# Consolidated Balance Sheets

| As at December 31, ($ thousands) | **2006** | 2005 |
|---|---|---|
| ASSETS | | |
| Current Assets | | |
| Cash and equivalents (Note 4) | **$ 50,387** | $ 29,177 |
| Accounts receivable (Note 5) | **83,369** | 72,417 |
| Inventories and prepaid expenses | **1,174** | 1,724 |
| Cost in excess of billings | **620** | 13,127 |
| Income taxes recoverable | **-** | 3,310 |
| | **135,550** | 119,755 |
| | | |
| Long-term cash and equivalents (Note 4) | **4,000** | - |
| Future income tax assets (Note 13) | **631** | 435 |
| Property and equipment (Note 6) | **17,816** | 15,556 |
| Refundable deposit (Note 2) | **-** | 1,000 |
| Goodwill (Notes 9) | **7,315** | 7,315 |
| Intellectual property (Note 7) | **189** | - |
| | **$ 165,501** | $ 144,061 |
| LIABILITIES | | |
| Current Liabilities | | |
| Line of credit (Note 10) | **$ 12,000** | $ 7,780 |
| Accounts payable | **86,191** | 81,775 |
| Income taxes payable | **4,327** | - |
| Future income tax liability (Note 13) | **3,902** | 3,706 |
| Demand term loan (Note 12) | **6,825** | 7,540 |
| Current portion of long-term debt (Note 11) | **917** | 597 |
| | **114,162** | 101,398 |
| | | |
| Long-term debt (Note 11) | **3,419** | 2,301 |
| Future income tax liabilities (Note 13) | **231** | 143 |
| | **117,812** | 103,842 |
| Contingencies, Commitments and Guarantees (Notes 16, 17 and 18) | | |
| SHAREHOLDERS' EQUITY | | |
| Share capital (Note 14) | **15,508** | 15,472 |
| Contributed surplus (Note 14) | **5,779** | 5,754 |
| Retained earnings | **26,402** | 18,993 |
| | **47,689** | 40,219 |
| | **$ 165,501** | $ 144,061 |

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

On behalf of the board of directors:

Peter Adams
Chairman of the Board and
Interim Chief Executive Officer

Harry King
Director

# Consolidated Statements of Earnings

| For the years ended December 31,<br>($ thousands, except per share amounts) | 2006 | 2005 |
|---|---|---|
| CONSTRUCTION OPERATIONS | | |
| Contract revenue | $ 531,290 | $ 479,820 |
| Contract costs | 480,129 | 440,015 |
| Contract Income | 51,161 | 39,805 |
| | | |
| Interest income | 896 | 250 |
| Sundry income | 369 | 858 |
| Indirect and administrative expenses | (36,123) | (31,735) |
| Depreciation and amortization | (2,666) | (2,765) |
| Interest expense | (945) | (991) |
| Earnings before income taxes | 12,692 | 5,422 |
| Income tax (expense) recovery (Note 13) | | |
| Current income tax | (4,464) | 3,321 |
| Future income tax | (88) | (4,949) |
| | (4,552) | (1,628) |
| Net earnings | $ 8,140 | $ 3,794 |
| | | |
| Net earnings per Common Share (Note 15) | | |
| Basic | $ 0.46 | $ 0.24 |
| Fully diluted | $ 0.45 | $ 0.24 |

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

# Consolidated Statements of Retained Earnings

| For the years ended December 31,<br>($ thousands) | 2006 | 2005 |
|---|---|---|
| Retained earnings, beginning of period | $ 18,993 | $ 15,199 |
| Net earnings | 8,140 | 3,794 |
| Return of Laird escrowed shares (Note 14) | (731) | - |
| Retained earnings, end of period | $ 26,402 | $ 18,993 |

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

# Consolidated Statements of Cash Flow

| For the years ended December 31,<br>($ thousands) | **2006** | 2005 |
|---|---|---|
| OPERATING ACTIVITIES | | |
| Net earnings | **$ 8,140** | $ 3,794 |
| Depreciation and amortization | **2,666** | 2,765 |
| Gain on disposal of equipment | **(5)** | (13) |
| Gain on disposal of properties for sale | **-** | (620) |
| Future income tax | **88** | 4,949 |
| Stock-based compensation (Note 14) | **110** | 376 |
| | **10,999** | 11,251 |
| Net change in accounts receivable, inventories and prepaid expenses | **(10,402)** | 4,847 |
| Net change in accounts payable | **4,416** | 14,412 |
| Net change in costs in excess of billings | **12,507** | (31,064) |
| Net change in income taxes payable/recoverable | **7,637** | (2,356) |
| | **25,157** | (2,910) |
| INVESTING ACTIVITIES | | |
| Proceeds on disposal of property for sale | **-** | 723 |
| Long-term cash and equivalents | **(4,000)** | - |
| Proceeds on disposal of equipment | **226** | 24 |
| Additions to intellectual property | **(252)** | - |
| Additions to property and equipment | **(3,896)** | (2,573) |
| | **(7,922)** | (1,826) |
| FINANCING ACTIVITIES | | |
| Proceeds under line of credit | **24,570** | 7,780 |
| Repayments under line of credit | **(20,350)** | - |
| Issuance of short-term debt | **-** | 7,000 |
| Issuance of long-term debt | **967** | 9,011 |
| Repayment of long-term debt | **(717)** | (9,520) |
| Repayment of demand term loan | **(715)** | (260) |
| Redemption of term deposit | **-** | 4,000 |
| Issuance of common shares | **220** | 4,183 |
| | **3,975** | 22,194 |
| Increase in cash | **21,210** | 17,458 |
| Cash, beginning of period | **29,177** | 11,719 |
| Cash, end of period | **$ 50,387** | $ 29,177 |

| SUPPLEMENTAL CASH FLOW INFORMATION | **2006** | 2005 |
|---|---|---|
| Cash paid (received) during the year for: | | |
| Interest expense | **$ 957** | $ 1,239 |
| Income tax | **$ (3,173)** | $ (965) |

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

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## 1. SIGNIFICANT ACCOUNTING POLICIES

The Churchill Corporation ("the Corporation") provides building construction, heavy industrial general contracting, industrial insulation contracting, industrial electrical and instrumentation contracting and related services within Canada.

The consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles, and reflect the following policies:

### PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the following subsidiaries, their subsidiaries and limited partnership:

Stuart Olson Construction Ltd. (100%)

Insulation Holdings Inc. (100%)

Triton Construction Inc. (100%)

Triton Projects Limited Partnership (100%)

Laird Electric Inc. (100%)

Churchill Industrial Group Ltd. (100%)

Joint ventures are accounted for on the proportionate consolidation basis, which results in the Corporation recognizing its pro rata share of the assets, liabilities, revenues, and expenses of each of the entities.

### VARIABLE INTEREST ENTITIES

Effective January 1, 2005, the Corporation adopted the recommendations of CICA Handbook Accounting Guideline 15 (AcG – 15) *Consolidation of Variable Interest Entities*, effective for annual or interim periods beginning on or after November 1, 2004. Variable Interest Entities refer to those entities that are subject to control on a basis other than ownership of voting interests. AcG – 15 provides guidance for identifying Variable Interest Entities and criteria for determining which entity, if any, should consolidate them. The Corporation determined that it does not hold an interest in a variable interest entity and there was no material impact on the consolidated financial statements from the adoption of AcG – 15.

### IMPLICIT VARIABLE INTERESTS

Effective January 1, 2006, the Corporation adopted the Emerging Issues Committee's Abstract 157 Implicit Variable Interests under AcG - 15 (EIC 157)  The EIC requires that the Corporation address whether any implicit or potential variable interests exists when specific conditions exist and account for them in accordance with the CICA Handbook Accounting Guideline 15 (AcG – 15) – Consolidation of Variable Interest Entities. The Corporation has determined that there is no material impact on the consolidated financial statements from the adoption of EIC 157.

## NON-MONETARY TRANSACTIONS

Effective January 1, 2006, the Corporation adopted the amended recommendations of CICA Handbook Section 3831 Non-monetary transactions, (formerly Section 3830 of the same title) effective for annual or interim periods beginning on or after January 1, 2006. Section 3831 requires all non-monetary transactions be measured at fair value unless certain conditions are satisfied. The Corporation has determined that there is no material impact on the consolidated financial statements from the adoption of Section 3831.

## STOCK BASED COMPENSATION FOR EMPLOYEES ELIGIBLE TO RETIRE BEFORE THE VESTING DATE

Effective December 31, 2006, the Corporation adopted the Emerging Issues Committee's Abstract 162 *Stock-based compensation for employees eligible to retire before the vesting date* (EIC 162). The EIC establishes guidance where an entity has a stock-based compensation plan that contains provisions that allow an employee to continue vesting in an award in accordance with the stated vesting terms after the employee has retired from the entity and, therefore, is no longer providing service to the entity in return for the award. This abstract is to be applied retroactively, with restatement of prior periods, to all stock-based compensation awards accounted for in accordance with Section 3870 in financial statements issued for interim and annual periods ending on or after December 31, 2006. The Corporation has determined that there is no material impact on the consolidated financial statements from the adoption of EIC 162.

## USE OF ESTIMATES

Consolidated financial statements prepared in accordance with generally accepted accounting principles require management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expense during the reporting period. Actual results could differ from these estimates. A certain amount of uncertainty is inherent in estimating the cost of completing construction projects, the estimated useful life of equipment and corresponding depreciation rates, the useful life of intellectual property and corresponding amortization rates, allowances for doubtful accounts receivable, future income taxes, provision for legal contingencies, valuation of stock options and the fair value of goodwill, intangible assets and other financial instruments. The impact on the consolidated financial statements of future changes in such estimates could be material.

## INVENTORIES

Inventories are recorded at the lower of cost and net realizable value.

## PROPERTY AND EQUIPMENT

Property and equipment are recorded at cost and depreciated using either the diminishing-balance or the straight-line methods over their estimated useful lives at the rates indicated in Note 6.

## ASSET IMPAIRMENT

The Corporation tests for the impairment of long-lived assets held for use through a two-step process, with the first step determining when an impairment is recognized, and the second step measuring the amount of the impairment. An impairment loss is recognized when the carrying amount of a long-lived asset exceeds the sum of the undiscounted cash flows expected to result from its use and eventual disposition, and is measured as the amount by which the long-lived asset's carrying amount exceeds its fair value.

## EMPLOYEE FUTURE BENEFITS

The Corporation and its subsidiaries have a Registered Retirement Savings Plan and an Employee Share Purchase Plan. The Corporation contributes to the plans based on the amount of employee contributions. The Corporation accounts for contributions as an expense in the period that they are made (Note 21). The Corporation does not provide post employment or post-retirement benefits.

## CONTRACT INCOME

Contract revenue for cost-plus contracts is recorded as the service is performed and the related expenses are incurred. Contract revenue from fixed-price contracts is recognized on the percentage of completion basis. Percentage of completion is determined by relating either the actual cost of work or the actual hours performed to date, to the current estimated total cost or estimated total hours for each contract. Any projected loss is recognized immediately.

## INCOME TAXES

The Corporation uses the asset and liability method of accounting for future income taxes. Under this method, future income tax assets and future income tax liabilities are recorded based on temporary differences between the carrying amount of balance sheet items and their corresponding tax bases. In addition, the future benefits of income tax assets, including unused tax losses, are recognized, subject to a valuation allowance, to the extent it is more likely than not such future benefits will ultimately be realized. Future income tax assets and liabilities are measured using enacted tax rates and laws expected to apply when the tax liabilities or assets are to be either settled or realized.

## EARNINGS PER SHARE

Fully diluted earnings per share is computed using the treasury stock method, whereby it is assumed that any proceeds obtained upon the exercise of outstanding options would be used to buy back Common Shares at the average market price during the period.

## STOCK-BASED COMPENSATION PLAN

The Corporation utilizes the fair value based method of accounting for stock options which were granted to employees on or after January 1, 2002. Under this method, the estimated fair value of the stock options granted is recognized over the applicable vesting period as a charge to stock compensation expense and a credit to contributed surplus. When these options are exercised, the proceeds received and the related amounts of contributed surplus are credited to share capital. For options granted prior to January 1, 2002, the Corporation continues to follow the applicable generally accepted accounting principle under which no expense is recognized; when these options are exercised, the proceeds are a credit to share capital.

The Corporation has one stock option plan as described in Note 14.

## CASH AND EQUIVALENTS

For the purposes of presentation, on the Consolidated Statements of Cash Flow, cash and equivalents are comprised of bank balances and short term investments with original terms to maturity of less than 90 days.

## INTANGIBLE ASSETS AND GOODWILL

The Corporation records intangible assets with indefinite lives and goodwill at cost. The Corporation tests its goodwill and intangible assets with infinite lives for impairment on an annual basis, or more frequently if events and changes in circumstances indicate that the asset might be impaired. Consistent with current industry-specific valuation methods and recommendations for assessment, the Corporation uses a combination of the discounted cash flow model and the market comparable approach for determining the fair value of its reporting units. The Corporation has selected December as its annual test time.

## FINANCIAL INSTRUMENTS – DISCLOSURE AND PRESENTATION

Effective January 1, 2005, the Corporation adopted the amended recommendations of CICA Handbook Section 3860, *Financial Instruments – Disclosure and Presentation* effective for annual or interim periods beginning on or after November 1, 2004. Section 3860 requires that certain obligations that may be settled at the issuer's option in cash or the equivalent value by a variable number of the issuer's own equity instruments be presented as a liability. The Corporation determined there is no impact on these consolidated financial statements from the adoption of amendments to Section 3860.

## GUARANTEES

The Corporation discloses the nature, amount and term of obligations under guarantee and has provided additional disclosure in Note 18.

# 2. ACQUISITION OF SUBSIDIARY ($ thousands)

On February 7, 2003, the Corporation acquired all of the issued and outstanding shares of Laird Electric Inc. (Laird) for $9,743 plus a refundable deposit of $1,000. The $10,743 payment was comprised of $8,520 plus the issuance from treasury of 826,412 Common Shares of the Corporation valued at $2,223.

The refundable deposit of $1,000 was recoverable in the event that Laird did not achieve a cumulative financial performance objective by December 31, 2005. The potential refund was secured by shares of the Corporation held in escrow without further recourse. Under the escrow agreement, the vendors were required to maintain $1,000 in escrow either through shares or equivalent cash if shares were released.

In 2006, the shares were returned from escrow for cancellation to satisfy the refundable deposit since the specified cumulative performance measures were not met (Note 14).

# 3. JOINT VENTURES

The Corporation and its subsidiaries are partners in incorporated and unincorporated joint ventures. These consolidated financial statements include the proportionate share of assets, liabilities, revenue, expenses, net income and cash flow of these joint ventures as follows:

| ($ thousands) | 2006 | 2005 |
|---|---|---|
| Current and total assets | $ 2,367 | $ 220 |
| Current and total liabilities | 2,431 | 277 |
| Contract revenue | 1,783 | 5,619 |
| Contract costs and expenses | 1,789 | 5,456 |
| Net (loss) earnings | (7) | 162 |
| Cash flow provided by operating activities | 564 | 107 |

## 4. CASH ($ thousands)

Included in cash and equivalents balance of $50,387 (2005 - $29,177) is $10,654 (2005 - $9,857) which is restricted under the British Columbia Lien Act and relates to the payment of current liabilities related to specific construction projects. Cash balances of $762 (2005 - $119) are in joint venture accounts. $4,000 has been classified as long-term as it is restricted in use.

## 5. ACCOUNTS RECEIVABLE

Accounts receivable are comprised of:

| ($ thousands) | | 2006 | | 2005 |
|---|---|---|---|---|
| Trades receivable | $ | 54,833 | $ | 49,385 |
| Holdback | | 24,453 | | 20,290 |
| Other | | 4,083 | | 2,742 |
| | $ | 83,369 | $ | 72,417 |

## 6. PROPERTY AND EQUIPMENT

| ($ thousands) | 2006 | | | | | | 2005 | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Cost | | Accumulated Depreciation | | Net Book Value | | Net Book Value | Depreciation Rates |
| Land | $ | 1,599 | $ | - | $ | 1,599 | $ | 1,599 | - |
| Buildings and improvements | | 11,840 | | 3,119 | | 8,721 | | 7,862 | 4% - 30% |
| Vehicles and equipment | | 25,456 | | 17,960 | | 7,496 | | 6,095 | 6% - 100% |
| | $ | 38,895 | $ | 21,079 | $ | 17,816 | $ | 15,556 | |

Depreciation for the year amounted to $2,603 (2005 - $2,534).

## 7. INTELLECTUAL PROPERTY

| ($ thousands) | | 2006 | | 2005 |
|---|---|---|---|---|
| Cost | $ | 252 | $ | - |
| Accumulated amortization | | 63 | | - |
| Net Book Value | $ | 189 | $ | - |

The intangible assets relate to intellectual property resulting from the design and implementation of processes related to the Corporation’s computer system. The intangible assets will be amortized straight line over 3 years.

## 8. INTANGIBLE ASSETS

| ($ thousands) | 2006 | 2005 |
|---|---|---|
| Cost | $ - | $ 1,000 |
| Accumulated amortization | - | 1,000 |
| Net Book Value | $ - | $ - |

The intangible assets relate to employment contracts which arose on the acquisition of Laird and were amortized over the term of the related contracts on a straight-line basis. Amortization for the year of $0 (2005 - $231) was recorded.

## 9. GOODWILL

| ($ thousands) | 2006 | 2005 |
|---|---|---|
| Goodwill | $ 7,315 | $ 7,315 |

The goodwill arose on the acquisition of Laird (Note 2).

## 10. LINES OF CREDIT ($ thousands)

The bank indebtedness is comprised of an operating line of credit with a maximum availability of $21,000 (2005- $12,000). The line of credit bears interest at prime plus 1.0%. The total amount ultimately available under this facility is subject to limits based on certain financial ratios. In addition, availability of the operating line is subject to default provisions of the Corporation's credit facilities' debt covenants (Note 12).

In contemplation of a pending private placement, on April 25, 2005, the Corporation received short-term funding of $7,000 at 9%, repayable on July 31, 2005. Upon shareholder approval, the balance of the $7,000 loan outstanding was converted to Common Shares at $2.00 per share which represented market value of the shares at the date the agreement was entered (Note 14). The conversion of the loan was treated as a non-cash item for the purposes of the consolidated statements of net cash flow.

## 11. LONG-TERM DEBT

| ($ thousands) | 2006 | 2005 |
|---|---|---|
| Mortgage payable | $ 1,226 | $ 1,260 |
| Finance contracts and capital leases | 3,110 | 1,638 |
| | 4,336 | 2,898 |
| Less current portion | (917) | (597) |
| | $ 3,419 | $ 2,301 |

The mortgage payable bears interest at 6.47%, is repayable in blended monthly payments of $10, matures in November 2009, and is secured by land and buildings with a net book value of $2,199 and a site specific General Security Agreement.

Finance contracts and certain capital leases bear a weighted average interest rate of 2.4%, are payable in blended monthly payments of $63, mature at various dates up to 2011, and are secured by vehicles and equipment with a net book value of $1,810.

The Corporation has added a leasing facility with a borrowing limit of up to $3,000 to assist the Corporation with the purchase of capital assets. The leasing facility bears interest at the three year GIC rate plus 3.25%, is repayable in blended monthly payments of $22, and is secured by vehicles and equipment with a net book value of $1,192. As at December 31, 2006, the Corporation has utilized $1,347 of the leasing facility. Of this utilized portion $1,188 has been treated as a non-cash item in the Consolidated Statements of Cash Flow.

Interest expense on long-term debt during the twelve months ended December 31, 2006 was $167 (2005 - $589).

Estimated principal payments in the next five years are:

| Scheduled Repayment<br>($ thousands) | | |
|---|---|---|
| 2007 | $ | 917 |
| 2008 | | 854 |
| 2009 | | 657 |
| 2010 | | 443 |
| 2011 | | 447 |
| Thereafter | | 1,018 |

## 12. DEMAND TERM LOAN ($ thousands)

The Corporation's demand term loan has certain demand features. As a result, $5,980 of the demand term loan, which is scheduled to be repaid beyond 12 months, has been classified as a current liability on the balance sheet. The Corporation's bank has acknowledged that the $5,980 will not be considered a current liability for the purpose of calculating debt covenants.

The demand term loan bears interest at prime plus 1.25%, is repayable in monthly payments of $65, matures in August 2011, and is secured by a mortgage on the modular fabrication facility, mortgages on two of the Corporation's properties, various general security agreements and unlimited guarantees from the Corporation and its wholly owned subsidiaries. The net book value of the land and buildings at December 31, 2006 is $6,940.

The demand term loan, and the line of credit (Note 10) are subject to certain debt covenants calculated on a quarterly basis. At December 31, 2006, the Corporation was in compliance with its debt covenants.

For the year ended December 31, 2006, interest expense on the demand term loan was $507 (2005 - $148).

# 13. INCOME TAXES

The Corporation's tax expense differs from the provision computed at statutory rates as follows:

| ($ thousands) | | 2006 | | 2005 |
|---|---|---|---|---|
| Net earnings before income taxes | $ | 12,692 | $ | 5,422 |
| Non-deductible expenses | | 598 | | 551 |
| Earnings subject to tax | $ | 13,290 | $ | 5,973 |
| Income tax at statutory rate of 32.49% (2005 - 33.62%) of taxable income | $ | 4,318 | $ | 2,008 |
| Valuation allowance on non-capital loss carryforwards | | 266 | | - |
| Effect of change in tax rates for future income tax and tax recovery | | (200) | | (119) |
| Other | | 168 | | (261) |
| Income tax expense | $ | 4,552 | $ | 1,628 |

The components of the future income tax assets and liabilities are as follows:

| ($ thousands) | | 2006 | | 2005 |
|---|---|---|---|---|
| Tax loss carryforwards | $ | 1,895 | $ | 3,834 |
| Valuation allowance on non-capital loss carryforwards | | (266) | | - |
| Equipment and other assets | | 78 | | 165 |
| Unbilled work-in-progress and holdback receivable | | (5,655) | | (7,551) |
| Other | | 446 | | 138 |
| | $ | (3,502) | $ | (3,414) |
| Classified as: | | | | |
| Long-term asset | $ | 631 | $ | 435 |
| Current liability | | (3,902) | | (3,706) |
| Long-term liability | | (231) | | (143) |
| | $ | (3,502) | $ | (3,414) |

The Corporation has accumulated net capital losses for income tax purposes of $7,172 which may be carried forward indefinitely to reduce future capital gains. The value of these losses has not been recognized in these consolidated financial statements.

The Corporation has accumulated non-capital losses for income tax purposes of $5,841 which expire as follows:

| | |
|---|---:|
| 2008 | 154 |
| 2009 | 7 |
| 2010 | 117 |
| 2014 | 1,089 |
| 2015 | 912 |
| 2026 | 3,562 |

## 14. SHAREHOLDERS' EQUITY

### SHARE CAPITAL

*Authorized*

Unlimited Preferred Shares issuable in series with rights set by the directors
Unlimited Common Shares

| Issued | 2006 | | | 2005 | | |
|---|---:|---|---:|---:|---|---:|
| ($ thousands, except share and per share amounts) | Shares | Share Capital | | Shares | Share Capital | |
| Common Shares: | | | | | | |
| Issued, beginning of year | 17,895,686 | $ | 15,472 | 12,238,352 | $ | 4,289 |
| New shares issued | - | | - | 5,323,000 | $ | 10,646 |
| Shares cancelled | (311,528) | | (269) | - | | - |
| Stock options exercised | 83,333 | | 305 | 334,334 | | 537 |
| Issued, end of year | 17,667,491 | $ | 15,508 | 17,895,686 | $ | 15,472 |

### PRIVATE PLACEMENT

On May 13, 2005, the shareholders issued 5,323,000 Common Shares pursuant to two private placement agreements for total proceeds of $10,646. The agreements are with two parties for $3,646 and $7,000 (Note 10) respectively.

### CONTRIBUTED SURPLUS

Contributed surplus is comprised of $5,128 which arose in 1997 from the acquisition of Preferred Shares, with an issue price of $9,829, for $4,142 plus associated acquisition costs of $559 and $651 (2005 - $626) arising from cumulative compensation cost of options to acquire common shares of the Corporation issued since January 1, 2002. Current year activity includes an increase of $110 in compensation costs of options to acquire common shares with a decrease in compensation expense due to a reclassification of $85 to common shares as a result of the exercise of certain stock options.

## SHARE-BASED COMPENSATION PLAN

The Corporation maintains an Employees and Directors Share Option Plan under which options may be granted by the Board of Directors for Common Shares of the Corporation. As at December 31, 2006, the maximum number of options available for issue under this plan is 545,082 (2005 – 86,666). The exercise price of each option can not be lower than the public market price on the date the options are granted. The Board of Directors sets the exercise period for each option granted, which may not exceed ten years, and the vesting term, which may not exceed five years.

## LAIRD ELECTRIC RETURN OF SHARES

Under the Laird purchase agreement, 311,528 shares with a stated value of $269 were issued from treasury and placed in escrow to support a refundable deposit of $1,000 (Note 2). If Laird did not achieve specified cumulative performance measures by December 31, 2005, the deposit was due to be refunded to Churchill by April 30, 2006. During the year ended December 31, 2006, the shares were returned from escrow for cancellation to satisfy the refundable deposit with a difference of $731 being charged to retained earnings.

A summary of the Corporation's outstanding share options under the Employee and Directors Share Option Plan at December 31, 2006 and 2005, indicating changes during the years ended on those dates is presented below:

| ($ thousands, except share and per share amounts) | 2006 | | 2005 | |
|---|---|---|---|---|
| | Number of Share Option | Weighted Average Exercise Price | Number of Share Option | Weighted Average Exercise Price |
| Outstanding, beginning of year | 605,000 | $ 2.91 | 564,334 | $ 2.35 |
| Granted | 50,000 | 3.05 | 475,000 | 2.86 |
| Cancelled | - | - | (100,000) | 3.84 |
| Exercised | (83,333) | 2.64 | (334,334) | 1.61 |
| Outstanding, end of year | 571,667 | $ 2.96 | 605,000 | $ 2.91 |

The following table summarizes information about share options outstanding under the Plan at December 31, 2006:

| Exercise Price | Expiry Date | Options Outstanding Dec. 31, 2006 | Options Exercisable Dec. 31, 2006 |
|---|---|---|---|
| $ 3.84 | Aug. 9, 2007 | 25,000 | 25,000 |
| 2.95 | Oct. 7, 2007 | 105,000 | 105,000 |
| 2.40 | May 10, 2010 | 66,667 | - |
| 2.55 | June 14, 2010 | 50,000 | 16,666 |
| 2.80 | Sept. 14, 2010 | 50,000 | - |
| 3.15 | Nov. 30, 2010 | 225,000 | 225,000 |
| 3.05 | Jan. 4, 2011 | 50,000 | 25,000 |
| | | 571,667 | 396,666 |

The fair value of each option granted by the Corporation was estimated using the Black-Scholes option-pricing model and assuming no dividends are paid on common shares, weighted average risk-free interest rate of 3.59% (2005 – 3.56%), an average life of 3.7 years (2005 – 3.7 years), and a weighted average volatility of 46.04% (2005 – 46.05%). The amounts computed, according to the Black-Scholes pricing model, may not be indicative of the actual values realized upon the exercise of these options by the holders.

### SHAREHOLDER RIGHTS PLAN

The Corporation has an Amended and Restated Shareholder Rights Plan (the "Plan") which attaches one Right, with an Exercise Price of $20.00, to each outstanding Common Share of the Corporation. The Rights expire on September 30, 2007 unless exchanged or redeemed on an earlier date. Such Rights can only be exercised on the occurrence of a triggering event, which is defined as a person (an "Acquiring Person") acquiring, or publicly announcing its intention to acquire, 20% or more of the Common Shares, other than by an acquisition pursuant to a takeover bid permitted by the Plan. Upon occurrence of a triggering event, as described above, each Right entitles the holder, other than an Acquiring Person, to purchase that number of Common Shares of the Corporation having an aggregate market price equal to twice the Exercise Price, for a cash amount equal to the Exercise Price.

## 15. NET EARNINGS PER COMMON SHARE

Basic earnings per share is computed on the basis of the weighted average number of Common Shares outstanding. Fully diluted earnings per share is computed on the basis of the weighted average number of Common Shares outstanding plus the effect of outstanding stock options using the treasury stock method.

The components of basic and fully diluted earnings per share are as follows:

| Net earnings<br>($ thousands, except share and per share amounts) | 2006 | 2005 |
|---|---|---|
| | $ 8,140 | $ 3,794 |
| Weighted average number of common shares outstanding | 17,746,020 | 15,739,334 |
| Incremental number of shares under treasury stock method | 214,616 | 115,971 |
| | 17,960,636 | 15,855,305 |
| Net earnings per Common Share: | | |
| Basic | $ 0.46 | $ 0.24 |
| Fully diluted | $ 0.45 | $ 0.24 |

## 16. CONTINGENCIES

a) Subsidiaries of the Corporation are contingently liable for normal contractor obligations relating to performance and completion of construction contracts as well as obligations of associates in certain joint ventures.

b) The Corporation and its subsidiaries are defendants in lawsuits arising in the normal course of operations and involving various amounts. Management is of the opinion that the results of these actions should not have any material effect on the financial position of the Corporation. Any awards or settlements will be reflected in the Statement of Earnings as the matters are resolved.

## 17. COMMITMENTS

The Corporation and its subsidiaries lease certain equipment, vehicles, office premises, and are also committed to future annual payments in respect of a service agreement. Future minimum lease payments over the next five years are:

| ($ thousands) | |
|---|---:|
| 2007 | 1,489 |
| 2008 | 1,174 |
| 2009 | 950 |
| 2010 | 700 |
| 2011 | 407 |

## 18. GUARANTEES ($ thousands)

The Corporation is a partner in joint ventures (Note 3) for which it has provided a joint and several guarantee, increasing the maximum potential payment to the full value of the work remaining under the contract. The cost of completing the contracts cannot reasonably be determined, and may be greater or less than the unbilled portion of the contracts.

The Corporation has entered into a joint and several guarantee under the representations and warranties given as a part of a transaction whereby the Corporation's equity investment sold the majority of its assets to a third party in 2003. The Corporation also agreed to have $189 of its proceeds placed into an escrow account until February, 2008 to provide against product warranty claims and claims under the representations and warranties. There is no maximum potential payment under the guarantee. The Corporation has not recorded the escrow amounts as an asset as at December 31, 2006.

The Corporation indemnifies its directors and officers against claims reasonably incurred and resulting from the performance of their services to the Corporation and maintains liability insurance for its directors and officers as well as the directors and officers of its subsidiaries.

## 19. RELATED PARTY TRANSACTIONS ($ thousands)

The Corporation incurred rental costs of $21 (2005 - $24) related to market rental payments for housing provided to a senior officer who maintained offices in both Calgary and Edmonton. At December 31, 2006, $0 (2005 - $0) is included in accounts payable.

The Corporation incurred legal fees of $246 (2005 - $183) for services related to various legal matters with a law firm for which a director of the Corporation is also a partner of the firm. At December 31, 2006, $32 (2005 - $15) is included in accounts payable.

The Corporation incurred facility costs of $120 (2005 - $60) relating to rental of a building which is owned by a director of the Corporation. At December 31, 2006, $0 (2005 - $0) is included in accounts payable.

The Corporation incurred fees of $3 (2005 - $14) paid to a company under the control of a director of the Corporation. At December 31, 2006, $0 (2005 - $14) is included in accounts payable.

Related party transaction costs were incurred in the ordinary course of business where normal trade terms apply.

## 20. SEGMENTED INFORMATION

The Corporation operates as a construction and maintenance services provider, primarily in western Canada. The Corporation is managed using five business segments: Buildings, Industrial General Contracting, Industrial Insulation Contracting, Industrial Electrical Contracting, and Corporate and Other.

***Buildings*** is active in the construction of commercial, institutional, light-industrial and multi-unit residential buildings.

***Industrial General Contracting*** includes heavy industrial general contracting, fabrication, site work and ongoing maintenance.

***Industrial Insulation Contracting*** includes all insulation, siding, fireproofing, asbestos abatement and plant maintenance services including, in certain instances, services provided to our industrial general contracting and industrial electrical contracting companies.

***Industrial Electrical Contracting*** includes industrial electrical, instrumentation and power line construction and maintenance services including, in certain instances, services provided to our industrial general contracting companies.

***Corporate and Other*** includes the Corporation's non-core investments as well as all corporate costs not allocated directly to another business segment.

The accounting policies of the reportable segments are the same as those described in Note 1. The segmented information provided is after the elimination of inter-segment management fees and loan balances and any related interest charges.

| Year Ended December 31, 2006<br>($ thousands) | Contract Revenue | Earnings (Loss) Before Tax | Depreciation & Amortization | Goodwill | Total Assets | Capital Expenditures |
|---|---|---|---|---|---|---|
| Buildings | $ 291,159 | $ 8,729 | $ 608 | $ - | $ 72,157 | $ 2,809 |
| Industrial General Contracting | 52,396 | (2,405) | 606 | - | 16,804 | 528 |
| Industrial Insulation Contracting | 77,674 | 5,421 | 315 | - | 21,845 | 159 |
| Industrial Electrical Contracting | 110,134 | 4,407 | 646 | 7,315 | 38,261 | 1,031 |
| Corporate and Other | - | (3,455) | 491 | - | 16,434 | 557 |
| Inter-segment Adjustments | (73) | (5) | - | - | - | - |
| | $ 531,290 | $ 12,692 | $ 2,666 | $ 7,315 | $ 165,501 | $ 5,084 |

| As Reported<br>Year Ended December 31, 2005<br>($ thousands) | Contract Revenue | Earnings (Loss) Before Tax | Depreciation & Amortization | Goodwill | Total Assets | Capital Expenditures |
|---|---|---|---|---|---|---|
| Buildings | $ 227,481 | $ 4,360 | $ 581 | $ - | $ 45,713 | $ 496 |
| Industrial General Contracting | 100,670 | (800) | 693 | - | 32,271 | 347 |
| Industrial Insulation Contracting | 74,634 | 2,734 | 400 | - | 29,967 | 121 |
| Industrial Electrical Contracting | 79,827 | 2,657 | 709 | 7,315 | 27,361 | 1,365 |
| Corporate and Other | - | (3,546) | 382 | - | 8,749 | 244 |
| Inter-segment Adjustments | (2,792) | 17 | - | - | - | - |
| | $ 479,820 | $ 5,422 | $ 2,765 | $ 7,315 | $ 144,061 | $ 2,573 |

For the purposes of presentation, capital expenditures of $1,188 relating to capital leases from the leasing facility has been treated as a non-cash item and as such has not been reflected on the Consolidated Statements of Cash Flow (Note 11).

In 2005, the Corporation had $72,631 of revenue from one significant customer which represented greater than 10% of contract revenue. This revenue was earned in the Industrial Electrical Contracting and Industrial Insulation Contracting segments. In 2006, revenue from a single customer was not in excess of 10% of contract revenue.

A significant portion of the Industrial General Contracting, Industrial Insulation Contracting and Industrial Electrical Contracting segments contract revenue is derived from customers which operate directly or indirectly in the energy supply industry. Fluctuations in energy prices may impact future revenue derived from these customers. The Corporation does not actively manage this risk.

## 21. EMPLOYEE CONTRIBUTION PLANS ($ thousands)

The Corporation and its subsidiaries have a Registered Retirement Savings Plan and an Employee Share Purchase Plan whereby they match voluntary contributions made by employees to a maximum of 5% of base salary for each plan. Contributions made by the Corporation during the year to the plans were $2,384 (2005 - $1,832).

## 22. FINANCIAL INSTRUMENTS

Financial instruments consist of recorded amounts of receivables and other like amounts that will result in future cash receipts, as well as accounts payable, short-term borrowings, and any other amounts that will result in future cash outlays.

### RISK MANAGEMENT

The financial risk is the risk to the Corporation's earnings that arises from fluctuations in the interest rates and foreign exchange rates and the degree of volatility of these rates. The Corporation is exposed to interest rate risk on its floating rate operating line and its demand term loan as disclosed in Notes 10 and 12. The Corporation does not use derivative instruments to reduce its exposure to this risk. The Corporation is not currently exposed to any direct foreign currency risk.

### CREDIT RISK

The Corporation is exposed to credit risk through accounts receivable. This risk is minimized by the number of customers in diverse industries and geographic centers. The Corporation performs an assessment of its potential customers as part of its work procurement process, including an evaluation of financial capacity. The Corporation maintains provisions for potential credit losses, and any such losses to date have been within management's expectations.

### FAIR VALUE OF FINANCIAL INSTRUMENTS

As at December 31, 2006, the carrying value of financial instruments of the Corporation approximates their fair values.

## 23. COMPARATIVE FIGURES

Certain of the comparative figures have been adjusted to be consistent with the current year's presentation.