04 to each warrant. The common shares and warrants are subject to a four-month hold period.

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5. Common Shares (continued)

On August 19, 2005 Computershare Trust Company released the 690,000 common shares, held in trust for employees of VMS-Europe pursuant to a trust agreement dated in 1993, to the transfer agent who subsequently cancelled these shares, the effect of which reduces the issued common shares.

6. Warrants

Issued and outstanding:

Expiry date	Exercise Price	Number of Warrants	Amount
April 22, 2007	\$ 0.35	5,135,413	\$ 256,771
April 25, 2007	\$ 0.345	750,000	37,500
August 10, 2007	\$ 0.30	1,646,000	65,840
Balance - December 31, 2005		7,531,413	\$ 360,111

During the period ended September 30, 2005 4,111,110 warrants expired.

7. Stock Options

	Number of Shares	Weighted average exercise price
Balance - June 30, 2005	7,271,668	\$ 0.21
Granted during the first quarter	600,000	\$ 0.30
Granted during the second quarter	1,102,300	\$ 0.25
Expired during the second quarter	(850,000)	\$ 0.10
Balance - December 31, 2005	8,123,968	\$ 0.23

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8. Income taxes

Canadian GAAP requires a valuation allowance to be recorded against any future tax asset to the extent that it is more likely than not that the future income tax asset will not be realized. This is also the Company's stated accounting policy.

Historically, the Company has determined that it has not met this test so the Company has recorded a full valuation allowance against the potential value of all of its tax losses and deductions available to be taken against future years' income tax returns. As a result there has been no future income tax asset.

During the current fiscal year, the Company has determined that the U.S. subsidiaries are generating sufficient profits that it is more likely than not that a portion of the losses and deductions attributable to these U.S. subsidiaries will be used. Consequently, Canadian GAAP and the Company's stated policy requires that the valuation allowance be reduced accordingly. The difference between the total value of these tax benefits less the valuation allowance is the amount of the future income tax asset that is recorded by the Company.

During the quarter the Company recorded a \$959,757 non-cash income tax benefit related to the recognition of future income tax assets of its U.S. subsidiaries. In the first quarter the Company recorded a future income tax benefit of \$484,589.