

- ▶ Call Select
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- ▶ Dial 'n' Save
- ▶ Phone Cards

2005 Annual Report



Licensed as a Class A, International Carrier by the CRTC, Phonetime operates a diversified telecommunications business over one of the largest and most advanced private switched long-distance and VoIP telecommunications networks in Canada.

Focused on profits and dedicated to quality in all facets of its business – from technology to customer service – Phonetime is one of Canada’s few consistently profitable competitive long distance telecommunications companies.

Phonetime’s balanced portfolio of services includes pre-paid and post-paid (1+ equal access) retail products for individual consumers and businesses as well as wholesale long-distance call delivery to large and small domestic and international carriers. This balance enables Phonetime to maximize revenue from the utilization of available capacity and to minimize costs through volume.

To deliver these services, Phonetime has built a network of 36 Points-of-Presence located in most major urban areas across Canada and with connections to over 140 countries around the world. This scalable network is currently capable of processing 3 billion minutes of long distance calling annually using some of the most sophisticated technology available today.

With offices and call centres in Toronto, Vancouver, and Montreal, Phonetime delivers multi-lingual marketing and sales programs as well as customer service to its current and potential customers across the country. Phonetime is a TSX Venture-listed company trading under the symbol, “PHD”.

Phonetime has made significant progress towards re-balancing its business from being solely reliant on the highly competitive, lower-margin, long distance phone card business; into a business with three primary sources of revenue and profit. These sources are: (1) the 1+ equal access service delivered by our Call Select subsidiary; (2) the delivery of Wholesale long distance calls across Canada on behalf of other telecommunication companies (primarily international and VoIP carriers); and (3) the long distance phone card business, (which keeps our overall cost of sales down with its volume of traffic). This is consistent with our focus on achieving profits over the long term through a program of diversification, which we announced last year at this time. Accordingly, we are pleased to provide an overview of the results of our efforts over the past year on a company-wide basis as well as on a segmented basis.

Company Revenue, Gross Profit and Net Earnings

Phonetime continues to be one of the few players in the Canadian telecommunications industry with solid gross profit margins. In 2005, Phonetime improved its gross profit margin to 37.5%, up from 35.6% in 2004 and 20.8% in 2003. This translated into gross profits of \$6.6 million in 2005 compared to gross profits of \$6.5 million in 2004, despite a decline in revenue from \$18.2 million to \$17.6 million. To put the decline in revenue in perspective, it should be understood that the revenue in 2004 declined quarter over quarter as the Company commenced its program of focusing on profitability through diversification. Phonetime experienced significant revenue growth in its profitable wholesale and 1+ Call Select businesses in each quarter of 2005. Call Select revenue increased from just \$494,000 in 2004 to \$4.9 million in 2005 – a tenfold increase – which offset the decline in the card business projected last year. This is shown graphically in the chart below, which tracks revenue by quarter for the past two years:



Operating Expenses increased in 2005 by \$503,000 to \$6.5 million, from \$6.0 million in 2004 (resulting in a Net Earnings decline of \$398,800 from \$500,000 in 2004 to \$102,000 in 2005) for two main reasons. First, the Company grew its network by 50% from 24 to 36 Points of Presence (POPs) in major urban areas across the country. As a result of this expansion program, the Company now operates one of the largest private telecommunications networks in the country and has enhanced Phonetime’s attractiveness as a one-stop supplier of wholesale Canadian long distance services to International and VoIP carriers. The second reason for the increase in operating expenses was Phonetime’s additional support of Call Select’s operations by extending credit facilities and by funding the expansion of its Vancouver call centre from 50 to 80 seats. Our growing wholesale business and the increasing revenues of Call Select suggest that these investments are likely to result in an improved bottom line on a go-forward basis.

Call Select

As indicated above, Call Select’s revenue increased 10-fold to nearly \$4.9 million over the past year from its delivery of 1+ equal access services primarily to ethnic communities across the country. This was the result of organic growth and the acquisition of BeeTel Communications Inc. in 2005. Call Select is currently owned 80% by Phonetime, with the balance being held by Call Select’s management team. Phonetime is in the process of acquiring management’s stake through the issuance of shares of Phonetime, which will have numerous beneficial effects for all stakeholders, including Call Select’s management team, which will continue to manage the business under multi-year employment contracts. At present, Call Select is generating revenue of approximately \$700,000 per month and at its current growth rate should near \$1 million per month by the end of 2006. This growth is attributable to increased seats in the call centre in Vancouver plus the recently opened call centre in Montreal that caters to French and Muslim communities in Quebec. A call centre is being planned for Toronto and expansion opportunities in the United States are being evaluated.

Phonetime International

Phonetime has a well-established reputation for delivering quality pre-paid products and services. Our nationally recognized phonecard brands such as Bravo, Call Value, Chit Chat, Eureka, Hot, and Nuvo cards, plus others, continue to be well received. Dial'n'Save continues to grow by referrals. As a result, we have a high rate of retention of distributors and retail agents. Having said this, the long distance card business has been experiencing systemic competitive pressure over the past several years, resulting in lower revenue due to lower long distance calling rates and therefore lower average per card sale prices (while we process more minutes than ever). By way of example, an average card sale of \$10 in 2003 switched to a \$5 average sale in 2004 and then to a \$2 average sale in 2005 while still providing the user with approximately the same calling time. The result is that while absolute minutes processed by Phonetime increased from 2003 to 2005, revenue from this traffic declined due to a decrease in the revenue per minute. We expect that this competitive pressure will continue, particularly as cable companies enter the market with their VoIP services. The positive side to this situation is that Phonetime is able to keep its cost of sales competitive because it processes an ever increasing number of minutes of long distance traffic, resulting in higher profits from its 1+ equal access services and wholesale services.

Wholesale Delivery Services

Phonetime provides Long Distance origination and termination across Canada for a number of large international and VoIP carriers. For competitive purposes, the financial contribution from these services have been incorporated into the figures of Phonetime International, however, the traffic statistics will give a sense of the growth and importance of this segment of our business as the third leg of our diversification strategy. Specifically, in January 2005, we processed 2.5 million minutes of wholesale traffic to Canadian destinations and by December 2005 we had grown the wholesale minutes over ten-fold to 27.6 million minutes. Over 70% of the Company's wholesale traffic is carried on our own fixed cost Canada-wide Network, thus contributing higher margins and profits. In 2006, with the 50% expansion of the Phonetime network to include 12 additional major urban cities as well as increasing capacity into existing cities, the company anticipates both added volume and further profits from its Wholesale activities in 2006. Included in these figures is traffic between Radiant and Phonetime. Radiant Americas BV currently owns or controls approximately 17% of Phonetime's equity; however the relationship between the companies goes well beyond their investment. Specifically, Radiant purchased \$449,000 of wholesale traffic in 2005 vs. \$124,659 in 2004 an increase of 259%. As a supplier, Radiant sold \$515,000 of wholesale traffic to the Company in 2005 vs. \$555,000 in 2004, a decrease of 8%.

Financial Administration

Over the past 12 months we have continued to work hard to improve our balance sheet. As you read through our audited financial statements, you will note the elimination of long term debt and the improvement of our current ratio (current assets/current liabilities) from 1.15:1 in 2004 to 1.30:1 in 2005. Our consistency in this regard played a role in our acquiring a bank line of credit of \$250,000 in mid-2005 and, although we have never used the line, the Company may seek to increase it in order to support our anticipated growth. On the following pages, we discuss our financial results in greater detail; however, we wish to note that we are now very well positioned to expand both from internally generated business and as well as from strategic acquisitions and investments.

In Summary

We have had a very satisfying year in many respects; however, as we transition the Company into a balanced telecommunications operation, we expect challenges. As always, we approach these challenges by considering our alternatives and implementing highly innovative solutions. With respect to our corporate objectives for 2006, we intend to stay the course – building Call Select and our wholesale delivery service, while maintaining a strong presence in the card business to keep our cost structure competitive.

We want to take this opportunity to thank all our stakeholders, including our dedicated employees, agents, suppliers, shareholders, and our customers for their support over the past 12 months and we look forward to working with all of you in the coming year.

Yours very truly,



Wayne Silver
President & C.E.O.



Rodney Franklin
Chairman & C.F.O.

MANAGEMENT'S DISCUSSION AND
ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS

The following discussion and analysis is management's assessment of the results and financial condition of Phonetime Inc., (the "Company") and should be read in conjunction with the audited consolidated financial statements for the years ended December 31, 2005 and 2004, together with the related notes contained therein. The Company's most recent filings are available on the System for Electronic Document Analysis and Retrieval ("SEDAR") and can be accessed through the Internet at www.sedar.com. All dollar amounts are in Canadian dollars. The date of this management's discussion and analysis is April 27, 2006.

Forward Looking Statements

Certain information included in this discussion may constitute forward-looking statements. Forward-looking statements are based on current expectations and entail various risks and uncertainties. These risks and uncertainties could cause or contribute to actual results that are materially different than those expressed or implied. The Company disclaims any obligation or intention to update or revise any forward-looking statement, whether as a result of new information, future events, or otherwise.

RESULTS OF OPERATIONS

The following tables set forth items derived from the consolidated statements of operations (expressed in \$000's except for earnings per share) for each of the eight most recently completed quarters.

Fiscal 2005	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Total
Revenue (\$000's)	\$3,810	\$4,278	\$4,619	\$4,890	\$17,597
Net Earnings (Loss)	(\$170)	(\$85)	\$108	\$249	\$102
Earning (Loss) / Share					
Basic	(\$.003)	(\$.002)	\$.002	\$.005	\$.002
Fully Diluted	(\$.003)	(\$.002)	\$.002	\$.005	\$.002

Fiscal 2004	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Total
Revenue (\$000's)	\$5,757	\$4,388	\$4,302	\$3,785	\$18,232
Net Earnings (Loss)	\$424	\$(85)	\$37	\$124	\$500
Earning (Loss) / Share					
Basic	\$.008	(\$.002)	\$.001	\$.003	\$.010
Fully Diluted	\$.008	(\$.002)	\$.001	\$.003	\$.010

Quarterly net earnings and earnings per share have been restated to reflect the correction of an error as explained in note 16 of the Company's audited consolidated financial statements.

Results of Operations

Quarter Ended December 31, 2005 compared to the Quarter Ended December 31, 2004.

The following table sets forth items derived from the consolidated statement of operations for the three month periods ended December 31, 2005 and 2004 (in \$000's)

Quarter Ended December 31st	2005	2004	Variance
Revenue	\$4,890	\$3,785	\$1,105
Cost of sales	\$2,888	\$1,993	(\$895)
Administrative expenses	\$1,576	\$1,383	(\$193)
Other operating expenses	\$177	\$285	\$108
Earnings (loss) before income taxes	\$249	\$124	\$125
Income taxes (recovered)	\$0	\$0	\$0
Net earnings (loss) for the period	\$249	\$124	\$125

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Revenue for the three months ended December 31, 2005 has increased by \$1.1 million over the same period of the prior year from approximately \$3.8 million to \$4.9 million. Cost of Sales for the three months ended December 31, 2005 increased by nearly \$900,000 from approximately \$2 million in the three months ended December 31, 2004 to \$2.9 million in the same period of 2005. The increase in Cost of Sales is consistent with the increase in revenue and the product mix experienced in the last quarter.

Throughout 2005, Management was effective in maintaining control on Cost of Sales relative to Revenue. However, in order to maintain the Company's purchasing power, which is essentially driven by traffic on the network, revenue was allowed to increase at lower margins in this quarter compared to the prior year (40.9% in 2005 vs. 47.3% in 2004). In other words, the Company lowered prices on certain products in this quarter. For the year, Gross Profit Margin improved to 37.5% in 2005 from 35.6% in 2004.

It is also noteworthy that despite the 29.2% or the \$1.1million increase in revenue for the quarter ended December 31, 2005 vs. the same period of the prior year; Administrative and Other Operating Expenses only increased by \$85,000 or 5.1%, thereby allowing the Company to record an increase of \$125,000 in Net Earnings for the period compared to the same period of the prior year.

The following table sets forth items derived for the consolidated statement of operations for the years ended December 31 2005, 2004 and 2003.

Year Ended December 31st	2005	2004	2003
Revenue	\$17,597	\$18,232	\$28,612
Cost of sales	\$11,003	\$11,743	\$22,647
Gross Profit	\$6,594	\$6,489	\$5,965
Administrative expenses	\$5,684	\$5,106	\$5,467
Other expenses	\$808	\$883	\$836
Gain on settlement of litigation	\$0	\$0	\$835
Provision for Loss on Long Term Investment	\$0	\$0	\$(410)
Earnings (loss) before income taxes	\$102	\$500	\$87
Income taxes (recovered)	\$0	\$0	\$0
Net earnings (loss) for the period	\$102	\$500	\$87
Total assets	\$5,099	\$4,758	\$6,986
Total long-term financial liabilities	\$361	\$65	\$247
Cash Dividends declared per share	\$0	\$0	\$0

Results of Operations

For Year Ended December 31, 2005 Compared to the Years Ended December 31, 2004 and 2003

Sales from Phonetime Inc. operations were \$17.6 million for fiscal 2005 compared to \$18.2 million for the year ended December 31, 2004 and \$28.6 million in 2003. This represents a decrease of \$635,000 or just 3.48% compared to 2004. This was the result of management's decision to continue its focus on improving the Company's balance sheet with bottom line profits – a program which was commenced in 2004 as noted in last year's annual report. It was this program that led to the \$10.4 million decline in revenue between 2004 and 2003 and a substantive improvement of \$838,000 in Net Earnings before the Gain on Settlement of Litigation (\$835,000 in 2003) between those years.

Accordingly, Gross Profit was \$6.6 million for the year ended December 31, 2005 representing a Gross Profit Margin of 37.5%, compared to \$6.5 million for the previous year and a Gross Profit Margin of 35.6%. This consistency in Gross Margin is a direct result of the Company's ability to maintain its pricing and sales volumes in a competitive environment. .

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While it appears from an analysis of the top-line results that the Company experienced negative growth, what has happened beneath the surface is that the realignment of the business as announced last year is successfully underway. Specifically, Phonetime has been moving away from its near total reliance on the highly competitive, lower margin calling card business towards a business model that includes a balance of calling cards, 1+ calling (Call Select), and the delivery of wholesale traffic through its Canadian network on behalf of a variety of international carriers. The Segmented Information presented in Note 15 of the Financial Statements highlights the decline of calling card revenue, which is included in the Telecommunications column along with wholesale revenue. This area of the business declined from \$17,989,816 in 2004 to \$15,325,788 in 2005, representing a decline of 15%. However, the decline would have been much more severe without the wholesale business that is included in this figure. In the same period, revenue from 1+ Services grew from \$494,224 in 2004 to \$4,870,555 in 2005 (nearly 10 times the revenue of the prior year). The total of these revenues is greater than the total reflected in the Financial Statements due to the Inter-Segment Eliminations, also quantified in Note 15.

Operating expenses for the year ended December 31, 2005 increased by a total of \$502,000 to \$6.5 million, from \$6.0 million in 2004, as a result of the Company's deployment of 12 new Points of Presence ("POPs") on the network across Canada and its continued support for Call Select's operations plus the move to larger premises to enable the Call Centre to increase to 80 seats. The investment in new POPs has allowed Phonetime to increase the volume of its profitable wholesale traffic as well as open the door to new opportunities. When comparing the three years, it is noteworthy that operating expenses remain fairly consistent and while Management is aware that ratio of operating expenses to sales is higher now than in 2003 and even 2004 (36.8% in 2005, 32.8% in 2004, and 22.0% in 2003), every area of operations is subject to review on a quarterly basis to determine if there are opportunities to reduce overhead expenses without negatively impacting on the delivery of quality services or administrative efficiency. On the latter point, the most important issues are the timely collection of cash from agents and wholesale customers and regulatory compliance.

Interest expense for the year ended December 31, 2005 decreased to \$77,562 from \$82,572 in the previous year. Interest expense declined primarily as a result of the Company's elimination of long term debt. Interest expense was also impacted by the acquisition of certain capital lease obligations mid-way through 2005.

Amortization expense decreased to \$770,188 for the year ended December 31, 2005 from \$810,116 in 2004.

For the year ended December 31, 2005, the Company earned \$101,683 compared to Net Earnings of \$500,165 for the year ended December 31, 2004 and just \$87,000 for the year ended December 31, 2003. The decrease in earnings for the 2005 year was due, primarily, to the Company's increased investment in Call Select, which included the expansion of its call centre facilities in Vancouver from a 50 seat operation to an 80 seat operation. Phonetime also invested in the deployment of 12 new POPs, as noted above. While Net Earnings in 2005 were essentially equivalent to those of 2003, these earnings were generated from substantially lower revenue (\$11 million less), which was the result of the Company's continued focus on higher margin products and services.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents at Year End amounted to \$294,834 in 2005, compared to \$372,579 in 2004. Although cash flows from operating activities increased by \$441,320 in 2005 compared to 2004, investing and financing activities reduced cash by \$233,318 and \$285,747 respectively, resulting in a net decrease of cash and cash equivalents by \$77,745 during the year.

Cash generated from operating activities increased by approximately \$441,000 in 2005. The major changes comprised net earnings of \$101,683, a decrease in short term investments of \$136,269, an increase in accounts receivable of \$666,680, and an increase in accounts payable of \$409,628. Investing activities comprised of the acquisition of equipment valued at \$132,643 and intangible assets of \$100,675 (representing the acquisition of

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Beetel Communication Inc.'s customer list). Financing activities in 2005 were comprised of payments towards lease obligations (\$288,245), the elimination of long term debt (\$34,804), and the reduction of debt due to related parties. The Company also generated \$66,850 from miscellaneous financing activities.

The Company has funded operations primarily from positive cash flow generated from its operations. The Company has no bank debt at year end. As noted above, the Company's activities used net cash of \$77,745 in the year ended December 31, 2005, primarily due to the investment in POPs and the Company's continued support of Call Select, which contributed most of the increase in Phonetime's accounts receivable during the year.

The working capital ratio increased to 1.30:1 at December 31, 2005, up from 1.18:1 at December 2004, which results from the combined increase in accounts receivable (due primarily from the increase in Call Select's business) and the reduction in deferred revenue resulting from a decline in the calling card segment of the business, as discussed above.

The Company's operations will continue to require capital to fund the development of its network and services in Canada, and for other corporate purposes, including acquisitions, marketing and other working capital needs. Interested parties and the Bank have been approached to raise capital and as a result, the Company acquired an operating line of credit of \$250,000 in the second quarter of 2005. To date, this line of credit has not been utilized. The Company is seeking to increase this line of credit to support growth in future years.

The Company continues to focus on measures to reduce costs and achieve growth in wholesale operations through sales to international carriers, while renegotiating arrangements with suppliers. Although management has implemented strong marketing and business strategies, there can be no assurance that these initiatives will continue to sustain profitability and positive cash flow. This inability would have a material adverse effect on Phonetime's business, operating results and financial conditions.

The Company has contractual commitments with respect to lease obligations as disclosed in Note 10 to the financial statements.

Off-Balance Sheet Arrangements

The Company had no off-balance sheet arrangements as at December 31, 2005 or at December 31, 2004.

Financial Instruments and Other Instruments

The Company had no financial instruments other than normal course working capital balances as presented on the balance sheet as at December 31, 2005 and December 31, 2004.

RISK AND UNCERTAINTIES

The primary risks the Company faces are credit risk, currency risk, regulatory, and competitive risk. Credit risk arises from the sales of products on credit terms to customers. To mitigate this risk, the Company takes an aggressive approach to collecting outstanding receivables (notwithstanding its latitude towards Call Select), and taking legal action to collect from slow or non-payers. Furthermore, the Company attempts to mitigate its credit risk through the establishment of credit limits, enforced terms of sales with its customers, and the requirement for deposits and pre-payments from certain customers. Credit limits are also reviewed and monitored regularly.

With respect to currency risk, approximately 68% of the Company's purchases and 6% of its sales are in foreign currency. Consequently, those related liabilities and expenses are exposed to foreign exchange fluctuations. As at December 31, 2005, accounts payable from U.S. suppliers was \$606,438 (compared to \$569,862 in 2004) and accounts receivable from U.S. customers was \$163,141 (compared to \$2,587 in 2004). The Company uses forward exchange contracts to reduce its exposure to foreign exchange risk when economic indicators suggest the use of currency risk mitigation techniques are in order. As at December 31, 2005, no such contracts were outstanding.

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Telecommunications companies in Canada operate under the Telecommunications Act and are regulated by the Canadian Radio-Television and Telecommunications Commission ("CRTC"). The CRTC has been actively promoting competition in the long-distance telecommunications market for the past 20 years and these efforts continue. Accordingly, Phonetime is registered as a Class A carrier as it operates its own telecommunications facilities. This means the Company is subject to periodic procedural and information requests as well as the payment of royalties to the CRTC. In 2005, Phonetime remitted approximately \$69,000 in royalties. Failure to remit the royalties or to co-operate with the CRTC in its procedural requirements or requests for information can result in the revocation of its license. This risk is viewed as extremely minimal, provided Phonetime continues to comply with the CRTC, as the Company has for the past 11 years.

The long distance telecommunications market in which Phonetime operates is highly competitive and fragmented, which means pricing is under constant pressure from both large and well established players exerting their buying power plus small start-up companies seeking to gain a "foothold" in the market, not to mention all the players in-between. In the last few years, Voice over Internet Protocol ("VoIP") service providers have also begun to assert themselves, which also puts the pressure on the Company to lower prices to meet the competition. To mitigate this risk, Phonetime focuses on certain market segments (i.e. ethnic markets in the case of Call Select), as well as ensuring that it operates at the lowest possible cost, in part by using VoIP technologies throughout its network, as well as other advanced telecommunications hardware and software. Phonetime also operates one of the largest private telecommunications networks in the country now comprised of 36 Points of Presence providing local access across the country, which gives Phonetime an advantage in attracting wholesale long distance customers.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The Company's discussion and analysis of its results of operations and financial condition are based upon its consolidated financial statements that have been prepared in accordance with generally accepted accounting principals in Canada. The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities. Estimates and assumptions are evaluated on an ongoing basis and are based on historical and other factors believed to be reasonable under the circumstances. The results of these estimates may form the basis of the carrying value of certain assets and liabilities and may not be readily apparent from other sources. Actual results, under conditions and circumstances different from those assumed, may differ from estimates.

Allowance for Doubtful Accounts:

The Company maintains accounts receivable allowances for estimated losses resulting from the inability of its customers to make payments. Additional allowances may be required if the financial condition of the Company's customers deteriorates.

Future Income Taxes:

The Company uses the asset and liability method to provide for income taxes on all transactions recorded in the consolidated financial statements. The asset and liability method requires that income taxes reflect the expected future tax consequences of temporary differences between the carrying amounts of assets or liabilities and their tax bases. Future income tax assets and liabilities are determined for each temporary difference based on the tax rates, which are expected to be in effect when the underlying items of income and expenses are expected to be realized. A valuation allowance is provided to the extent that it is more likely than not that those future income tax assets will not be realized.

Revenue Recognition

Revenue from prepaid phone cards, wholesale long-distance minutes, and 1+ long-distance services are recognized as phone time is used by the customer. Revenue from phone cards is deferred for the amount of

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unused time. Management has estimated unused phone time based on historical patterns of the phone card usage, which includes estimates of the lead-time for the first call and the residual talk time on the cards at the year-end date. Dealer deposits represents amounts paid against future purchase of wholesale long distance minutes.

Non-Capital Losses

The company has non-capital losses of approximately \$3,305,938 for income tax purposes, which may be used to reduce taxable income in future years.

Share-based compensation

On January 1, 2004, the Company adopted prospectively the new recommendations of the CICA Handbook, Section 3870, entitled "Stock-based Compensation and Other Stock-based Payments". This section defines notably recognition, measurement and disclosure standards for stock-based compensation to employees. These standards define a fair value based method of accounting and encourage entities to adopt this method of accounting for its stock-based employee compensation plans. Under this method, compensation cost should be measured at the grant date based on the fair value of the award and should be recognized over the related service period.

At present, the Company has no Employee Stock Option Plan in place. However from time-to-time, options are granted on the basis of merit and longevity with the company. There were 2,177,000 stock options granted during the year ended December 31, 2005 (compared to nil in 2004). At December 31, 2005 there were 3,464,000 options outstanding. Please see Note 11 of Phonetime's Consolidated Financial Statements for a detailed discussion of the Company's stock options.

RELATED PARTY TRANSACTIONS

Radiant International Holdings BV is both a customer and a supplier of long distance minutes and a major shareholder (over 17% of the Company's common shares). As a customer, Radiant purchased \$449,000 of phone time in 2005 (compared to \$124,659 in 2004) and as a supplier, Radiant sold \$515,000 of phone time to the Company in 2005 (compared to \$555,000 in 2004). These sales and purchases are included in Phonetime's revenue and cost of sales.

Call Select management group own 20% of Call Select shares.

Amounts due to certain directors and companies controlled by them are noninterest bearing and have no fixed terms of repayment.

Included in selling, general and administrative expenses is rent paid on premises to certain directors of \$135,600 (December 31, 2004 \$135,600).

These transactions were conducted in the normal course of operations and on terms similar to those with arm's length parties. They have been measured at exchange rates being the amount of consideration established and agreed to by the related parties.

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SHARE DATA

The following sets forth the outstanding Share Data for the Company as at December 31, 2005 and as at April 27, 2006:

- a) **Authorized:**
The authorized share capital of the Company consists of 500,000 redeemable, voting, Series A special shares, and an unlimited number of common shares and special shares.
- b) **Issued:**
The issued share capital of the Company consists of 50,809,422 Common Shares.

ADDITIONAL INFORMATION

Evaluation of disclosure controls and procedures

Public companies are required to perform an evaluation of disclosure controls and procedures annually and to disclose management's conclusions about the effectiveness of these disclosure controls and procedures in its annual MD&A.

The Company has established and is maintaining disclosure controls and procedures to provide reasonable assurance that material information relating to the Company and its consolidated subsidiaries is disclosed in annual filings, interim filings or other reports and recorded, processed, summarized and reported within the time periods specified as required by securities regulations.

Management has evaluated the effectiveness of the Company's disclosure controls and procedures for the year ended December 31, 2005 and believes that they are sufficient to provide reasonable assurance that the Company's disclosures are compliant with securities regulations.

Other

Additional information relating to the Company is available on SEDAR at www.sedar.com.

GENERAL

Except where otherwise indicated, information contained herein is given as of April 27, 2006.

P H O N E T I M E I N C .

CONSOLIDATED FINANCIAL
STATEMENTS FOR THE YEAR
ENDED DECEMBER 31, 2005

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CONSOLIDATED FINANCIAL
STATEMENTS FOR THE YEAR
ENDED DECEMBER 31, 2005

AUDITOR'S REPORT

To the shareholders of Phonetime Inc. :

We have audited the consolidated balance sheets of Phonetime Inc. as at December 31, 2005 and December 31, 2004 and the consolidated statements of earnings and deficit, and cash flows for the years then ended. These 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 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 December 31, 2004 and the results of its operations and its cash flows for the years ended December 31, 2005 and December 31, 2004 in accordance with Canadian generally accepted accounting principles.

Markham, Canada
March 17, 2006



Chartered Accountants

P H O N E T I M E I N C .

CONSOLIDATED
BALANCE SHEETS
AS AT DECEMBER 31,

	2005	2004 (note 16)
ASSETS		
Current assets		
Cash and cash equivalents	\$ 294,834	\$ 372,579
Short term investment (note 4)	27,483	163,752
Accounts receivable	3,120,680	2,454,000
Inventories	215,558	220,385
Prepaid expenses and deposits	179,465	247,799
	3,838,020	3,458,515
Property and equipment (note 5)	1,172,123	1,299,752
Intangible assets (notes 3 and 6)	88,930	-
	\$ 5,099,073	\$ 4,758,267
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities	\$ 2,191,612	\$ 1,781,984
Dealer deposits	20,500	78,000
Current portion of long term debt (note 7)	-	34,804
Current portion of capital lease obligations (note 8)	185,044	204,980
Deferred revenue	536,297	863,547
Due to related parties (note 9)	5,825	35,373
	2,939,278	2,998,688
Capital lease obligations (note 8)	294,771	64,909
Other (note 3)	66,850	-
	3,300,899	3,063,597
Shareholders' equity		
Share capital (note 11)	5,873,077	5,873,077
Contributed surplus (note 11)	1,821	-
Deficit (note 17)	(4,076,724)	(4,178,407)
	1,798,174	1,694,670
	\$ 5,099,073	\$ 4,758,267

See accompanying notes

Approved on behalf of the Board:



Director



Director

P H O N E T I M E I N C .

CONSOLIDATED STATEMENTS
OF EARNINGS AND DEFICIT FOR THE
YEARS ENDED DECEMBER 31,

	2005	2004 (note 16)
Sales	\$ 17,596,662	\$ 18,231,947
Cost of sales	(11,003,199)	(11,743,183)
Gross profit	6,593,463	6,488,764
Operating expenses	(5,683,934)	(5,105,998)
Gain on foreign exchange	39,904	10,087
Amortization	(770,188)	(810,116)
Interest on long term debt (notes 7 and 8)	(77,562)	(82,572)
	(6,491,780)	(5,988,599)
Earnings before income taxes	101,683	500,165
Provision for income taxes (note 12)		
Current	280,281	432,598
Reduction of income taxes on application of prior years' losses	(280,281)	(432,598)
	-	-
Net earnings for the year	101,683	500,165
Deficit, beginning of year (note 17)	(4,178,407)	(4,678,572)
Deficit, end of year	\$ (4,076,724)	\$ (4,178,407)
Basic earnings per share (note 11c)	\$ 0.002	\$ 0.010
Diluted earnings per share (note 11c)	\$ 0.002	\$ 0.010

See accompanying notes

P H O N E T I M E I N C .

CONSOLIDATED STATEMENTS
OF CASH FLOWS FOR THE YEARS
ENDED DECEMBER 31,

	2005	2004 (note 16)
Operating activities:		
Net earnings for the year	\$ 101,683	\$ 500,165
Non cash items:		
Amortization	770,188	810,116
Issue of option for compensation	1,821	-
	<u>873,692</u>	<u>1,310,281</u>
Net change in non cash working capital balances:		
Short term investment	136,269	(2,474)
Accounts receivable	(666,680)	871,700
Inventories	4,827	105,945
Prepaid expenses and deposits	68,334	22,219
Dealer deposits	(57,500)	(7,500)
Accounts payable and accrued liabilities	409,628	(1,643,542)
Deferred revenue	(327,250)	(330,559)
	<u>(432,372)</u>	<u>(984,211)</u>
Cash flows from operating activities	441,320	326,070
Investing activities:		
Additions to equipment	(132,643)	(107,042)
Additions to intangible assets	(100,675)	-
Cash flows from investing activities	(233,318)	(107,042)
Financing activities:		
Long term debt, net	(34,804)	(212,648)
Capital lease obligations, net	(288,245)	(499,224)
Due to related parties	(29,548)	(76,255)
Other	66,850	-
Cash flows from financing activities	(285,747)	(788,127)
Net decrease in cash and cash equivalents during the year	(77,745)	(569,099)
Cash and cash equivalents, beginning of year	372,579	941,678
Cash and cash equivalents, end of year	\$ 294,834	\$ 372,579

See accompanying notes

NOTES TO CONSOLIDATED FINANCIAL
STATEMENTS FOR THE YEAR ENDED
DECEMBER 31, 2005

1. GENERAL:

Phonetime Inc. and its subsidiary companies (the "Company") sell and market long distance telephone calling cards and provide wholesale long distance telephone services to other carriers. Call Select Inc. (CS) was incorporated on April 6, 2004 and is headquartered in Vancouver BC. Phonetime Inc. owns 80% of CS and the remaining 20% is held by the senior management of CS. CS focuses on marketing Equal Access (known as 1+) long distance services to the ethnic residential and small/medium business markets across Canada.

2. SIGNIFICANT ACCOUNTING POLICIES

Management has prepared these consolidated financial statements in accordance with Canadian generally accepted accounting principles and are expressed in Canadian dollars. The significant accounting policies are as follows:

a) Basis of consolidation:

The consolidated financial statements include the accounts of Phonetime Inc. and its subsidiaries, Phonetime International Inc., Provincial Products Inc. and Call Select Inc. as at December 31, 2005. All inter company transactions and balances have been eliminated. Share of losses in subsidiaries in excess of minority interest capital are allocated to the parent.

b) Implementation of new Generally Accepted Accounting Principles:

During 2003, the Canadian Institute of Chartered Accountants amended CICA 3870 "Stock Based Compensation and Other Stock Based Payments". The pronouncement required expensing of stock options effective for fiscal years beginning on or after January 1, 2004. For options to employees, directors and consultants granted prior to January 1, 2004, the Company recognized no compensation expense but has disclosed the pro forma net income and earnings per share in note 11 as if the Company had expensed the fair value of the options over the vesting period of the options.

Beginning on January 1, 2004, the Company accounts for stock options using the fair value method. Under this method, compensation expense for stock options granted is measured at the fair value at the grant date using the Black Scholes valuation model. Compensation expense is recognized on a straight line basis over the vesting period of the options granted and is credited to contributed surplus. The consideration paid on the exercise of options is credited to capital stock. The difference between the amount paid and the fair value as determined is credited to contributed surplus.

c) Use of estimates:

The preparation of financial statements in conformity with Canadian generally accepted accounting principles ("GAAP") 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 the reported amounts of revenue and expenses during the reporting period. By their nature, these estimates are subject to uncertainty and the effects of changes in these estimates in future periods on the consolidated financial statements could be significant.

NOTES TO CONSOLIDATED FINANCIAL
STATEMENTS FOR THE YEAR ENDED
DECEMBER 31, 2005

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

c) Use of estimates (continued)

Examples of significant estimates include but are not limited to: the amount of receipts recognized as revenue; the allowance for doubtful accounts; the allowance for inventory obsolescence; the estimated useful lives of assets; the composition of future income tax assets and liabilities; the fair value of intangibles; the valuation of stock based compensation and accruals.

d) Inventories:

Inventories consist of long distance telephone calling cards. Inventories are valued at the lower of cost and net realizable value, with cost determined on a first in, first out basis.

e) Cash and cash equivalents:

Cash and cash equivalents, consists of cash on hand, balances with banks and investments in money market instruments with terms to maturity of less than 90 days.

f) Property and equipment:

Property and equipment are stated at cost. Amortization is calculated as follows:

Furniture and fixtures	4 years straight line
Computer and telecommunication equipment	4 years straight line
Computer software	3 years straight line
Leasehold improvements	5 years straight line

g) Intangible:

Customer lists acquired are deferred and amortized on a straight line basis over sixty months. The carrying value of the assets will periodically be compared to the estimated undiscounted cash flows that may be generated from the related business and any impairment in fair value will be recognized as a charge to the statement of earnings.

h) Future income taxes:

The Company uses the asset and liability method to provide for income taxes on all transactions recorded in the consolidated financial statements. The asset and liability method requires that income taxes reflect the expected future tax consequences of temporary differences between the carrying amounts of assets or liabilities and their tax bases. Future income tax assets and liabilities are determined for each temporary difference based on the tax rates which are expected to be in effect when the underlying items of income and expenses are expected to be realized. A valuation allowance is provided to the extent that it is more likely than not that future income tax assets will not be realized.

NOTES TO CONSOLIDATED FINANCIAL
STATEMENTS FOR THE YEAR ENDED
DECEMBER 31, 2005

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

i) Foreign currency translation:

Transactions denominated in foreign currencies are translated into Canadian dollars using the temporal method. Under this method, monetary assets and liabilities are translated using the rate of exchange in effect at the balance sheet date, whereas other non monetary assets and liabilities are translated at the rate of exchange in effect on the date of the transactions. Revenue and expenses are remeasured at monthly average rates prevailing throughout the period, except for amortization which is measured at exchange rates prevailing when the related assets were acquired. Exchange gains and losses resulting from translation are included in the statement of operations.

j) Revenue recognition:

Revenue from prepaid phone cards, wholesale long distance minutes and 1+ long distance services are recognized as phone time is used by the customer. Revenue from phone cards is deferred for the amount of unused time. Management has estimated unused phone time based on historical patterns of the phone card usage which includes estimates of the lead time for the first call and the residual talk time on the cards at the year end date. Dealer deposits represents amounts paid against future purchases of wholesale long distance minutes.

k) Impairment of long lived assets:

Long lived assets are tested for recoverability whenever there are changes in circumstances, such as future asset utilization and business climate, that indicate their carrying amount may not be recoverable. An impairment loss is recognized when their carrying value exceeds the total undiscounted cash flows expected from their use and eventual disposition. The amount of the impairment loss is determined as the excess of the carrying value of the asset over its fair value. No impairment loss was recognized in 2005 or 2004.

l) Hedging relationships and accounting for derivative financial instruments:

The Company occasionally uses derivative financial instruments for hedging purposes in the management of foreign currency rate exposures. The Company's policy is not to use derivatives for trading or speculative purposes. The Company has chosen not to designate its derivative forward foreign exchange contracts as hedges. Consequently, derivatives for which hedge accounting is not applied are carried on the balance sheet at fair value, with changes in fair value being recorded in the statement of operations.

m) Recently issued accounting standards:

Financial Instruments Recognition and Measurement:

In April 2005, the CICA issued Handbook Section 3855, "Financial Instruments Recognition and Measurement", effective for the fiscal years beginning on or after October 1, 2006. This new section establishes standards for the recognition and measurement of all financial instruments, provides a characteristic-based definition of a derivative financial instrument, provides criteria to be used to determine when a financial instrument should be recognized, and provides criteria to be used when a

NOTES TO CONSOLIDATED FINANCIAL
STATEMENTS FOR THE YEAR ENDED
DECEMBER 31, 2005

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

m) Recently issued accounting standards (continued)

financial instrument is to be extinguished. The Company is currently evaluating the impact of this standard on its financial statements.

Comprehensive Income:

In April 2005, the CICA issued new Handbook Section 1530, Comprehensive Income, and Section 3251, Equity, effective for fiscal years beginning on or after October 1, 2006. Section 1530 establishes standards for reporting comprehensive income. It defines other comprehensive income to include revenue, expenses, gains and losses that, in accordance with primary sources of GAAP, are recognized in comprehensive income, but excluded from net income. Section 1530 does not address issues of recognition or measurement for comprehensive income and its components. Section 3251 establishes standards for the presentation of equity and changes in equity during the reporting period. The requirements in Section 3251 are in addition to Section 1530 and recommend that an enterprise should present separately the following components of equity: retained earnings, accumulated other comprehensive income, the total for retained earnings and accumulated other comprehensive income, contributed surplus, share capital and reserves. The Company is currently evaluating the impact of this standard on its financial statements.

Hedges:

In April 2005, the CICA issued new Handbook Section 3865, Hedges, effective for fiscal years beginning on or after October 1, 2006. This new section establishes standards from when and how hedge accounting may be applied. The Company is currently evaluating the impact of this standard on its financial statements.

Non-monetary transactions:

In June 2005, the CICA issued new Handbook Section 3831, Non monetary transactions, effective for fiscal years beginning on or after January 1, 2006. This standard requires all non monetary transactions to be measured at fair value unless they meet one of four very specific criteria. Commercial substance replaces culmination of the earnings process as the test for fair value measurement. A transaction has commercial substance if it causes an identifiable and measurable change in the economic circumstances of the entity. The adoption of this standard is not expected to have an impact on the Company's financial statements.

3. ACQUISITION

During the year, the Company acquired the assets of Beutel Communications Inc. The assets purchased for cash consideration of \$100,000 plus 5% of the gross revenue realized from Beutel customers for a period of thirty six months after the closing date. The fair value of assets acquired is as follows:

Telecommunication equipment	\$ 50,000
Software	40,000
Intangible - customer lists	100,675
	\$ 190,675

NOTES TO CONSOLIDATED FINANCIAL
STATEMENTS FOR THE YEAR ENDED
DECEMBER 31, 2005

3. ACQUISITION (CONTINUED)

The fair value of the customer lists of \$100,675 is comprised of cash consideration of \$10,000 plus the discounted obligation to the seller of 5% of the projected gross revenue from Beetel customers over the next 36 months. Future gross revenue is estimated based on historical data.

As at December 31, 2005, the unpaid discounted obligation is \$66,850.

4. SHORT TERM INVESTMENT

Short term investment is comprised of a GIC bearing interest at 2% maturing in November 2006. .

5. PROPERTY AND EQUIPMENT

2005

	Cost	Accumulated Amortization	Net
Furniture and fixtures	\$ 134,006	\$ 114,772	\$ 19,234
Computer and telecommunication equipment	2,752,193	1,806,721	945,472
Computer software	539,669	398,422	141,247
Leasehold improvements	166,349	100,179	66,170
	\$ 3,592,217	\$ 2,420,094	\$ 1,172,123

2004

	Cost	Accumulated Amortization	Net
Furniture and fixtures	\$ 126,336	\$ 109,309	\$ 17,027
Computer and telecommunication equipment	3,089,826	2,037,172	1,052,654
Computer software	499,668	305,026	194,642
Leasehold improvements	121,588	86,159	35,429
	\$ 3,837,418	\$ 2,537,666	\$ 1,299,752

Included in computer and telecommunication equipment are capital leases with a net book value of \$669,529 (2004 \$418,103).

6. INTANGIBLE

	Cost	Accumulated Amortization	Net
Customer lists (note 3)	\$ 100,675	\$ 11,745	\$ 88,930

NOTES TO CONSOLIDATED FINANCIAL
STATEMENTS FOR THE YEAR ENDED
DECEMBER 31, 2005

7. LONG-TERM DEBT

	2005	2004
Corporate term loan in US dollars bearing interest at 5% per annum and principal and interest repayments of \$17,510 (US \$12,076) monthly to maturity in February 2005.	\$ -	\$ 34,804
Less: current portion	-	(34,804)
	\$ -	\$ -

Included in interest on long term debt are interest charges on the above loan of \$332 (December 31, 2004 \$7,520).

8. CAPITAL LEASE OBLIGATIONS

Future minimum lease payments under capital leases are as follows:

2006	\$ 251,763
2007	223,157
2008	96,908
2009	8,359
2010 and subsequent year	10,449
	590,636
Less: interest portion at average rate of 18.8 %	110,821
	479,815
Less: current portion	(185,044)
	\$ 294,771

Interest expense on capital lease obligations of \$77,230 (December 31, 2004 \$75,052) has been included in interest on long term debt.

9. RELATED PARTIES TRANSACTIONS

The following table summarizes the Company's related party transactions for the year:

	2005	2004
Revenue		
Sale of phone time to a related company which has over 17% of common shares of the Company	\$ 449,000	\$ 124,659
Cost of sales		
Purchase of phone time from a related company which has over 17% of common shares of the Company	515,000	555,000
Operating expenses		
Rent paid on premises owned by certain directors	135,600	135,600

NOTES TO CONSOLIDATED FINANCIAL
STATEMENTS FOR THE YEAR ENDED
DECEMBER 31, 2005

9. RELATED PARTIES TRANSACTIONS (CONTINUED)

These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

At the end of the year, the amounts due from/(to) related entities are as follows:

	2005	2004
Related company which has over 17% of common shares of the Company	\$ 79,875	\$ (38,620)
Certain directors	\$ (5,825)	\$ (35,373)

10. COMMITMENTS

The Company is committed to future minimum annual lease payments under various operating leases as follows:

2006	\$ 242,261
2007	193,125
2008	193,125
2009	192,560
2010	200,259
	\$ 1,021,330

11. SHARE CAPITAL

a) Authorized:

The authorized share capital of the Company consists of 500,000 redeemable, voting, Series A special shares, and an unlimited number of common shares and special shares.

b) Common shares issued:

Changes in the issued and outstanding common shares are as follows:

	Number of Shares	Dollar Amount
Balance as at December 31, 2004	50,809,422	\$ 5,873,077
Balance as at December 31, 2005	50,809,422	\$ 5,873,077

NOTES TO CONSOLIDATED FINANCIAL
STATEMENTS FOR THE YEAR ENDED
DECEMBER 31, 2005

11. SHARE CAPITAL (CONTINUED)

c) Earnings per share:

Earnings per share is calculated using the weighted average number of common shares outstanding throughout the year.

The weighted average number of common shares outstanding for calculation of earnings per share are as follows:

	Basic	Diluted
Balance, December 31, 2005	50,809,422	50,809,422
Balance, December 31, 2004	50,809,422	50,809,422

In calculating diluted earnings per share for 2005, stock options were excluded due to their antidilutive effect. The average market price in 2005 was \$0.06 (December 31, 2004 – \$0.06) which was below the average option price of \$0.12.

d) Fixed stock option plan:

The Company has a fixed stock option plan under which, the maximum aggregate number of shares which may be purchased shall not exceed 8,000,000, subject to adjustment or increase of such numbers pursuant to changes in the capital stock of the Company.

At December 31, 2005, common shares of the Company were reserved as follows for stock options:

Price	Expiry Date	Number
\$0.23	July 2007	25,000
\$0.15	May 2007	1,262,000
\$0.10	December 2010	2,177,000

A summary of the status of the stock option plan as of December 31, 2005 and 2004, and changes during the years ended on those dates is presented below:

Fixed Options	2005		2004	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding beginning of year	2,175,000	\$ 0.15	2,733,000	\$ 0.15
Granted	2,177,000	\$ 0.10	-	\$ -
Forfeited	(888,000)	\$ 0.15	(558,000)	\$ 0.15
Outstanding end of year	3,464,000	\$ 0.12	2,175,000	\$ 0.15
Options exercisable year end	3,464,000	\$ 0.12	2,175,000	\$ 0.15

Included in the options were 2,100,000 options issued to the directors of the Company at an average exercise price of \$0.125.

NOTES TO CONSOLIDATED FINANCIAL
STATEMENTS FOR THE YEAR ENDED
DECEMBER 31, 2005

11. SHARE CAPITAL (CONTINUED)

d) Fixed stock option plan (continued)

The following table summarizes information about fixed stock options outstanding at December 31, 2005:

Options Outstanding and Exercisable			
Range of Exercise Prices	Number Outstanding December 31, 2005	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price
\$0.10 - \$0.15	3,464,000	4 years	\$ 0.12

As disclosed in Note 2, the fair value of stock options granted after January 1, 2004 is recognized as compensation cost. During the year ended December 31, 2005, \$1,821 (2004 - nil) was credited to Contributed Surplus as a compensation expense.

If compensation costs had been determined using the fair value method for stock options granted before January 1, 2004, net earnings and earnings per share information would have been as follows:

	2005		2004	
	Disclosed	Pro forma	Disclosed (note 16)	Pro forma (note 16)
Net earnings	\$ 101,683	\$ 81,269	\$ 500,165	\$ 483,235
Earnings per share	\$ 0.002	\$ 0.002	\$ 0.010	\$ 0.010
Diluted earnings per share	\$ 0.002	\$ 0.002	\$ 0.010	\$ 0.010

For purposes of calculating the compensation cost, the fair value of stock options is recognized using the straight line method over the vesting period of the stock options.

The fair value of options granted is estimated at the attribution date using the Black Scholes options pricing model on the basis of the following assumptions for attributions granted during the year:

Expected dividend on shares	None
Expected average volatility	132%
Weighted average risk free interest rate	3.83%
Expected average	4 years

There were 2,177,000 stock options granted during the year ended December 31, 2005 (nil in 2004).

e) Minority shareholders' agreement:

The Company has entered into an agreement with the minority shareholders of Call Select. On or after April 1, 2006, the minority shareholders have the option to sell their minority interest at their fair market value at that date to the Company. The Company also has the option to acquire these shares on the same terms. The Company can settle the transaction for cash or by issuance of common shares or combination thereof provided that the number of shares do not represent more than (3%) three percent of the Company's total outstanding common shares.

NOTES TO CONSOLIDATED FINANCIAL
STATEMENTS FOR THE YEAR ENDED
DECEMBER 31, 2005

12. INCOME TAXES

Income tax expense differs from the amounts which would be obtained by applying the combined Canadian basic Federal and Provincial income tax rate to earnings before income taxes. These differences result from the following items:

Year ended December 31,	2005	2004 (note 16)
Earnings before income taxes	\$ 101,683	\$ 500,165
Combined applicable Canadian basic Federal and Provincial income tax rate	36.12%	36.12%
Income taxes based on combined income tax rate	36,728	180,660
Increase in taxes due to timing differences in amortization of assets	77,942	23,873
Increase in taxes due to non-deductible expenses	16,246	19,658
Increase in income taxes resulting from losses of subsidiary companies for which an income tax benefit has not been recognized	149,365	208,407
Income tax expense	\$ 280,281	\$ 432,598

The Company has non capital losses of approximately \$3,305,938 for income tax purposes which may be used to reduce taxable income in future years, expiring between 2007 and 2015. No future tax asset has been recognized in respect of these amounts.

Significant components of the Company's future income tax assets, are as follows:

Year ended December 31,	2005	2004
Potential tax benefit related to:		
Operating losses carried forward	\$ 1,194,104	\$ 1,296,679
Total future tax assets	1,194,104	1,296,679
Valuation allowance	(1,194,104)	(1,296,679)
Net future income tax assets	\$ -	\$ -

The Company is currently undergoing an audit by the Canada Revenue Agency (CRA) relating to its subsidiary, Phonetime International Inc., for the fiscal years ended December 31, 2002 and 2003. The tax audit is not yet complete. Adjustments, if required as a result of the audit, will be accounted for prospectively. The amount of the adjustment, if any, has currently not been estimated and CRA has proposed no adjustments to date. Any adjustment will affect the loss carryforward of the Company.

NOTES TO CONSOLIDATED FINANCIAL
STATEMENTS FOR THE YEAR ENDED
DECEMBER 31, 2005

13. FINANCIAL INSTRUMENTS

Credit risk management:

The Company's exposure to credit risk arises from the possibility that its customers may fail to meet their obligations. The Company has credit evaluation, approval and monitoring processes, intended to mitigate these potential credit risks.

The Company evaluates the collectibility of accounts receivable and records an allowance for doubtful accounts, which reduces the receivables to the amount management reasonably believes will be collected. A specific allowance is recorded against customer receivables that are considered to be impaired on the Company's knowledge of the financial condition of its customers. As at December 31, 2005 concentration of credit risk exists as four customers comprised 11% of accounts receivable.

Currency risk:

Approximately 68% and 6% of the Company's purchases and sales, respectively, are in foreign currency. Consequently, those related liabilities and expenses are exposed to foreign exchange fluctuations. As at December 31, 2005, accounts payable from US suppliers was \$606,438 (2004, \$569,862) and accounts receivable from US customers was \$163,141 (2004, \$2,587). The Company uses forward exchange contracts to reduce its exposure to foreign exchange risk. As at December 31, 2005, no such contracts were outstanding.

Fair value:

The Company's financial instruments include cash and cash equivalents, short term investments, accounts receivable, accounts payable and accrued liabilities, capital lease obligations and amounts due to related parties. Due to the short term maturity of cash and cash equivalents, short term investments, accounts receivable, accounts payable and accrued liabilities, the carrying values of these financial instruments are reasonable estimates of their fair value.

The fair value of amounts due to related parties are not determinable due to the unavailability of similar borrowing arrangements on an arm's length basis.

The fair value of the components of long term debt and capital lease obligations are estimated by reference to current market prices for other debt securities with similar terms and characteristics. The carrying amount and fair value of these liabilities are as follows:

	2005		2004	
	Carrying Amount	Fair value	Carrying Amount	Fair value
Long term debt and obligations under capital leases	\$ 546,665	\$ 503,158	\$ 304,693	\$ 300,295

Interest rate risk:

The Company is not exposed to interest rate risk as all current and long term obligations bear no interest or are at fixed interest rates.

Credit facility:

The Company has an authorized operating facility of \$250,000 available in Canadian dollars or US dollar equivalent, none of which were utilized at year end (2004 - \$nil). The credit facility bears interest at the bank's prime rate plus 1.75%. The loan is secured by a general security agreement constituting a first ranking security interest on all assets of a subsidiary.

NOTES TO CONSOLIDATED FINANCIAL
STATEMENTS FOR THE YEAR ENDED
DECEMBER 31, 2005

14. SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Non cash operating, investing and financing activities are as follows:

Acquisitions of equipment through lease obligations	\$ 498,171
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15. SEGMENTED INFORMATION

The Company's reportable segments, as determined by management, are strategic business units that offer different products and services. The Company has three reportable segments: phone cards, wholesale long distance and other services (telecommunications), 1+ long distance services (1+ services) and corporate. All operating segments are in Canada. However, the Company purchases and sells products in Canada and United States. The accounting policies of the segments are the same as those described in significant accounting policies (note 2). The Company accounts for inter segment transfers at the exchange amount.

2005	Telecom- munications \$	1+ services \$	Corporate \$	Intersegment Eliminations \$	Total \$
Sales	15,325,786	4,870,555	-	(2,599,679)	17,596,662
Expenses	(13,997,445)	(4,961,348)	(288,115)	2,599,679	(16,647,229)
Interest on long term debt	(76,531)	(1,031)	-	-	(77,562)
Amortization	(733,903)	(36,285)	-	-	(770,188)
Net earnings (loss)	517,907	(128,109)	(288,115)	-	101,683
Total asset	4,815,748	1,333,239	5,219,900	(6,269,814)	5,099,073

2004	Telecom- munications \$	1+ services \$	Corporate \$	Intersegment Eliminations \$	Total \$
Sales	17,989,816	494,224	-	(252,093)	18,231,947
Expenses	(15,974,808)	(862,394)	(253,985)	252,093	(16,839,094)
Interest on long term debt	(82,407)	(165)	-	-	(82,572)
Amortization	(808,614)	(1,502)	-	-	(810,116)
Net earnings (loss) (note 16)	1,123,987	(369,837)	(253,985)	-	500,165
Total assets	4,649,342	299,896	5,494,879	(5,685,850)	4,758,267

NOTES TO CONSOLIDATED FINANCIAL
STATEMENTS FOR THE YEAR ENDED
DECEMBER 31, 2005

15. SEGMENTED INFORMATION (CONTINUED)

Geographic disclosures are as follows:

Year ended December 31,	2005	2004
Revenue:		
Canada	\$ 16,515,123	\$ 17,616,084
U.S.	1,081,539	615,863
	<u>\$ 17,596,662</u>	<u>\$ 18,231,947</u>

16. CORRECTION OF ERROR

The consolidated financial statements as at December 31, 2004 and for the year then ended have been corrected for an accounting error made regarding allocation of the losses in its subsidiary to non controlling interests in excess of its share of the capital of the subsidiary.

As a result of the above correction, comparative amounts for non controlling interest balance has been adjusted to Nil, net earnings for the year has decreased and cumulative deficit has increased by \$73,967.

17. RESTATEMENT OF PRIOR YEAR'S FINANCIAL STATEMENTS

The consolidated financial statements have been restated to give effect to the correction of the error (note 16).

The following is a summary of the effect of the correction of the error:

	Balances as previously reported	Correction of accounting error (note 16)	Balances as restated
Non controlling interest	\$ (73,957)	\$ 73,957	\$ -
Net earnings for the year	\$ 574,132	\$ (73,967)	\$ 500,165
Deficit end of year	<u>\$ (4,104,440)</u>	<u>\$ (73,967)</u>	<u>\$ (4,178,407)</u>

18. COMPARATIVE FIGURES

Certain 2004 comparative figures have been reclassified to conform with the presentation adopted for 2005.

OFFICERS

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Rodney Franklin
Chairman & C.E.O.

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BANK

Royal Bank of Canada
50 Bramalea Road
Bramalea, Ontario L6T 2W8

AUDITORS

Klasner & Solomon
Chartered Accountants
260 Town Center Boulevard
Suite 201
Markham, Ontario L3R 8H8

REGISTRAR

Computershare
100 University Avenue
8th Floor
Toronto, Ontario M5J 2Y1

LISTING

TSX Venture Exchange Symbol: PHD

SHARE INFORMATION

Shares Outstanding: 50,809,422

ANNUAL GENERAL &
SPECIAL MEETING OF
SHAREHOLDERS

Wednesday June 21, 2006
10:30 am
Board Room II
Valhalla Inn
1 Valhalla Inn Road
Toronto, Ontario M9B 1S9



3035 Wharton Way, Mississauga, ON Canada L4X 2B4

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