

## MANAGEMENT'S DISCUSSION AND ANALYSIS

*The following Management's Discussion and Analysis ("MD&A") provides discussion and analysis of the three months ended March 31, 2007 and 2006, and should be read in conjunction with the unaudited consolidated financial statements as at and for the three months ended March 31, 2007, and should also be read in conjunction with the audited consolidated financial statements and the MD&A for zed.i solutions inc. ( the "Company" or "Zedi")for the year ended December 31, 2006*

*The annual consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). The Company reports on certain non-GAAP measures that are used by management to evaluate performance of the business. Because non-GAAP measures do not have a standardized meaning, securities regulators require that non-GAAP measures be clearly defined and qualified, reconciled to their nearest GAAP measure and be given no more prominence than the closest GAAP measure. For the reader's reference, the definition, calculation and reconciliation of non-GAAP measures is provided in section 13: Reconciliation of Non-GAAP Measures.*

*Additional information is available on the Company's website ([www.zedi.ca](http://www.zedi.ca)) and all previous public filings, including the annual information form (AIF), are available through SEDAR ([www.sedar.com](http://www.sedar.com)).*

### **Forward-Looking Statements**

Certain statements contained in this MD&A constitute forward-looking statements. These statements relate to future events or the Company's future performance. All statements other than statements of historical fact may be forward-looking statements. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements. The Company believes that the expectations reflected in those forward-looking statements are reasonable but no assurance can be given that these expectations will prove to be correct and such forward-looking statements included in this MD&A should not be unduly relied upon.

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## **1 Business Overview**

Zedi specializes in production operations management, delivering systems and services that help oil and gas producers to better manage people, assets and information. We help our customers increase earnings and decrease operating costs, through improved utilization of assets. In addition, our solutions and services help our customers mitigate compliance risk.

Established in 1987, Zedi™ has over 240 upstream, midstream and oilfield services customers who are primarily located in Western Canada. Zedi monitors over 7,600 wells and manages over 100,000 assets with our solutions that are delivered through five lines of business:

- a. *Zedi Fixed Asset Management™* – the business of maximizing the utilization and effectiveness of fixed assets used during production operations, plus meeting compliance standards, all delivered through Roughneck™.
- b. *Zedi Health, Safety & Environment™* – the business of tracking, reporting, managing, and communicating HS&E programs to ensure a safe work environment and regulatory compliance, delivered through our Roughneck application.
- c. *Zedi Surveillance™* – the business of monitoring, collecting, and digitizing high quality data at the source, delivered with Smart-Alek®, Zedi SCADA™, Smart-Skid™ and MTRAC®.
- d. *Zedi Production Optimization™* – the business of analyzing the data collected and taking action to impact operations in order to improve hydrocarbon production, and is delivered to our customers through tools available on [www.smart-alek.com](http://www.smart-alek.com), and with our Zedi SCADA and embedded MTRAC offerings.
- e. *Zedi Production Volume Measurement™* – the business of web-based, on demand, production and revenue accounting, delivered through our PetroNet™ application.

## **2 Corporate Vision and Strategy**

The vision of Zedi is to be a global leader in the management of decentralized production operations through continued focus on:

- a. *People* – Zedi will partner with its employees to promote their personal development, growth and success and together they achieve and share the benefits of corporate success.
- b. *Customers* – With a primary view toward improving customer earnings, Zedi will structure all of its customer interactions to deliver a personal experience that positively addresses customer needs, enabling them to achieve greater success.
- c. *Data* – Zedi will deliver and further develop products and services that add to the quality and quantity of well and field operation data and increase its value by transforming it to information.
- d. *Open Interface* – Zedi will leverage the high data value through developing the FINE® system, Zedi's intelligent network, to be vendor neutral, seeking to be an industry standard and enabling broad surveillance inputs and application extractions through an open interface.
- e. *Execution* – Zedi will balance near term returns with long term wealth by focusing on market sectors that it can dominate and by making pragmatic decisions that maximize shareholder return.

### **3 Key Performance Indicators**

Zedi monitors a number of key performance indicators including those set out below (*see selected quarterly information table for past eight quarters in section 5*). In addition, Zedi tracks a number of customer specific indicators:

- a. **RECURRING REVENUE AS A PERCENTAGE OF OPERATIONS AND SG&A**  
Growth of this indicator ensures that our decisions and actions are supporting a strategy of building a significant foundation of recurring revenue in relation to the size of the operations. This also serves to measure our success in structuring our operations on a scalable basis.
- b. **RECURRING REVENUE AS A PERCENTAGE OF TOTAL CASH EXPENDITURES**  
This indicator combines the investment in R&D and capital assets with the operating expenses to monitor the scalability of the business model with operating and investing activities combined.
- c. **TOTAL REVENUE**  
This measure is an overall indication of our success and progress toward achieving a dominant position in the marketplace.
- d. **PERCENT GROSS MARGIN**  
This serves to measure our success in developing and delivering our products and services efficiently and on a scalable basis.
- e. **INCOME PER SHARE**  
As a primary measure of return to shareholders, this measure also ensures the acquisitions we make are accretive to shareholders.

### **4 Overall Performance**

#### **4.1 Materiality for Disclosure**

Management determines whether or not information is “material” based on whether it believes a reasonable investor’s decision to buy, sell or hold securities in the Company would be significantly influenced or changed if the information were omitted or misstated.

#### **4.2 Events or Activities Impacting the Business in the First Quarter of 2007**

Activities that took place during Q1 of 2007 that will have both short and long term impact include:

- A launch of our new brand in early February with events for customers, analysts and employees. The launch was designed to provide a strategic repositioning of Zedi products and solutions to better reflect the offerings and the value delivered for production operations practices in the oil and gas industry.
- A 63% reduction in drilling activity year over year resulted in fewer wells being completed in Q1. This reduced activity impacted the demand for monitoring equipment and resulted in lower revenues in the first quarter.
- Strengthening commodity pricing related to decreased gas storage volume as a result of lower drilling activity. This reflects the sensitive supply and demand balance for natural gas and will create some pressure to increase drilling activity.
- The introduction and delivery of a calendar of customer training sessions delivered in a classroom setting and on-line instructor led training. The sessions were filled to capacity with high satisfaction ratings from participants. We believe corporate adoption of our solutions will be directly impacted by the ability of our customers to effectively utilize the tools we deliver.
- The corporate adoption of PetroNet Production Accounting by Crescent Point Energy Trust and Duvernay Oil Corp. was announced in January. The adoption by these two

organizations and others resulted in a 17% overall increase in our PetroNet customer base during Q1.

- An agreement with NAL Resources Management Ltd. to utilize the Zedi Fixed Asset Management™ solution in its operations management practices.
- The rollout of a balanced scorecard and variable compensation program using Revenue as the gating factor with measurements related to Business Efficiency, Customer Excellence, Team, Technical Development & Project Delivery, Business Development and Investor Relations.

#### **4.3 Impact of Stock-Based Compensation on Reported Results**

Throughout this MD&A the Company will at times describe or discuss results with Stock-based compensation not included. The following information will provide readers of our financial statements with an opportunity to fully understand the impact of stock-based compensation on results and to provide context for the Company's discussion of results with stock-based compensation excluded.

The Company currently has three forms of stock-based compensation: stock options, deferred share units and restricted share units.

##### Stock Options

The shareholders of the Company approve the stock option plan each year at the AGM. The current plan authorizes the Board of Directors of the Company to grant options numbering up to 10% of the number of issued and outstanding shares, which structure has remained unchanged since the Company's initial public offering. As an important part of the Company's compensation strategy options are granted annually to all employees to recruit and retain the best talent. All options are granted at market price on the date of grant, vest in thirds on the first three anniversaries from the date of grant and expire in thirds on the second third and fourth anniversaries. This results in a rolling plan with options expiring each year and new ones being granted at market prices at that time.

The following table shows the status of stock options outstanding for the first quarter 2007 and for the year 2006:

	<u>March 31, 2007</u>		<u>December 31, 2006</u>	
	<b>Options</b>	<b>Weighted Average Exercise Price</b>	<b>Options</b>	<b>Weighted Average Exercise Price</b>
Outstanding, beginning of year	<b>10,222,763</b>	<b>\$ 1.33</b>	9,143,357	\$ 1.41
Granted	-	-	4,306,496	1.02
Exercised	<b>(174,344)</b>	<b>0.42</b>	(1,804,147)	0.44
Expired/cancelled	<b>(142,033)</b>	<b>1.68</b>	(1,422,943)	1.92
Outstanding, end of period	<b>9,906,386</b>	<b>\$ 1.34</b>	10,222,763	\$ 1.33
Options exercisable, end of period	<b>2,854,649</b>		2,471,986	

Exercise Prices	<u>Options Outstanding</u>			<u>Options Exercisable</u>		
	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price	
\$0.00-\$0.20	3,334	1.1 yrs	\$0.20	3,334	\$0.20	
\$0.21-\$0.49	332,691	0.8 yrs	\$0.42	332,691	\$0.42	
\$0.50-\$1.00	3,423,249	3.7 yrs	\$0.91	3,334	\$0.62	
\$1.01-\$2.00	4,910,213	2.5 yrs	\$1.47	1,509,911	\$1.47	
\$2.01-\$2.88	1,236,899	1.8 yrs	\$2.32	1,005,379	\$2.31	
<b>\$0.20 - \$2.88</b>	<b>9,906,386</b>	<b>2.8 yrs</b>	<b>\$1.34</b>	<b>2,854,649</b>	<b>\$1.64</b>	

#### Deferred Share Units

A deferred share unit is compensation paid in the form of a right to a share that is not received until the occurrence of a future event. The Company currently offers to directors an option to receive compensation for directors' fees either in cash or deferred share units. Directors' fees are currently \$18,000 per year.

#### Restricted Share Units

A restricted share unit is compensation paid in the form of a right to a share that is not received until a later date.

#### Stock-based Compensation Expense

The total of the stock-based compensation expense for Q1 2007 was \$640,834, which is broken down in the table below.

The portion of the expense related to stock options is calculated using the Black-Scholes option pricing model at the time the options are granted. The model incorporates an historical volatility analysis to determine valuation. Historical volatility may or may not be a reliable indication of future volatility. Although the expense is calculated at the time options are granted, it is reported over the vesting period for the options. The Company's standard vesting period is three years in which case the expense will be reported proportionately in each of the next 12 quarters from the date of grant.

The following table shows the breakdown of the stock-based compensation expense reported in Q1 2007.

<b>Annual Option Grant Date</b>	<b>Number of options outstanding as at Mar. 31, 2007</b>	<b>Exercise Price</b>	<b>Expensed in Q1 2007</b>	<b>Remaining to be expensed in future periods.</b>
January 29, 2004	282,691	\$0.42	\$ 2,607	\$ -
January 6, 2005	1,162,562	\$2.30	201,475	178,886
November 1, 2005 <sup>1</sup>	3,948,879	\$1.46	227,714	1,472,971
December 13, 2006	3,419,915	\$0.91	116,049	1,276,019
Various dates <sup>2</sup>	1,092,339	\$1.51 <sup>3</sup>	92,837	439,965
Option Totals	9,906,386		\$640,682	\$ 3,367,841
<b>DSU Grant Date</b>	<b>Number of DSUs as at Mar. 31, 2007</b>	<b>Price</b>	<b>Expensed in Q1 2007</b>	<b>Remaining to be expensed in future periods.</b>
June 30, 2006	2,143	\$0.97	\$ 43	-
September 29, 2006	3,879	\$0.97	78	-
December 31, 2006	1,579	\$0.97	31	-
September 25, 2006	250,000	\$1.16	-	-
DSU Totals	257,601	\$0.97	\$ 152	-
<b>RSU Grant Date</b>	<b>Number of RSUs as at Mar. 31, 2007</b>	<b>Price</b>	<b>Expensed in Q1 2007</b>	<b>Remaining to be expensed in future periods.</b>
September 25, 2006	400,000	\$1.16	-	-
RSU Totals	400,000	\$1.16	-	-
All stock-based comp. totals			\$640,834	
<sup>1</sup> The timing of the annual grant was shifted from the beginning of the year to the fall board meeting to align with annual compensation program reviews. <sup>2</sup> There are some options granted in between the annual grants related to new hires during the year or staff added through acquisitions. <sup>3</sup> This is the weighted average exercise price.				

## Discussion of Performance Results Excluding the Stock-based Compensation Expense

Significant historical share price volatility has impacted the valuation of stock options for the purpose of recording of a stock-based compensation expense. A number of options that have already been expensed have in fact expired without being exercised and a large number of options that were expensed in the first quarter of 2007 remain significantly out of the money. The expensed options do not impact cash flow or the operations of the Company. From the table above the reader can assess the specific options that the expense relates to, a significant portion of the expense being for options that are significantly out of the money and some of which having already expired. Therefore, the Company will at times discuss the performance of the Company with this expense excluded (a reconciliation to the nearest GAAP measure is provided in section 13).

Although there is no cash impact from stock-based compensation the Company recognizes there is a dilutive effect and therefore the Company believes that "earnings per share fully diluted" is a reliable method of measuring value with the impact of stock-based compensation taken into account. Where the Company discusses a result with stock-based compensation not included it also discusses the result including stock-based compensation so that the reader can accurately assess the performance of the Company.

### **4.4 Consolidated Highlights**

(\$ in thousands except per-share amounts)	Three Months ended March 31			
	2007	2006	Change	% Change
Revenue	8,435	11,308	(2,873)	(25%)
Gross Profit	4,347	5,230	(883)	(17%)
EBITDA <sup>(1)</sup>	1,451	2,206	(755)	(34%)
Net Income before income taxes	887	1,808	(921)	(51%)
Net income	316	2,708	(2,392)	(88%)
Net income per share, basic	0.00	0.03	(0.03)	N/A
Net Income per share, diluted	0.00	0.03	(0.03)	N/A
Cash from operations	2,806	2,034	772	38%
Free cash flow <sup>(2)</sup>	1,200	2,020	(820)	(41%)

<sup>(1)</sup> Earnings before interest, taxes, depreciation and amortization is a non-GAAP measure. See Section 13.1 Earnings before interest, taxes, depreciation and amortization (EBITDA)

<sup>(2)</sup> Free cash flow is a non-GAAP measure. See Section 13.2 Free cash flow.

The following table reviews some results excluding stock-based compensation (please see section 4.3 above for a full explanation of the stock-based compensation expense).

(\$ in thousands except per-share amounts)	Three Months ended March 31			
	2007	2006	Change	% Change
Net Income before income taxes <sup>(1)</sup>	1,528	2,347	(819)	(35%)
Net Income per share before taxes, basic <sup>(1)</sup>	0.01	0.02	(0.01)	(50%)
Net Income per share before taxes, diluted <sup>(1)</sup>	0.01	0.02	(0.01)	(50%)
<sup>(1)</sup> This is a non-GAAP measure. See Section 13 for reconciliation to the nearest GAAP measure.				

The Company continues to maintain positive growth trends. For specific comments on trends and financial performance please see sections 5.3 and 6 below.

## 5 Selected Quarterly Information

### 5.2 Quarterly Results Summary

The following table sets forth certain financial information on a consolidated basis for the last eight financial quarters:

	2007	2006			2005			
(expressed in \$000's except per share and % amounts)	First Quarter	Fourth Quarter	Third Quarter	Second Quarter	First Quarter	Fourth Quarter	Third Quarter	Second Quarter
Total Revenues	<b>8,435</b>	10,760	6,793	8,276	11,308	9,348	5,986	5,888
Recurring Revenue <sup>(1)</sup>	<b>2,123</b>	2,220	1,764	1,651	1,425	1,303	1,176	1,045
Recurring Revenue <sup>(1)</sup> as a % of Operation Expenses <sup>(2)</sup>	<b>94%</b>	90%	93%	73%	57%	65%	70%	60%
Recurring Revenue <sup>(1)</sup> as a % of Total Cash Expenditures <sup>(3)</sup>	<b>66%</b>	65%	68%	54%	44%	56%	58%	41%
Percent Gross Margin	<b>52%</b>	49%	44%	43%	46%	48%	52%	49%
Income (Loss)	<b>316</b>	1,759	(850)	402	2,708	1,813	2,517	349
Income (Loss) (per share) - basic and diluted	<b>0.00</b>	0.02	(0.01)	0.00	0.03	0.02	0.03	0.00
Income before taxes excluding the stock-based compensation expense <sup>(4)</sup>	<b>1,528</b>	3,827	504	675	2,347	1,911	921	755
Income per share before taxes excluding stock-based compensation expense - basic and diluted <sup>(4)</sup>	<b>0.01</b>	0.04	0.01	0.01	0.02	0.02	0.01	0.01
Note: <sup>(1)</sup> Recurring Revenue includes all fees that are billed to customers on a recurring basis. <sup>(2)</sup> Operational Expenses includes all expenses except for Stock based compensation. In addition, the \$1,656,000 reduction in R&D expense recorded in Q4 2006 is not included in Operational Expenses. <sup>(3)</sup> Total Cash Expenditures includes all Operational Expenses plus the amount of R&D deferred in the period and all amounts for the acquisition of capital assets. In addition, the \$1,656,000 reduction in R&D expense recorded in Q4 2006 is not included in Operational Expenses. <sup>(4)</sup> This is a non-GAAP measure. See Section 13 for reconciliation to the nearest GAAP measure.								

### 5.3 Comments on Corporate Performance Trends

Revenue in the first quarter reflects the general slow down that has been experienced in the Canadian oil and gas industry, with a 25% drop in revenue compared to the first quarter of 2006. Despite the lower revenue, the Company increased the percent gross margin and continued to see growth in the recurring revenue as a percent of operation expenses and total cash requirements. The Company anticipates activity in the industry to remain slower than 2006 for the next two quarters.

The recurring revenue in Q1 of \$2,123,000 is down slightly from Q4 2006, which is not an actual drop in the recurring revenue. At the end of 2006 there were some year end adjustments to recognize some fees that were not recognized earlier in the year, which resulted in the Q4 recurring revenues being slightly higher. If those amounts had been recognized throughout 2006 the growth trend of recurring revenue would be very linear. Recurring revenue as a percentage of operational expenses continues to grow year over year. The Company expects there to be some fluctuation in this number

quarter to quarter but tracks the year over year trend to be sure the Company is continuing to take advantage of the scalability of its business model. For 2006 the percent of recurring revenue to operating expenses was 77%, growing from 66% in 2005, 51% in 2004 and 27% in 2003. Management expects growth of recurring revenue to continue.

At the end of 2006 the Company added a second key performance indicator related to recurring revenue. By combining the investment in R&D and capital assets with the operating expenses the Company is able to monitor the ability of recurring revenue to meet the total cash requirements. The trend tracks relatively close to the prior measure, looking solely at operation expenses. For 2006 the percent of recurring revenue to total cash expenditures is 57%, growing from 49% in 2005, 46% in 2004 and 25% in 2003. Management expects this type of growth trend for the recurring revenue to continue as we have achieved in the past. This trend is very positive, validating the strength of the business model and demonstrating significant financial stability for the future.

Percent gross margin continues to improve from lower levels experienced in 2006 as the impact from the 1xRtt transition program was completed. In addition, the Company released a new model of the Smart-Alek in the fourth quarter, which has reduced costs, with higher margins than the older model. Fluctuations between quarters reflect the different revenue mix, which have different gross margins.

The net income trend tends to follow the revenue trend fairly closely.

## **6 Results of Operations – First Quarter 2007**

### **6.1 Revenue**

The Company is reporting a drop in revenue year over year reflecting a very strong Q1 in 2006 and the slow down that has been experienced in the Canadian oil and gas industry.

The Company generated revenues of \$8,435,000 for the three months ended March 31, 2007 compared to \$11,308,000 for the three months ended March 31, 2006. This represents a decrease of 25% for the quarter. The decrease is primarily a result of market factors in the reduction of drilling activity and capital spending by producers.

### **6.2 Cost of Sales**

The cost of sales for the three months ended March 31, 2007 was \$4,088,000 resulting in a 52% margin compared to a 46% margin on cost of sales of \$6,078,000 for the same period in 2006. The increase in margins is attributable to the addition of the higher margin PetroNet production accounting business, a lower cost Smart-Alek model and growth of the recurring revenue stream for network service fees, which has higher margins.

### **6.3 Operating Expenses**

Operating expenses include compensation and benefits of the information technology, customer support, purchasing, shipping, quality assurance and operations departments, facility cost for Edmonton, Alberta and all related expenditures for these departments, excluding those costs charged to cost of sales.

Operating expenses for the quarter ended March 31, 2007 were \$434,000, which is higher than the same period for 2006 by \$37,000 or 9%. The increase is primarily attributed to the addition of the PetroNet operations, which was added in April of 2006, as well as some growth in operations overall. Operating expense, as a percentage of revenue was 5.1% for the first quarter ended March 31, 2007, as compared to 3.5% for the same quarter in 2006. The Company's operating expenses are fairly stable, reflecting the scalability of the business model, but similarly they do not reduce as revenues are lower, which results in a higher percentage of revenue during slower periods.

### **6.4 Sales, General and Administrative Expenses**

Sales, general and administrative (SG&A) expenses include compensation and benefits of sales, marketing, executives, financial, legal, human resources and administrative staff, lease obligations, advertising, trade shows, travel, marketing materials and general supplies.

The SG&A expense was \$1,576,000 for the first quarter ended March 31, 2007. This expense was \$277,000 less during the quarter ended March 31, 2007, compared to the same quarter last year. SG&A expense as a percentage of revenue was 18.7% for the first quarter 2007 as compared to 16.4% for the same quarter in 2006. The decrease in the SG&A expense for the quarter is due to lower commissions and costs tied directly to revenue. Nevertheless, the SG&A expense is somewhat higher as a percentage of revenue due to staff and expenses from the acquisition of PetroNet and from new hires. The result is consistent with management's expectations and although there may be quarter to quarter fluctuation SG&A expenses are expected to decrease year over year as a percentage of revenue with anticipated sales growth.

### **6.5 Research & Development**

The Company is engaged in research and development work. Research costs are expensed as incurred. Development costs are expensed in the period incurred, unless they meet the criteria for

deferral established by GAAP. Further, in accordance with GAAP, development costs are deferred only to the extent that their recovery can reasonably be regarded as assured. Management reviews the applicable criteria on a regular basis and if the criteria are no longer met, any remaining unamortized balance is written off as a charge to income. Research and development costs are reduced by any scientific research tax credits.

The Company defers a portion of its development costs, to be amortized over a five-year period. The five-year period was consistent with the historical lifecycle of prior product versions and more appropriately matches the product revenue stream with its development costs.

Research and Development (R&D) expenses include compensation and benefits of all the development teams working on the continuing development of our products as well as the testing activities. These expenses also include the cost to retain independent contractors and consultants, software licensing expenses, and all related administrative expenses and supplies.

The total R&D cost was \$982,000 in the first quarter 2007 up from \$714,000 in the first quarter of the prior year. The Company capitalized \$737,000 of development costs in the first quarter and expensed \$245,000 of the costs. The overall increase in R&D activity primarily reflects the additional development activity related to the integration of new technology from the acquisitions of Menex, Roughneck and PetroNet and the development of a new Smart-Alek model. In addition there was ongoing development of a number of new products to continue to fill out a full operations management solution suite.

## **6.6 Stock-based Compensation**

Effective January 1, 2004, Canadian accounting standards require recognition of compensation costs arising out of stock-based compensation plans under the fair value based method. Under the fair value based method, compensation cost is measured at fair value at the date of the grant and expensed over the stock option's vesting period.

The Company's non-cash stock-based compensation expense was \$641,000 for the quarter ended March 31, 2007, compared with \$539,000 for the quarter ended March 31, 2006 (please refer to section 4.3 for a full discussion of the breakdown of the stock-based compensation expense).

## **6.7 Net Income**

The overall net income for the first quarter 2007 was \$316,000 or \$0.00 per share compared to \$2,708,000 or \$0.03 per share for the same period in 2006 for an overall decrease of \$2,392,000 or 88%. A future income tax provision amount of \$571,000 was recognized in the first quarter 2007 as compared to a recovery of \$900,000 for the same period in 2006 or a decrease of 163%.

Net Income before taxes (excluding the impact of recognition of the future tax asset) better represents the performance of the Company. Net Income before taxes in the first quarter of 2007 was \$887,000. With stock-based compensation factored out net income before taxes was \$1,528,000 in the first quarter. This represents 35% decrease in the first quarter over the first quarter in 2006.

## **6.8 Amortization of Capital and Intangible Assets**

In the first quarter the amortization of capital and intangible assets was \$648,000, of which \$215,000 related to intangible assets acquired in the purchase of Menex, Roughneck and PetroNet, which are non-recurring capital expenditures. Amortization of deferred development costs accounted for \$292,000 and patents accounted for \$2,000. The balance of \$139,000 is for the amortization of other capital assets that are required for the day-to-day operations of the Company.

## 6.9 Future Income Tax Assets

In assessing the realizability of future tax assets, management considers whether it is more likely than not that some portion or all of the future tax assets will not be realized. The ultimate realization of future tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of temporary differences, projected future taxable income, and tax planning strategies in making this assessment. The amount of the future tax asset considered realizable could change materially in the near term based on future taxable income during the carry forward period. During the three months ended March 31, 2007, the estimate of current tax expense is nil due to the availability of tax losses carrying forward. As the Company has expenses that are non-deductible for tax purposes, the provision for taxes is higher than the expense based on the expected tax rate of 32%.

## 7 Financial Condition

The following are the significant changes in the consolidated balance sheets between March 31, 2007 and December 31, 2006.

(\$ thousands)	March 31, 2007	December 31, 2006	Change	Explanation
<b>Current Assets</b>				
Cash and cash equivalents	11,656	9,753	1,903	The growth in cash is primarily a result of continuing positive earnings.
Accounts receivable	10,161	9,757	404	The growth in receivables reflects the increased sales activity.
Inventories	7,882	7,164	718	Inventory levels remained relatively stable.
<b>Current Liabilities</b>				
Accounts payable	1,430	2,018	(588)	In line with expectations
Accrued liabilities	718	1,169	(451)	In line with expectations
Deferred revenue	4,432	1,680	2,752	Invoicing of contracts are yearly, but revenue is deferred and recognized monthly. This amount fluctuates depending upon the timing of contract renewals.
<b>Working Capital<sup>(1)</sup></b>	<b>23,234</b>	21,962	1,272	This reflects the continued strong growth of cash flow.
<b>Capital Assets</b>	<b>1,511</b>	1,441	70	Increase is in line with expectations and growth.
<b>Other Assets</b>				
Intangibles	4,040	4,227	(187)	Reducing as result of depreciation.
<sup>(1)</sup> Current Assets minus current liabilities is an indicator of the ability to finance current operations and meet obligations as they fall due.				

## **8 Liquidity and Capital Resources**

The Company's cash balance at March 31, 2007 was \$11,656,000, an increase of \$1,903,000 from the December 31, 2006 balance. The Company's cash flows from operating, financing and investing activities, as reflected in the Consolidated Statements of Cash Flow, are summarized below:

	<b>Three Months ended March 31</b>	
(\$ thousands)	<b>2007</b>	<b>2006</b>
<b>Opening cash</b>	<b>9,753</b>	6,368
Cash provided by operations	<b>2,806</b>	2,034
Cash provided by financing	<b>73</b>	116
Cash used in investing	<b>(976)</b>	(1,301)
<b>Closing cash</b>	<b>11,656</b>	7,217

The increase in cash from operations reflects the continued growth in earnings. The cash from financing is from the exercise of options throughout the quarter. The cash used in investing is related to the normal capital purchases throughout the year, which is more fully described in a later section and the acquisition of Roughneck.

The following table presents summarized working capital information.

	<b>Three Months ended March 31,</b>	
(\$ thousands)	<b>2007</b>	<b>2006</b>
Current assets	<b>29,815</b>	25,319
Current liabilities	<b>6,581</b>	6,660
Working capital	<b>23,234</b>	18,659
Current ratio	<b>4.62</b>	3.80

The Company has historically experienced two normal trends that impact liquidity throughout the year. Inventory build up and annual fee billing. The Company's inventory typically peaks through the winter months reflecting the buildup for the peak activity period. The Company bills network fees on an annual basis and in the past renewals were all timed on a calendar year this resulted in a growth in cash in the second quarter as these billings are received. This as well resulted in an increase in the deferred revenue as the revenue is recognized on a monthly basis for network fees and the unrecognized revenue appears in the deferred revenue until it is earned. In 2005 the Company changed its contract renewal policy and began to renew contracts on their anniversaries. This will minimize the peaks and gradually level the receipts and deferred revenue throughout the year.

The Company had capital spending of \$976,000 during the first quarter of 2007 funded from the cash flow from operations. Spending was as follows:

Computer Hardware	\$ 65,000
Computer Software	\$ 54,000
Vehicles	\$ 0
Furniture & Equipment	\$ 35,000
Manufacturing Tools & Equipment	\$ 10,000
Leasehold Improvements	\$ 45,000
Patents and Trademarks	\$ 5,000
Deferred Development Costs	\$ 737,000
Intangibles	\$ 25,000

## Credit Facilities

The Company has credit facilities of \$5,000,000 to cover increased cash needs during peak demand periods. The interest rate is at Royal Bank Prime plus 1.5%. Security consists of a general security agreement creating a security interest in all of the Company's personal property. The credit facility contains customary covenants. Zedi is currently not using any of the credit facility available.

## Financial Instruments

The Company does not currently have any outstanding financial instrument contracts.

## Cash Requirements

The following aggregated information about our contractual obligations and other commitments is to provide insight into the Company's short and long term liquidity and capital resource requirements. The information does not include obligations that have original maturities of less than one year or planned capital expenditures.

(\$ thousands)	Total	Within 1 year	2 to 3 years	3 to 5 years
Long-term debt	60	1	2	3
Operating leases	3,326	610	1,240	1,476
Total	3,386	611	1,242	1,479

### *Long-term Debt*

The long-term debt is a loan payable to Natural Resources Canada under an Industry Energy Research and Development (IERD) program. The loan is repayable at the rate of 1.5% of gross revenues from the sale of product developed under the program. Payments are due semi-annually, no more than 30 days after the end of June and December. The loans bears no interest except for over due payments, which bear interest at Bank of Canada prime plus 2%. The loan is unsecured.

### *Operating Leases*

The Company has various operating leases for office premises in Edmonton and Calgary and vehicles.

## Capital Expenditures

Capital expenditures are funded from cash flow from operations. The Company may adjust opportunity capital spending throughout the year depending on results. The most significant capital spending will be for deferred development costs.

Based on current projections the Company has sufficient working capital required to meet capital spending requirements and achieve projected sales and production levels, as sales increase.

## Outstanding Share Information

	Quarter ending Mar. 31, 2007
Common Shares	
Opening shares	101,853,849
Stock options exercised	175,344
Closing shares	102,029,193

## **9 Critical Accounting Estimates**

### **9.1 Critical Accounting Estimates**

Zedi's significant accounting policies are described in Note 2 of its annual 2006 consolidated financial statements and the 2006 MD&A.

## **10 Disclosure Controls and Internal Controls**

The Company has established and maintains disclosure controls and procedures. The CEO and CFO of the Company have evaluated the effectiveness of the Company's disclosure controls and procedures as of March 31, 2007 and have concluded that such disclosure controls and procedures are effective to provide reasonable assurance that material information relating to the Company and its subsidiaries would be made known to them by others within those entities.

During 2006, the Company implemented a new software program to coordinate and manage its internal control system. This replaced a system that was primarily paper-based and prepares the Company to more adequately manage internal controls as it continues to grow. There were no changes to the Company's internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting in the first quarter of 2007 other than as described below.

The Company conducts regular reviews and internal audits to identify weaknesses in its internal controls over financial reporting and to ensure that an environment of continuous improvement becomes a part of the culture of the Company. As a result of these internal audits, the Company identified weaknesses in the internal controls related to invoicing procedures for recurring contracts. A system for ensuring the timeliness of invoicing for renewing contracts was not adequate. New procedures have been implemented and changes to the design of the internal controls and documentation of new procedures was completed in the first quarter of 2007.

## **11 Outlook**

Moving forward in 2007, Zedi expects to deliver:

- Continued diversification of revenues through increased market penetration by all lines of business – Surveillance, Optimization, Production Volume Measurement, Fixed Asset Management and Health, Safety & Environment. This will build on the trend that was evident in our 2006 results where Smart-Alek® hardware revenue was 47% of the total revenue compared to 64% in 2004.
- Continued progress toward 100% coverage of operating costs and cash requirements by recurring revenues.
- On-going investment in research & development to enhance existing products and to introduce new solutions that are in line with our strategic imperatives, such as:
  - The introduction of non-proprietary hardware that will interface with a broad base of third party well site controllers. This will facilitate the introduction of Zedi SCADA™ on wells where (a) customers already have an investment in legacy hardware and (b) tier one customers have established standards for well site controllers. The introduction of this solution, expected by Q4 2007, significantly expands the available market for sales.
- Continued focus on improving business efficiency within Zedi to drive improvements in earnings performance.
- Continued development of a comprehensive human resources strategy together with associated programs and activities directed at the development and retention of Zedi employees.

Observing the oil and gas industry we note:

- Industry associations such as the Canadian Association of Oilwell Drilling Contractors and the Petroleum Services Association of Canada predict a decrease by 4,000 in the number of wells drilled during 2007. This reduction in drilling activity will continue to impact the sale of our Smart-Alek® and Zedi SCADA™ solutions for new drills. Sales for the retrofit market will not be impacted by drilling activity.
- Reduced drilling activity will negatively impact natural gas storage and supply which should result in stronger commodity prices. Stronger prices combined with fewer new wells will focus producers on current operating costs and practices, an area where Zedi has the ability to add significant value.

## **12 Business Risks and Uncertainty**

The business risks and uncertainty are described in the Company's 2006 MD&A. The business risks and uncertainty are not materially changed from what is disclosed in the 2006 MD&A.

## **13 Reconciliation of Non-GAAP Measures**

### **13.1 Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA)**

The Company reports EBITDA because it is a key measure used by management to evaluate the performance of the business. The Company also believes EBITDA is a measure commonly reported and widely used by investors as an indicator of a company's operating performance and ability to incur and service debt, and as a valuation metric. The Company believes EBITDA assists investors in comparing a company's performance on a consistent basis without regard to depreciation and amortization, which are non-cash in nature and can vary significantly depending upon accounting methods or non-operating factors such as historical cost.

EBITDA is not a calculation based on GAAP and should not be considered an alternative to Net Income in measuring the Company's performance or used as an exclusive measure of cash flow because it does not consider the impact of working capital growth, capital expenditures, debt principal reductions and other sources and uses of cash, which are disclosed in the interim consolidated financial statements of cash flows. Investors should carefully consider the specific items included in the Company's calculation of EBITDA. While EBITDA has been disclosed herein to permit a more complete comparative analysis of the Company's operating performance and debt servicing ability relative to other companies, investors should be cautioned that EBITDA as reported by Zedi may not be comparable in all instances to EBITDA reported by other companies.

The following is a reconciliation of EBITDA with Net Income.

	<b>Three Months ended March 31</b>	
(\$ thousands)	<b>2007</b>	<b>2006</b>
<b>Net Income</b>	<b>316</b>	2,708
Amortization of capital assets and intangibles	<b>648</b>	424
Future income taxes	<b>571</b>	(900)
Interest	<b>(84)</b>	(26)
<b>EBITDA</b>	<b>1,451</b>	2,206

### **13.2 Free Cash Flow**

The Company reports free cash flow because it is a key measure used by management to evaluate the performance of consolidated operations. Free cash flow excludes certain working capital changes and other sources and uses of cash, which are disclosed in the interim consolidated statements of cash flows. Free cash flow is not a calculation based on GAAP and should not be considered an alternative to the interim consolidated statements of cash flows. Free cash flow is a measure that can be used to gauge the Company's performance over time. Investors should be cautioned that free cash flow as reported by Zedi may not be comparable in all instances to free cash flow as reported by other companies. While the closest GAAP measure is Cash provided by operating activities less Cash used for acquisition of capital assets, free cash flow is relevant because it provides an indication of how much cash generated by operations is available after capital expenditures, but before proceeds from divested assets and changes in certain working capital items (such as trade receivables and trade payables).

The following shows management's calculation of free cash flow:

	<b>Three Months ended March 31</b>	
(\$ thousands)	<b>2007</b>	<b>2006</b>
<b>EBITDA</b>	<b>1,451</b>	2,206
Stock-based compensation	<b>641</b>	539
Cash interest (paid)	<b>84</b>	26
Cash available for discretionary spending and capital expenditures	<b>2,176</b>	2,771
Capital expenditures		
Deferred development	<b>(736)</b>	(436)
Purchase of other capital assets	<b>(240)</b>	(315)
<b>Free Cash Flow</b>	<b>1,200</b>	2,020

### **13.3 Net Income before Taxes with Stock-based Compensation Excluded**

The Company reports net income before taxes with stock-based compensation excluded because it is a key measure used by management to evaluate the performance of the business. The Company believes this measure assists investors in comparing a company's performance on a consistent basis without regard to stock-based compensation, which is non-cash in nature and can vary significantly depending upon non-operating factors such as historical share price volatility. Please reference section 4.3 for further information on the stock-based compensation expense.

Net income before taxes with stock-based compensation excluded is not a calculation based on GAAP and should not be considered an alternative to net income before taxes.

The following shows management's calculation of net income before taxes with stock-based compensation excluded:

	<b>Three Months ended March 31</b>	
(\$ thousands)	<b>2007</b>	<b>2006</b>
<b>Net Income before Taxes</b>	<b>887</b>	1,808
Stock-based compensation	<b>641</b>	539
<b>Net Income before Taxes Excluding Stock-based Compensation</b>	<b>1,528</b>	2,347

### **13.4 Income per Share before Taxes with Stock-based Compensation Excluded, basic and diluted**

The Company reports income per share before taxes with stock-based compensation excluded because it is a key measure used by management to evaluate the performance of the business. The Company believes this measure assists investors in comparing a company's performance on a consistent basis without regard to stock-based compensation, which is non-cash in nature and can vary significantly depending upon non-operating factors such as historical share price volatility. Please reference section 4.3 for further information on the stock-based compensation expense.

Income per share before taxes with stock-based compensation excluded, basic and diluted is not a calculation based on GAAP and should not be considered an alternative to income per share before taxes, basic and diluted.

The following shows management's calculation of income per share before taxes with stock-based compensation excluded, basic and diluted:

	<b>Three Months ended March 31</b>	
(\$)	<b>2007</b>	<b>2006</b>
<b>Income per Share, basic and diluted</b>	<b>0.00</b>	0.03
Future Income Tax per Share	<b>(0.00)</b>	0.01
<b>Income per Share before Taxes, basic and diluted</b>	<b>0.00</b>	0.02
Stock-based compensation per share	<b>0.01</b>	0.01
<b>Income per Share Before Taxes Excluding Stock-based Compensation, Basic and Diluted</b>	<b>0.01</b>	0.03