

Synodon Inc.
Interim Financial Statements
For the First Quarter Ended January 31, 2007 and 2006
Unaudited

Notice: These management prepared, unaudited interim financial statements have not been reviewed by the Company's auditors

Synodon Inc.
(a development stage enterprise)
BALANCE SHEETS
(see note 1 – basis of presentation)
(unaudited)

As at	<u>January 31,</u> 2007	<u>October 31,</u> 2006
	\$	\$
ASSETS		
Current		
Cash	141,238	305
Accounts receivable	144,275	120,746
Investment tax credits recoverable	418,696	353,342
Contract deposit	41,878	—
Prepaid expenses	8,568	5,579
	<u>754,655</u>	<u>479,972</u>
Property, plant and equipment [note 3]	14,356	15,376
Deferred transaction costs	—	311,959
	<u>769,011</u>	<u>807,307</u>
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIENCY)		
Current		
Accounts payable and accrued liabilities	278,289	810,073
Government assistance advance [note 7]	68,233	158,830
Notes payable [note 4]	121,000	112,000
Deposit on distribution rights	65,875	65,875
	<u>533,397</u>	<u>1,146,778</u>
Shareholders' equity (deficiency)		
Share capital [note 5]	4,250,990	3,285,593
Contributed surplus [note 6]	383,687	322,006
Deficit	(4,399,063)	(3,947,070)
	<u>235,614</u>	<u>(339,471)</u>
	<u>769,011</u>	<u>807,307</u>

See accompanying notes

On behalf of the Board:

(signed) "*Adrian Banica*"

Adrian Banica, President and Chief
Executive Officer

(signed) "*John Pinsent*"

John Pinsent, Chief Financial
Officer

Synodon Inc.
(a development stage enterprise)
STATEMENTS OF LOSS AND DEFICIT
(unaudited)

	Three months ended	
	January 31	
	<u>2007</u>	<u>2006</u>
REVENUE	—	—
EXPENSES		
Research and development costs, net of government assistance <i>[note 8]</i>	209,358	82,943
Amortization	1,380	2,227
Financing charges and interest	4,197	16,700
Foreign exchange (gains)	(365)	(6,064)
Stock-based compensation	66,191	12,000
Office and general administrative	171,232	90,112
	<u>451,993</u>	<u>197,918</u>
Loss for the period	(451,993)	(197,918)
Deficit, beginning of the period	(3,947,070)	(3,101,473)
Deficit, end of the period	(4,399,063)	(3,299,391)
Loss per share		
- Basic and diluted	(0.02)	(0.01)
Weighted-average number of shares outstanding	18,297,213	13,343,511

See accompanying notes

Synodon Inc.
(a development stage enterprise)
STATEMENTS OF CASH FLOWS
(unaudited)

	Three months ended	
	January 31,	
	2007	2006
	\$	\$
	(unaudited)	
OPERATING ACTIVITIES		
Loss for the period	(451,993)	(197,918)
Add charges to operations not requiring a current cash payment:		
Stock-based compensation	66,191	12,000
Non-cash interest expense	—	815
Amortization	1,380	2,227
	(384,422)	(182,876)
Net change in non-cash working capital balances related to operations:		
Accounts receivable	(23,529)	(2,651)
Investment tax credits recoverable	(65,354)	—
Contract deposit	(41,878)	—
Prepaid expenses	(2,989)	1,575
Accounts payable and accrued liabilities	(531,784)	89,992
Government assistance advance	(90,597)	—
Cash used in operating activities	(1,140,553)	(93,960)
INVESTING ACTIVITIES		
Purchase of property, plant and equipment	(360)	—
Cash used in investing activities	(360)	—
FINANCING ACTIVITIES		
Deposits on share subscription	—	50,000
Repayment of notes payable	(3,000)	—
Issuance of notes payable	12,000	25,000
Issuance of shares	1,431,150	60
Share issuances costs	(158,304)	—
Cash provided by financing activities	1,281,846	75,060
Net increase (decrease) in cash during the period	140,933	(18,900)
Cash, beginning of period	305	26
Cash, end of period	141,238	(18,874)
Supplemental cash flow information		
Interest paid	806	147

See accompanying notes

Synodon Inc.
(a development stage enterprise)
NOTES TO FINANCIAL STATEMENTS
Interim Financial Statements as at January 31, 2007
(unaudited)

1. NATURE OF BUSINESS AND BASIS OF PRESENTATION

These financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles on a going concern basis which presumes the realization of assets and discharge of liabilities in the normal course of business for the foreseeable future.

The Company has incurred significant losses since incorporation and as at January 31, 2007, the Company has an accumulated deficit of \$4,399,063. The Company's ability to continue as a going concern is dependant upon achieving profitable operations, the continued financial support of its lenders and the ability to obtain additional debt or equity financing. The outcome of these matters cannot be predicted at this time. These financial statements do not include any adjustment to the amounts and classification of assets and liabilities that might be necessary should the Company be unable to continue in business. Such adjustments could be material.

2. SIGNIFICANT ACCOUNTING POLICIES

These unaudited interim financial statements should be read in conjunction with the October 31, 2006 annual financial statements. The same accounting policies and methods are used as in the 2006 financial statements. In management's opinion, the interim financial statements include all adjustments necessary to present fairly such interim financial statements.

3. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of the following:

	January 31, 2007		
	Cost	Accumulated amortization	Net book value
	\$	\$	\$
Computer equipment	35,136	29,328	5,808
Computer software	6,120	6,120	—
Laboratory equipment	3,865	1,892	1,973
Furniture and fixtures	12,391	5,816	6,575
	57,512	43,156	14,356

	October 31, 2006		
	Cost	Accumulated amortization	Net book value
	\$	\$	\$
Computer equipment	35,136	28,389	6,747
Computer software	6,120	6,120	—
Laboratory equipment	3,865	1,788	2,077
Furniture and fixtures	12,031	5,479	6,552
	57,152	41,776	15,376

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4. NOTES PAYABLE

The notes payable consist of the following:

	<u>January 31,</u>	<u>October 31,</u>
	<u>2007</u>	<u>2006</u>
	\$	\$
Convertible promissory notes		
Notes, bearing interest at 8% per annum	60,000	60,000
Demand promissory notes		
Notes, bearing interest at 8% per annum	61,000	52,000
	121,000	112,000

The convertible promissory notes are either redeemable or convertible at the option of the holder. These notes are due on demand and are convertible into 150,000 Class A common shares. The fair value of the equity component of these notes is estimated to be nil.

During the three-month period ended January 31, 2007, the Corporation issued demand promissory notes with a face value of \$12,000 and repaid a demand promissory note with a face value of \$3,000. These notes are payable to directors of the Company and are payable on demand.

5. SHARE CAPITAL

	<u>January 31,</u>	<u>October 31,</u>
	<u>2007</u>	<u>2006</u>
	\$	\$
Authorized		
Unlimited number of Class A voting common shares		
Unlimited number of Class B voting common shares		
Unlimited number of Class C non-voting common shares		
Unlimited number of Class D non-voting common shares		
Unlimited number of Class E non-voting, redeemable, retractable preferred shares		
Issued and outstanding		
20,117,050 Class A common shares	4,250,990	
17,255,550 Class A common shares		3,285,593

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5. SHARE CAPITAL (CONTINUED)

The following table sets out the change in share capital:

	Number of shares	Total \$
Balance, October 31, 2005	13,134,815	1,776,483
Issued in private placements, net of costs of issuance of \$45,475	2,741,499	1,054,751
Issued for services	174,916	69,966
Issued for commissions on private placement	11,820	4,728
Issued on conversion of note payable	50,000	21,150
Issued for cash from exercise of options	1,142,500	115
Reclassify from contributed surplus on exercise of options	—	358,400
Balance, October 31, 2006	17,255,550	3,285,593
Issued in IPO, net of costs of issuance of \$470,263	2,807,500	933,487
Issued for cash on the exercise of warrants	4,000	2,400
Issued for cash from the exercise of options	50,000	25,000
Reclassify from contributed surplus on exercise of options	—	4,510
Balance, January 31, 2007	20,117,050	4,250,990

Initial public offering

On December 29, 2006, the Company raised \$1,403,750 from an initial public offering of 2,807,500 Units at a price of \$0.50 per Unit net of offering costs of \$470,263. Each Unit consisted of one Class A common share and one half of a common share purchase warrant. Each whole common share purchase warrant entitles the holder thereof to acquire one Class A common share at an exercise price of \$0.60 for 12 months from the date of closing of the offering and at a price of \$0.75 for the period commencing 12 months and a day to 24 months from the date of closing of the offering.

In connection with the offering the agent received 280,750 non-transferable compensation options entitling the holder to purchase up to 280,750 Units at a price of \$0.50 for a period of 24 months from the offering's closing date.

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5. SHARE CAPITAL (CONTINUED)

Warrants

At January 31, 2007 the Company had 2,425,431 (2006 – 34,555) common share purchase warrants outstanding, as follows:

Exercise price \$	Expiry date	Number outstanding and exercisable
0.60 - 0.70	December 31, 2007	586,876
0.65	January – October 2008	34,555
0.40	December 31, 2008	25,000
0.65 US	December 31, 2009	98,500
0.60 – 0.75	December 28, 2008	1,399,750
0.50	December 28, 2008	280,750
		2,425,431

Share options

Pursuant to options that qualified for distribution pursuant to the prospectus, the Company granted during the period 540,000 share options to directors and employees of the Company at an exercise price of \$0.50, which will expire 5 years from granting of the option. These options vest over a three year period with 230,000 options vesting in January 2007, 155,000 options vesting in December 2007 with the remaining 155,000 options vesting in December 2008. There were also 50,000 options that were cancelled due to the employment termination of an option holder and 50,000 options that were exercised during the period.

A compensation expense of \$66,191 was recognized during the period with an offsetting credit to contributed surplus. The fair value for the options issued were estimated on the grant date using the Black-Scholes options pricing model with the following assumptions being Risk-free interest rate at 4.5%, expected volatility being 90%, with an expected life of 5 years and a 0% expected dividend yield. Option pricing models require the input of highly subjective assumptions including the expected price volatility. Changes in the subjective input assumptions can materially affect the fair value estimate, and therefore, the existing models do not necessarily provide a reliable measure of the fair value of the Company's stock options.

The following table summarizes information about share options outstanding at January 31, 2007:

Exercise price \$	Year of grant	Number outstanding and exercisable	Weighted-average remaining contractual life [years]	Weighted-average exercise price \$
0.45	2005	400,000	2.9	0.45
0.40	2006	550,000	2.9	0.40
0.50	2006	100,000	4.3	0.50
0.50	2007	490,000	5.0	0.50
\$0.40 – 0.50		1,540,000	3.7	0.4513

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6. CONTRIBUTED SURPLUS

The following table sets out the change in contributed surplus:

	Three Months	Year ended
	January 31,	October 31,
	2007	2006
	\$	\$
Balance, beginning of period	322,006	586,156
Stock-based compensation-Grant of options	72,191	92,400
Stock-based compensation-Cancellation of options	(6,000)	—
Issuance of warrants	—	3,000
Transfer to share capital on conversion of Convertible promissory notes	—	(1,150)
Transfer to share capital on exercise of options	(4,510)	(358,400)
Balance, end of period	383,687	322,006

7. GOVERNMENT ASSISTANCE

SDTC funding

During 2006 the Company entered into a funding agreement with Canada Foundation for Sustainable Development Technology (“SDTC”) for the purpose of fostering the development and adoption of technologies that contribute to a sustainable development technology infrastructure in Canada by contributing to the rapid development, demonstration and pre-commercialization of technological solutions which address climate change and air quality. Upon the Company attaining pre-determined milestones, SDTC will advance non-repayable funds totalling the lesser of \$650,000 and 24.77% of the eligible project costs, less 10% holdbacks on each advance. As at January 31, 2007, Milestone #1 was earned and the Company received \$137,835 (\$153,150 less 10% holdback) for this milestone. The Company also received an advance of \$391,320 (\$434,800 less 10% holdback for Milestone #2. As at January 31, 2007, the Company had earned \$366,567 of the Milestone #2 funding. The balance of \$68,233 has been recorded as deferred government assistance. Milestone #3 for field testing, in the amount of up to \$62,050 is anticipated to be claimed by May, 2007. During the quarter ended January 31, 2007, \$90,597 [quarter ended January 31, 2006 - \$nil] of SDTC funding has been included as a reduction of research and development costs.

Investment tax credits

As of November 1, 2007 the Company ceased to be considered a Canadian-Controlled Private Corporation for the purpose of earning refundable Investment Tax Credits (ITC’s). Instead, the Company will file ITC claims on qualified expenditures at a rate of 20% and will apply them in the future towards taxes payable.

IERD funding

During the year ended October 31, 2004, the Company qualified for funding under the Industry Energy Research and Development Program (IERD). Under this government funding program, IERD committed to advance Synodon an amount equal to 28% of eligible costs incurred, up to a maximum of \$600,000. If any other government assistance is received, then an adjustment will be made to the total contribution. A 10% holdback is withheld until final approval of completion of the project and has been included in

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accounts receivable. The advances are non-interest bearing and are only repayable upon revenue earned, at an amount of 3% of revenue earned in connection with the project. As at January 31, 2007, a total of

7. GOVERNMENT ASSISTANCE (CONTINUED)

\$580,403 [October 31, 2006 - \$580,403] was advanced to the Company from the IERD program less a 10% holdback in each year. During the three-month period ended January 31, 2007, \$Nil of IERD funding has been included as a reduction in research and development costs [three-month period ended January 31, 2006 - \$Nil].

8. RESEARCH AND DEVELOPMENT COSTS

Research and development costs and reductions due to government assistance are summarized as follows:

	Three months ended January 31, 2007	Three months ended January 31, 2006
	\$	\$
Research and development expenditures	365,309	82,943
Investment tax credit [note 7]	(65,354)	—
SDTC government assistance [note 7]		
Milestone #2	(90,597)	—
Research and development costs, net of government assistance	209,358	82,943

9. RELATED PARTY TRANSACTIONS

Officers, directors and shareholders provided promissory notes as well as services to the Company through consulting and rental agreements. The related party transactions occurred during the normal course of the Company's operations and are measured at their exchange amounts, which is the consideration amount established and agreed upon with the related parties.

- (a) The Company leased facilities from an officer who is also a shareholder. Total rental payments for the three-month period ended January 31, 2007 were \$1,500 [three-month period ended January 31, 2006 - \$1,500].
- (b) The Company incurred interest on promissory notes in the amount of \$1,230 during the three-month period ended January 31, 2007 [three-month period ended January 31, 2006 - \$Nil] payable to directors of the Company as noted in note 4.

10. SUBSEQUENT EVENTS

Conversion of Promissory Notes

On March 5, 2007 the Company converted promissory notes of \$60,000 plus accrued interest to January 31, 2007 totalling \$5,000 in exchange for 130,000 Class A common shares and 65,000 common share purchase warrants. Each common share purchase warrant entitles the holder thereof to acquire one Class A common share at an exercise price of \$0.60 until December 28, 2007 and at a price of \$0.75 for the subsequent 12 month period.