

Synodon Inc.
Interim Financial Statements
For the Third Quarter Ended July 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>July 31,</u> 2007	<u>October 31,</u> 2006
	\$	\$
ASSETS		
Current		
Cash	19,738	305
Accounts receivable	111,884	120,746
Investment tax credits recoverable	—	353,342
Contract deposit	21,100	—
Prepaid expenses	21,763	5,579
	174,485	479,972
Property, plant and equipment [note 3]	13,514	15,376
Deferred transaction costs	—	311,959
	187,999	807,307
LIABILITIES AND SHAREHOLDERS' DEFICIENCY		
Current		
Accounts payable and accrued liabilities	565,729	810,073
Government assistance advance [note 8]	62,050	158,830
Notes payable [note 4]	56,000	112,000
Current portion of obligations under capital lease [note 5]	41,796	—
Deposit on distribution rights	65,875	65,875
	791,450	1,146,778
Obligations under capital lease [note 5]	37,516	—
Total liabilities	828,966	1,146,778
Shareholders' deficiency		
Share capital [note 6]	4,316,890	3,285,593
Contributed surplus [note 7]	427,067	322,006
Deficit	(5,384,924)	(3,947,070)
	(640,967)	(339,471)
	187,999	807,307

See accompanying notes

On behalf of the Board:

(signed) "Adrian Banica"

Adrian Banica, President and Chief
Executive Officer

(signed) "John Pinsent"

John Pinsent CA, Chief Financial
Officer

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

	Three months ended		Nine months ended	
	July 31,		July 31,	
	2007	2006	2007	2006
	\$	\$	\$	\$
REVENUE	—	—	—	—
EXPENSES				
Research and development costs, net of government assistance <i>[note 9]</i>	455,241	3,395	842,893	187,207
Amortization	1,315	2,445	4,487	6,900
Advertising and marketing	—	—	—	790
Financing charges and interest	5,003	1,927	15,927	25,555
Foreign exchange (gains) losses	(2,643)	104	2,795	(4,515)
Stock-based compensation	22,049	16,300	109,570	90,700
Office and general administrative	146,064	100,325	484,246	307,359
	627,029	124,496	1,459,918	613,996
Loss from operations	(627,029)	(124,496)	(1,459,918)	(613,996)
Other income	5,375	—	22,064	—
NET LOSS AND COMPREHENSIVE				
LOSS FOR THE PERIOD	(621,654)	(124,496)	(1,437,854)	(613,996)
Deficit, beginning of the period	(4,763,270)	(3,590,973)	(3,947,070)	(3,101,473)
Deficit, end of the period	(5,384,924)	(3,715,469)	(5,384,924)	(3,715,469)
Loss per share				
- Basic and diluted	(0.03)	(0.01)	(0.07)	(0.04)
Weighted-average number of shares outstanding	20,249,023	17,255,550	19,590,737	15,676,299

See accompanying notes

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

	Three months ended		Nine months ended	
	July 31,		July 31,	
	2007	2006	2007	2006
	\$	\$	\$	\$
OPERATING ACTIVITIES				
Loss for the period	(621,654)	(124,496)	(1,437,854)	(613,996)
Add charges to operations not requiring a current cash payment:				
Stock-based compensation	22,049	16,300	109,570	90,700
Non-cash payment for services	—	—	—	69,966
Non-cash interest expense	—	—	—	815
Amortization	1,315	2,445	4,487	6,900
Research and development costs, financed by lease financing capital	87,858	—	87,858	—
	(510,432)	(105,751)	(1,235,939)	(445,615)
Net change in non-cash working capital balances related to operations:				
Accounts receivable	34,814	(379,835)	8,862	(481,022)
Investment tax credits recoverable	174,471	—	353,342	—
Contract deposit	27,598	180,739	(21,100)	(53,690)
Prepaid expenses	(13,516)	(17,096)	(16,184)	(17,867)
Accounts payable and accrued liabilities	173,353	45,000	(243,853)	(255,115)
Government assistance advance	45,610	285,600	(96,780)	285,600
Cash provided by (used in) operating activities	(68,102)	8,657	(1,251,652)	(967,709)
INVESTING ACTIVITIES				
Purchase of property, plant and equipment	(2,605)	(4,181)	(4,275)	(4,181)
Cash used in investing activities	(2,605)	(4,181)	(4,275)	(4,181)
FINANCING ACTIVITIES				
Deposits on share subscriptions	—	—	—	(20,000)
Proceeds on disposal of assets	—	—	1,650	—
Repayment of notes payable	—	—	(8,000)	(20,000)
Issuance of notes payable	—	—	12,000	83,000
Repayment of obligations under capital leases	(8,546)	—	(8,546)	—
Issuance of shares	300	—	1,436,560	1,079,341
Share issuance costs	—	—	(158,304)	(24,489)
Deferred transaction costs	—	(81,871)	—	(116,346)
Cash provided by (used in) financing activities	(8,246)	(81,871)	1,275,360	981,506
Net increase (decrease) in cash during the period	(78,953)	(77,395)	19,433	9,616
Cash, beginning of period	98,691	87,037	305	26
Cash, end of period	19,738	9,642	19,738	9,642
Supplemental cash flow information				
Interest paid	2,072	254	3,384	49,158

See accompanying notes

Synodon Inc.
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NOTES TO FINANCIAL STATEMENTS
Interim Financial Statements as at July 31, 2007
(unaudited)

1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

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 July 31, 2007, the Company has an accumulated deficit of \$5,384,924. 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.

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.

2. CHANGES IN ACCOUNTING POLICIES

New Accounting Policies

Effective January 1, 2007, The Corporation adopted new recommendations of the Canadian Institute of Chartered Accountants ("CICA") under CICA Handbook Section 1530 Comprehensive Income, Section 3251 Equity, Section 3855 Financial Instruments – Recognition and Measurement, and Section 3861 Financial Instruments - Disclosure and Presentation. These new Handbook Sections apply to fiscal years beginning on or after October 1, 2006.

Comprehensive Income

Section 1530 establishes standards for the reporting of comprehensive income. The section defines other comprehensive income to include revenues, expenses, and gains and losses that, in accordance with primary sources of GAAP, are recognized in comprehensive income but excluded from net income. The adoption of Section 1530 did not have any impact on the Company's financial statement presentation for the current period.

Equity

Section 3251 establishes standards for the presentation of equity and changes in equity during the current period. The requirements in this section are in addition to those of 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 or deficit and accumulated other comprehensive income, contributed surplus, share capital, and reserves. The Company currently has no other comprehensive income components.

Financial Instruments

Under Section 3855, all financial instruments are classified into one of five categories: held for trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets or other financial liabilities. All financial instruments and derivatives are measured in the balance sheet at fair value, except

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2. CHANGES IN ACCOUNTING POLICIES (CONTINUED)

for loans and receivables, held-to-maturity investments, and other financial liabilities which are measured at amortized cost. Subsequent measurement and changes in fair value will depend on their initial classification. Held for trading financial instruments are measured at fair value and changes in fair value are recognized in net loss. Available-for-sale financial instruments are measured at fair value with changes in fair value recorded on other comprehensive loss until the instrument is derecognized or impaired.

As a result of the adoption of Section 3855, the Company has classified its cash as held for trading. Accounts receivable are classified as loans and receivables. Accounts payable and accrued liabilities, notes payable and obligations under capital lease are classified as other liabilities, all of which are measured at amortized cost. Financing costs incurred to issue long-term debt are now applied to reduce the fair value of the associated debt and amortized to interest expense using the effective interest rate method.

3. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of the following:

	July 31, 2007		
	Cost	Accumulated	Net book
	\$	amortization	value
		\$	\$
Computer equipment	36,735	31,111	5,624
Computer software	6,521	6,271	250
Laboratory equipment	3,865	2,100	1,765
Furniture and fixtures	12,391	6,516	5,875
	59,512	45,998	13,514

	October 31, 2006		
	Cost	Accumulated	Net book
	\$	amortization	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

4. NOTES PAYABLE

The Notes payable consist of the following:

	July 31,	October 31,
	2007	2006
	\$	\$
Convertible promissory notes		
Notes, bearing interest at 8% per annum	—	60,000
Demand promissory notes		
Notes, bearing interest at 8% per annum	56,000	52,000
	56,000	112,000

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4. NOTES PAYABLE (CONTINUED)

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.

During the nine months ended April 30, 2007, the Corporation issued demand promissory notes with a face value of \$12,000 and repaid demand promissory notes with a face value of \$8,000. These notes are payable to directors of the Company and are payable on demand.

5. Obligations Under Capital Lease

	<u>July 31,</u> <u>2007</u>	<u>October 31,</u> <u>2006</u>
	\$	\$
Vencore Solutions LLC, at 8.25% interest		
Lease contract #1, payable \$1,776 monthly, due October 10, 2009	47,939	—
Lease contract #2, payable \$526 monthly, due October 25, 2009	14,213	—
Lease contract #3, payable \$1,281 monthly, due November 25, 2009	35,867	—
	98,019	—
Less amounts representing interest and lease arrangement costs	(18,707)	—
	79,312	—
Less current portion of long-term debt	(41,796)	—
	37,516	—

The Company signed a lease agreement with Vencore Solutions LLC (“Vencore”) on May 8, 2007 giving the Company the ability to borrow up to US \$385,000 in long-term lease financing. As at July 31, 2007, the Company has drawn \$90,668 (US \$84,749) of the total committed funding. The balance of funds will be used to procure research and development materials necessary for the helicopter installation of the system in anticipation of field trials. As part of the terms of the Lease Agreement, Synodon issued to Vencore 66,000 warrants, exercisable at Cdn\$0.65 and with a term of two years.

Under the agreement with Vencore security deposits representing 15% of amounts advanced, are included in contract deposits. In addition, the Vencore Lease Agreements are collateralized by a security interest in all assets owned by the Company.

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6. SHARE CAPITAL

	<u>July 31,</u> <u>2007</u>	<u>October 31,</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		
20,248,550 Class A common shares	4,316,890	
17,255,550 Class A common shares		3,285,593

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	5,500	3,300
Issued for cash from the exercise of options	50,000	25,000
Issued on conversion of notes payable and accrued interest	130,000	65,000
Reclassify from contributed surplus on exercise of options	—	4,510
Balance July 31, 2007	20,248,550	4,316,890

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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6. SHARE CAPITAL (CONTINUED)

Warrants

At July 31, 2007 the Company had 2,525,931 (2006 – 744,931) 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	1,398,250
0.50	December 28, 2008	280,750
0.60	December 29, 2009	36,000
0.65	May 15, 2009	66,000
		2,525,931

Share options

Pursuant to options that qualified for distribution pursuant to the prospectus, the Company granted 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 100,000 options that were cancelled due to the employment termination of two option holders.

A compensation expense of \$109,570 was recognized during the nine-month 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 July 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	2.7	0.45
0.40	2006	550,000	2.7	0.40
0.50	2006	100,000	4.1	0.50
0.50	2007	490,000	4.7	0.50
\$0.40 – 0.50		1,540,000	3.4	0.4513

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7. CONTRIBUTED SURPLUS

The following table sets out the change in contributed surplus:

	Nine Months July 31,	Year ended October 31,
	2007	2006
	\$	\$
Balance, beginning of period	322,006	586,156
Stock-based compensation-grant of options	115,571	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	427,067	322,006

8. 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. To-date, Milestone #1 and #2 has been earned and the Company has received \$529,155 (\$587,950 less 10% holdback) for these milestones. As at July 31, 2007, the Company has claimed and received Milestone #3 for field testing, in the amount of up to \$62,050 which has been recorded as deferred government assistance. During the nine months ended July 31, 2007, \$158,830 [nine months ended July 31, 2006 - \$302,350] of SDTC funding has been included as a reduction of research and development costs.

Investment tax credits

As of November 1, 2006 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 accounts receivable.

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8. GOVERNMENT ASSISTANCE (CONTINUED)

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 July 31, 2007, a total of \$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 nine-month period ended July 31, 2007, \$Nil of IERD funding has been included as a reduction in research and development costs [nine-month period ended July 31, 2006 - \$134,118].

9. RESEARCH AND DEVELOPMENT COSTS

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

	Nine months ended <u>July 31,</u> 2007 \$	Nine months ended <u>July 31,</u> 2006 \$
Research and development expenditures	1,066,381	623,675
Investment tax credit [note 8]	(64,658)	—
IERD government assistance [note 8]	—	(134,118)
SDTC government assistance [note 8] Milestone #2	(158,830)	(302,350)
Research and development costs, net of government assistance	842,893	187,207

10. 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 nine-month period ended July 31, 2007 were \$4,500 [nine-month period ended July 31, 2006 - \$3,000].
- (b) The Company incurred interest on promissory notes in the amount of \$3,689 during the nine-month period ended July 31, 2007 [nine-month period ended July 31, 2006 - \$nil] payable to directors of the Company as noted in note 4.

11. SUBSEQUENT EVENTS

Private Placement

On September 13, 2007 the Company closed a non-brokered private placement for gross proceeds of \$270,750. The closing was comprised of 492,271 Units at a price of \$0.55 per unit (the "Units"). The Units are comprised of one Class A common share and one half of one Class A common share purchase warrant (the "Warrants"). Each whole Warrant entitled the holder to purchase one additional Class A common share of the Corporation at a price of \$0.80 per share for a period of two years from the date of issue. The Corporation paid a finders fee totaling \$11,435 in connection with the sale of the Units.

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11. SUBSEQUENT EVENTS (CONTINUED)

Repayment of Notes Payable

Subsequent to July 31, 2007, the company repaid notes with a face value of \$44,000 plus accrued interest of \$3,097 to directors of the company. On September 13, 2007, the directors purchased 112,925 Units of the non-brokered private placement for a total value of \$62,125.

Issuance of Warrants

During the period from August 1, 2007 to September 13, 2007, a total of 5,750 common share purchase warrants were exercised into shares of the Company, at a price of \$0.60 per warrant for total proceeds of \$3,450. In addition, on September 13, 2007, 10,000 new warrants were issued.