

Financial Statements

Synodon Inc.
(a development stage enterprise)
October 31, 2007 and 2006

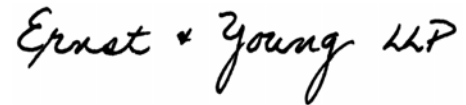
AUDITORS' REPORT

To the Shareholders of
Synodon Inc.

We have audited the balance sheets of **Synodon Inc.** (a development stage enterprise) as at October 31, 2007 and 2006 and the statements of loss and comprehensive loss 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 audits.

We conducted our audits 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 the 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 financial statements present fairly, in all material respects, the financial position of the Company as at October 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

The image shows a handwritten signature in black ink that reads "Ernst & Young LLP". The signature is written in a cursive, flowing style.

Edmonton, Canada
February 25, 2008

Chartered Accountants

Synodon Inc.
(a development stage enterprise)
BALANCE SHEETS
[see note 1 – going concern communication]

As at October 31

	2007	2006
	\$	\$
ASSETS <i>[note 7]</i>		
Current		
Cash	4,943	305
Accounts receivable <i>[note 10]</i>	114,827	120,746
Investment tax credits recoverable	—	353,342
Prepaid expenses and deposits	10,697	5,579
	130,467	479,972
Property and equipment <i>[note 3]</i>	15,970	15,376
Long-term deposits	18,786	—
Deferred transaction costs <i>[note 8]</i>	—	311,959
	165,223	807,307
LIABILITIES AND SHAREHOLDERS' DEFICIENCY		
Current		
Accounts payable and accrued liabilities	725,837	810,073
Deferred government assistance <i>[note 10]</i>	11,790	158,830
Notes payable <i>[note 4]</i>	33,000	112,000
Current portion of obligations under capital lease <i>[note 7]</i>	30,569	—
Deposit on distribution rights <i>[note 5]</i>	65,875	65,875
	867,071	1,146,778
Obligations under capital lease <i>[note 7]</i>	17,064	—
	884,135	1,146,778
Commitments and contingencies <i>[notes 5, 6, 9 and 10]</i>		
Shareholders' deficiency		
Share capital <i>[note 8]</i>	4,239,464	3,285,593
Warrants on issue of Units <i>[note 8]</i>	256,634	—
Contributed surplus <i>[note 8]</i>	538,248	322,006
Deficit	(5,753,258)	(3,947,070)
	(718,912)	(339,471)
	165,223	807,307

See accompanying notes

On behalf of the Board:

(signed) "Adrian Banica"

Adrian Banica, Director
Chief Executive Officer

(signed) "John Pinsent"

John Pinsent, Director
Chief Financial Officer

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

For the years ended October 31

	2007	2006
	\$	\$
EXPENSES		
Research and development costs, net of government assistance [notes 10 and 11]	1,061,767	205,312
Amortization	5,920	9,840
Advertising and marketing	—	290
Financing charges and interest	29,251	26,187
Foreign exchange gains	(38,197)	(4,642)
Stock-based compensation	131,619	92,400
Office and general administrative	638,107	516,210
	1,828,467	845,597
Loss from operations	(1,828,467)	(845,597)
Other income	22,279	—
Net loss and comprehensive loss for the year	(1,806,188)	(845,597)
Deficit, beginning of year	(3,947,070)	(3,101,473)
Deficit, end of year	(5,753,258)	(3,947,070)
Loss per share-basic and diluted	(0.09)	(0.05)
Weighted-average number of common shares outstanding	19,823,494	16,074,357

See accompanying notes

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

For the years ended October 31

	2007 \$	2006 \$
OPERATING ACTIVITIES		
Net loss for the year	(1,806,188)	(845,597)
Add charges to operations not requiring a current cash payment		
Stock-based compensation	131,619	92,400
Non-cash payment for services [note 8]	—	69,966
Non-cash interest expense [note 4]	5,000	815
Amortization	5,920	9,840
Research and development costs, financed by obligations under capital lease	90,668	—
	(1,572,981)	(672,576)
Net charges in non-cash working capital balances related to operations		
Accounts receivable	5,919	(77,542)
Investment tax credits recoverable	353,342	(305,751)
Prepaid expenses and deposits	(5,118)	896
Long-term deposits	(18,786)	—
Accounts payable and accrued liabilities	(103,661)	47,119
Deferred government assistance	(147,040)	158,830
Cash used in operating activities	(1,488,325)	(849,024)
INVESTING ACTIVITIES		
Proceeds on disposal of property and equipment	1,650	—
Purchase of property and equipment	(8,164)	(5,590)
Cash used in investing activities	(6,514)	(5,590)
FINANCING ACTIVITIES		
Repayment of notes payable	(52,000)	—
Issuance of notes payable	33,000	112,000
Repayment of obligations under capital lease	(23,610)	—
Issuance of common shares	1,725,197	1,079,341
Payment of share issuance costs	(183,110)	(24,489)
Deferred transaction costs	—	(311,959)
Cash provided by financing activities	1,499,477	854,893
Net increase in cash during the year	4,638	279
Cash, beginning of year	305	26
Cash, end of year	4,943	305
Supplemental cash flow information		
Interest paid	22,419	39,041

Other non-cash transactions [notes 4, 8 and 13]

See accompanying notes

Synodon Inc.
(a development stage enterprise)
NOTES TO FINANCIAL STATEMENTS

October 31, 2007 and 2006

1. NATURE OF BUSINESS AND GOING CONCERN COMMUNICATION

Nature of business

Synodon Inc. (the “Company”) was incorporated under the laws of Alberta. The Company is a development stage enterprise that is developing an airborne survey leak detection system. At present, the Company anticipates completion of its instrument by spring of 2008.

Going concern communication

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 is in the development stage, has incurred significant losses since incorporation and as at October 31, 2007, the Company had a working capital deficiency of \$736,604 and an accumulated deficit of \$5,753,258. The Company will require additional financing during its fiscal 2008 year in order to continue its operations. The Company's ability to continue as a going concern is dependent upon ultimately 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.

2. SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the Company have been prepared by management in accordance with Canadian generally accepted accounting principles. The precise determination of many assets and liabilities is dependent on future events. As a result, the preparation of financial statements for a period involves the use of estimates and approximations. Actual results could differ from those estimates and approximations. The financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the significant accounting policies summarized below.

New Accounting Policies

Effective November 1, 2006, the Company 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 applied 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 year.

Synodon Inc.
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NOTES TO FINANCIAL STATEMENTS

October 31, 2007 and 2006

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 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 in 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 financial 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. The adoption of this method of accounting for financing costs did not have any effect on the financial statements for loans issued prior to fiscal 2007.

The carrying values of accounts receivable, investment tax credits recoverable, accounts payable and accrued liabilities, notes payable and deposit on distribution rights approximate their fair values due to the relatively short periods to maturity of these instruments.

Property and equipment

Property and equipment are recorded at cost less accumulated amortization. Management assesses the carrying value of all property and equipment using its best estimate of undiscounted future cash flows whenever conditions arise which could indicate a possible impairment. Any impairment is recognized when it is identified and is measured by the amount by which the carrying value of the asset exceeds its estimated fair value.

Amortization is provided over the estimated useful lives of the assets using the following methods and rates with half-year amortization provided in the year of acquisition:

Computer equipment	3 years straight-line
Computer software	100%
Laboratory equipment	20% declining balance
Furniture and fixtures	20% declining balance

Synodon Inc.
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NOTES TO FINANCIAL STATEMENTS

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2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Revenue recognition

The Company's services are generally sold based upon purchase orders or contracts with customers that include fixed or determinable prices based upon kilometres surveyed. Revenue is recognized when services are rendered and only when collectability is reasonably assured.

Translation of foreign currencies

Monetary items denominated in foreign currency are translated to Canadian dollars at exchange rates in effect at the balance sheet date and non-monetary items are translated at rates of exchange in effect when the assets are acquired or obligations incurred. Revenues and expenses are translated at rates in effect at the time of the transactions. Foreign exchange gains and losses are included in expenses in the current period.

Research and development

Research costs are expensed as incurred. Development costs that meet specific criteria related to technical, market and financial feasibility are capitalized. To date, all development costs have been expensed.

Government assistance

Government assistance in connection with research activities is recognized as an expense reduction in the year that the related expenditure is incurred. Federal and provincial investment tax credits are accounted for as a reduction of expenditures in the year in which the credits are earned and when there is likely assurance of their recovery. Assistance related to future periods is deferred and recognized as an expense reduction as the related expenses are incurred.

Income taxes

The Company follows the liability method of accounting for income taxes. Under this method, future tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities, and measured using the substantively enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse. A valuation allowance is recorded against any future tax asset if it is more likely than not that the asset will not be realized.

Stock-based compensation

The Company utilizes the fair value-based method of accounting for stock-based compensation. Under the fair value-based method, compensation cost is measured at fair value at the date of grant using the Black-Scholes option pricing model with assumptions as described in note 8, and is expensed over the award's vesting period. Any consideration paid by employees upon exercise of stock options is recorded as an increase to share capital. The Company's stock-based compensation plan is more fully described in note 8.

Synodon Inc.
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NOTES TO FINANCIAL STATEMENTS

October 31, 2007 and 2006

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Loss per share

Basic loss per share is calculated by dividing net loss by the weighted-average number of common shares outstanding during the year. Diluted loss per share is calculated by dividing net loss by the weighted-average number of common shares outstanding during the year after giving affect to potentially dilutive financial instruments. The dilutive effect of stock options and warrants is determined using the treasury stock method.

3. PROPERTY AND EQUIPMENT

	2007		2006	
	Cost	Accumulated amortization	Cost	Accumulated amortization
	\$	\$	\$	\$
Computer equipment	36,735	31,692	35,136	28,389
Computer software	6,521	6,321	6,120	6,120
Laboratory equipment	7,271	2,544	3,865	1,788
Furniture and fixtures	12,873	6,873	12,031	5,479
	63,400	47,430	57,152	41,776
Net book value		15,970		15,376

4. NOTES PAYABLE

	2007	2006
	\$	\$
Convertible promissory notes		
Notes, bearing interest at 8% per annum	—	60,000
Demand promissory notes		
Notes, bearing interest at 8% per annum	33,000	52,000
	33,000	112,000

During the year ended October 31, 2007, promissory notes with a face value of \$60,000, plus accrued interest to January 31, 2007 totalling \$5,000, were exchanged 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 per share until December 28, 2007 and at a price of \$0.75 per share for the subsequent 12-month period.

During the year ended October 31, 2007, the Company issued promissory notes with a face value of \$33,000. These notes are payable on demand and include \$28,000 payable to directors of the Company.

Synodon Inc.
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NOTES TO FINANCIAL STATEMENTS
October 31, 2007 and 2006

4. NOTES PAYABLE (CONTINUED)

During the year ended October 31, 2007, interest expense of \$5,155 [October 31, 2006 - \$5,147] was recorded on these notes, of which \$3,848 [2006 - \$594] was payable to related parties. At October 31, 2007, unpaid interest of \$1,156 [October 31, 2006 - \$4,444] is included in accrued liabilities.

5. DEPOSIT ON DISTRIBUTION RIGHTS OPTION

During the year ended October 31, 2004, the Company granted a third party the right to purchase the distribution rights in the Saudi Arabian peninsula region in consideration for a fee of \$65,875. The distribution rights option expired on July 31, 2007. However, both parties have agreed to extend the option until the instrument is operational. At that time, the third party must decide whether to exercise the option or convert. Upon exercise of the option, the third party will have exclusive distribution rights over the designated area for a period of three years in conformance with specified terms. The third party will retain 30% of the service revenue generated from the region with the remainder of the revenue being retained by the Company. In the event that the third party does not exercise the right, the holder may elect to convert the deposit into Class A common shares of the Company at the per share value at the time of the last arm's length sale of Class A common shares by the Company prior to conversion.

6. COMMITMENTS

Under a new lease agreement effective October 1, 2007, the Company is committed to pay base rent and condominium fees for office premises until September 30, 2009. The payments required are as follows:

2008	\$ 69,600
2009	\$ 63,800
	<hr/>
	\$ 133,400

The Company has also entered into agreements with various third-party organizations whereby these parties will provide services or payments to the Company with a combined value of up to \$10,879. These services or payments are in support of the Company's research and development activities and are in exchange for the opportunity to either negotiate future distribution agreements or obtain discounted pricing for a period of time once the Company has commenced commercial operations. No payments or services have been provided or exchanged to date in connection with these agreements.

Synodon Inc.
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NOTES TO FINANCIAL STATEMENTS
October 31, 2007 and 2006

7. OBLIGATIONS UNDER CAPITAL LEASE

	2007 \$	2006 \$
Vencore Solutions LLC, at 8.25%		
Lease contract #1, payable \$1,559 monthly, due October 10, 2009	37,416	—
Lease contract #2, payable \$474 monthly, due October 25, 2009	11,365	—
Lease contract #3, payable \$1,165 monthly, due November 25, 2009	29,118	—
	77,899	—
Less amounts representing interest and lease arrangement costs	(30,266)	—
	47,633	—
Less current portion of obligations under capital lease	(30,569)	—
	17,064	—

During the year ended October 31, 2007, the Company signed a lease agreement with Vencore Solutions LLC (“Vencore”) giving the Company the ability to borrow up to US \$385,000 in long-term lease financing. The amount was subsequently revised to \$90,668 (US \$84,749). As at October 31, 2007, the Company has drawn \$90,668 (US \$84,749) of the total committed funding. The funds were used to procure research and development materials necessary for field trials. As part of the terms of the lease agreement, the Company issued to Vencore 66,000 warrants, exercisable at Cdn \$0.65 per share and with a term of two years. The fair value of these warrants of \$18,945 has been applied to reduce the carrying value of the lease obligation and will be recorded as a component of interest expense over the term of the obligation.

Under the agreement with Vencore, security deposits representing 15% of amounts advanced, are included in long-term deposits. In addition, the Vencore lease agreements are collateralized by a security interest in all property and equipment owned by the Company. The fair values of the capital leases approximate their carrying value.

Interest expense incurred on capital lease obligations for the year was \$7,040.

The lease payments required over the next three years and in aggregate are as follows:

	\$
2008	38,367
2009	38,367
2010	1,165
Total lease payments	77,899

Synodon Inc.
(a development stage enterprise)
NOTES TO FINANCIAL STATEMENTS

October 31, 2007 and 2006

8. SHARE CAPITAL

	2007 \$	2006 \$
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		
	2007 \$	2006 \$
Issued and outstanding		
20,746,571 Class A common shares	4,135,973	—
17,255,550 Class A common shares	—	3,285,593
	Number of shares #	Total \$
Balance, October 31, 2005	13,134,815	1,776,483
Issued in private placements, net of costs of issuance of \$44,475	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 \$441,694 and net of fair value of warrants of \$294,787	2,807,500	667,269
Issued in private placement, net of costs of issuance of \$20,070 and net of fair value of warrants of \$51,688	492,271	198,993
Issued for cash on the exercise of warrants	11,250	6,750
Issued for cash from exercise of options	50,000	25,000
Issued on conversion of notes payable and accrued interest <i>[note 4]</i>	130,000	51,350
Reclassify from contributed surplus on exercise of options	—	4,509
Balance, October 31, 2007	20,746,571	4,239,464

Synodon Inc.
(a development stage enterprise)
NOTES TO FINANCIAL STATEMENTS

October 31, 2007 and 2006

8. SHARE CAPITAL (CONTINUED)

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 \$441,694. 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 per share for 12 months from the date of closing of the offering and at a price of \$0.75 per share 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 per Unit for a period of 24 months from the offering's closing date and have been reflected as a cost of issuance and contributed surplus.

During the year ended October 31, 2007, the Company closed a private placement, issuing 492,271 Units at a price of \$0.55 per Unit, each consisting of one Class A common share and one half common share purchase warrant, for gross proceeds of \$270,751. Each whole common share purchase warrant entitles the holder to acquire a common share at an exercise price of \$0.80 per share on or before September 13, 2009. The costs of issuance were \$20,070.

Share options

Under the Company's share option policy, options to purchase common shares may be granted by the Board of Directors to directors, officers and employees. The Company has reserved up to 1,540,000 common shares available for the settlement of options. The exercise price per share and the vesting period shall be determined at the time of grant by the Board of Directors. Except for the first grant, which vested when specific performance criteria were met, options granted prior to October 31, 2007 have vested immediately. Options granted subsequent to October 31, 2006 generally vest over a period of three years. The option period for options granted as compensation to directors, officers and employees shall be a period of time fixed by the Board of Directors not to exceed five years. The option period for options granted in exchange for services is specified by the Board of Directors at the time of grant and ranged from three to 10 years for options granted prior to April 30, 2006. If an option has lapsed, the Board of Directors may grant new options covering the shares not purchased. If a participant ceases to be an employee or provider, the participant has 90 days to exercise his options or they are cancelled.

	2007		2006	
	Number of shares #	Weighted- average exercise price \$	Number of shares #	Weighted- average exercise price \$
Outstanding at beginning of year	1,100,000	0.4182	1,772,500	0.1623
Granted	540,000	0.5000	720,000	0.3871
Exercised	(50,000)	0.5000	(1,142,500)	0.0001
Cancelled	(50,000)	0.5000	(250,000)	0.4500
Outstanding at end of year	1,540,000	0.4513	1,100,000	0.4182
Options exercisable at end of year	1,230,000	0.4513	1,100,000	0.4182

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8. SHARE CAPITAL (CONTINUED)

The following table summarizes information about share options outstanding at October 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	2.2	0.45
0.40	2006	550,000	2.2	0.40
0.50	2006	100,000	3.6	0.50
0.50	2007	490,000	4.2	0.50
0.40 – 0.50		1,540,000	2.9	0.4513

The weighted-average fair value of share options is determined at the date of grant using the Black-Scholes option pricing model. For the year ended October 31, 2007, \$131,619 [2006 - \$92,400] has been recorded as compensation expense with an equal amount reflected in contributed surplus.

The compensation expense at each grant date was calculated using the following assumptions:

	2007	2006
Weighted-average exercise price	\$0.36	\$0.41
Expected dividend yield	0.00%	0.00%
Weighted-average risk-free interest rate	4.5%	3.95%
Expected volatility	90%	31.60%
Weighted-average expected life	5.0 years	5.0 years

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8. SHARE CAPITAL (CONTINUED)

Warrants

At October 31, 2007, the Company had 2,795,315 (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	1,392,500
0.60 - 0.75	December 28, 2008	65,000
0.50	December 28, 2008	280,750
0.65	May 15, 2009	66,000
0.80	September 13, 2009	246,134
		2,795,315

On December 28, 2006, the Company issued 1,403,750 common share purchase warrants from an initial public offering. The warrant holder is entitled to acquire one Class A common share at an exercise price of \$0.60 per share for a 12-month period expiring December 28, 2007 and at a price of \$0.75 per share for the period expiring December 28, 2008. The fair value of the warrants issued of \$0.21 per warrant was determined using the Black-Scholes option pricing model for warrants assuming a risk-free interest rate of 4.5%, a dividend yield of 0%, an expected volatility of 90% and an expected life of the warrants of two years. The resultant fair value of \$294,787 is included in the warrants on issue of Units. Costs of issuance were allocated to these warrants in the amount of \$98,755.

In connection with the initial public offering, the agent received one Class A common share at an exercise price of \$0.50 for a period of 24 months expiring December 28, 2008. The fair value of the warrants issued of \$0.25 per warrant was determined using the Black-Scholes option pricing model for warrants assuming a risk-free interest rate of 4.5%, a dividend yield of 0%, an expected volatility of 90% and an expected life of the warrants of two years. The resultant fair value of \$70,186 is included in the initial public offering issuance costs.

During the year ended October 31, 2007, the Company issued 65,000 common share purchase warrants from the conversion of promissory notes and accrued interest as described in note 4. The warrant holder is entitled to acquire one Class A common share at an exercise price of \$0.60 for a 12-month period expiring December 28, 2007 and at a price of \$0.75 for the period expiring December 28, 2008. The fair value of the warrants issued of \$0.21 per warrant was determined using the Black-Scholes option pricing model for warrants assuming a risk-free interest rate of 4.5%, a dividend yield of 0%, an expected volatility of 90% and an expected life of the warrants of two years. The resultant fair value of \$13,650 is included in the warrants on issue of Units. Costs of issuance on conversion of promissory notes and accrued interest were nil.

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8. SHARE CAPITAL (CONTINUED)

During the year ended October 31, 2007, the Company issued 66,000 common share purchase warrants from the lease agreement with Vencore as described in note 7. The warrant holder is entitled to acquire one Class A common share at an exercise price of \$0.65 for a 24-month period expiring May 14, 2009. The fair value of the warrants issued of \$0.28 per warrant was determined using the Black-Scholes option pricing model for warrants assuming a risk-free interest rate of 4.5%, a dividend yield of 0%, an expected volatility of 90% and an expected life of the warrants of two years. The financial value of these warrants of \$18,945 has been applied to reduce the carrying value of the capital lease obligation.

During the year ended October 31, 2007, the Company issued 246,134 common share purchase warrants from the issuance of a private placement. The warrant holder is entitled to acquire one Class A common share at an exercise price of \$0.80 for a 24-month period expiring September 13, 2009. The fair value of the warrants issued of \$0.21 per warrant was determined using the Black-Scholes option pricing model for warrants assuming a risk-free interest rate of 4.5%, a dividend yield of 0%, an expected volatility of 90% and an expected life of the warrants of two years. The resultant fair value of \$51,688 is included in warrants on issue of Units.

Warrants on issue of Units

The following table sets out the change in warrants on issue of Units:

	2007	2006
	\$	\$
Warrants issued on initial public offering of Units, net of issuance costs of \$98,755	196,032	—
Warrants issued on private placement Units, net of issuance costs of \$4,736	46,952	—
Warrants issued on conversion of promissory notes and accrued interest	13,650	—
Balance, end of year	256,634	—

The Company uses the treasury stock method to calculate loss per share and under this method options that are anti-dilutive are excluded from the calculation of diluted earnings per share. For the years ended October 31, 2007 and 2006, all outstanding options are considered anti-dilutive when the Company has recorded a loss available to common shareholders.

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8. SHARE CAPITAL (CONTINUED)

Contributed surplus

The following table sets out the change in contributed surplus:

	2007	2006
	\$	\$
Balance, beginning of year	322,006	586,156
Stock-based compensation	131,619	92,400
Issuance of warrants	89,132	3,000
Transfer to share capital on conversion of convertible promissory notes <i>[note 4]</i>	—	(1,150)
Transfer to share capital on exercise of options	(4,509)	(358,400)
Balance, end of year	538,248	322,006

9. INCOME TAXES

The Company's income tax expense is determined as follows:

	2007	2006
	\$	\$
Combined statutory federal and provincial tax rate at 32.12% [2006 – 16.12%]	(580,200)	(136,300)
Adjusted for		
Stock-based compensation	42,300	14,900
Unrecognized losses	535,100	109,000
Other	2,800	12,400
Income tax expense	—	—

Future tax assets

The tax effects of temporary differences that give rise to significant portions of the future tax assets are presented below:

	2007	2006
	\$	\$
Non-capital loss carryforwards	1,172,000	428,900
Scientific research and experimental development expense carryforwards	184,500	86,000
Equipment – differences in net book value and undepreciated capital costs	7,700	4,900
Cumulative eligible capital	13,000	8,400
Share issue costs	121,000	8,400
Investment tax credit carryforwards	—	500
	1,498,200	537,100
Less valuation allowance	(1,498,200)	(537,100)
	—	—

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9. INCOME TAXES (CONTINUED)

At October 31, 2007 the Company has approximately \$4,160,600 of non-capital losses available to reduce future taxable income and \$84,800 of investment tax credits available to reduce income taxes payable. The losses and investment tax credits expire as follows:

	Non-capital loss carryforwards	Investment tax credits
	\$	\$
2008	13,500	—
2009	73,100	—
2010	317,300	—
2013	—	1,900
2014	442,900	700
2015	1,013,000	600
2016	728,200	—
2017	1,572,600	81,600
	<u>4,160,600</u>	<u>84,800</u>

At October 31, 2007, the Company also has \$655,100 of scientific research and experimental development expenditures available to reduce net income for tax purposes in future periods. These expenditures may be carried forward indefinitely. The Company has provided a full valuation allowance against these potential future tax assets.

In assessing the realizability of future income tax assets, management considers whether it is more likely than not that some portion or all of the future income tax assets will not be realized. The ultimate realization of future income tax assets is dependent upon the generation of future taxable income and tax planning strategies in making this assessment.

10. GOVERNMENT ASSISTANCE

SDTC funding

During fiscal 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 advances 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 October 31, 2007, Milestones #1 and #2 were earned and the Company received \$529,155 (\$587,950 less 10% holdback) for these milestones. The Company also received an advance of \$55,845 (\$62,050 less 10% holdback) for Milestone #3. As at October 31, 2007, the Company had earned \$50,260 of the Milestone #3 funding. The balance of \$11,790 has been recorded as deferred government assistance. The balance of Milestone #3 for field testing, in the amount of \$11,790 was earned by December 31, 2007. During the year ended October 31, 2007, \$209,090 [2006 - \$429,120] of SDTC funding has been included as a reduction of research and development costs.

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10. GOVERNMENT ASSISTANCE

IERD funding

In 2004, the Company qualified for funding under the Industry Energy Research and Development Program (“IERD”). Under this government funding program, IERD committed to advance the Company 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. 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 October 31, 2007, a total of \$586,437 [2006 - \$580,403] was advanced to the Company from the IERD program, less a 10% holdback. During the year ended October 31, 2007, \$6,034 [2006 - \$194,663] of IERD funding has been included as a reduction of research and development costs.

Investment tax credits

The Company claims research and development deductions and the related investment tax credits for income tax purposes based on management’s interpretation of the applicable legislation under the Income Tax Act (Canada). These claims are subject to technical and expenditure review by the Canada Revenue Agency.

During fiscal 2007, the Company recorded the benefit related to refundable investment tax credits earned during the year of \$64,658 [2006 - \$305,751] as a reduction of research and development costs, of which \$64,658 related to the prior year’s activities.

11. RESEARCH AND DEVELOPMENT COSTS

Since inception the Company has incurred approximately \$4,200,982 of research and development expenditures in developing its technologies. Research and development costs and reductions due to government assistance in each of the past two years are summarized as follows:

	2007 \$	2006 \$
Research and development expenditures	1,341,549	1,134,846
Less government assistance		
SDTC	(209,090)	(429,120)
IERD	(6,034)	(194,663)
Investment tax credits	(64,658)	(305,751)
	1,061,767	205,312

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12. RELATED PARTY TRANSACTIONS

Officers, directors and shareholders provided promissory notes [note 4] as well as services to the Company through 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 fiscal 2007 were \$5,500 [2006 - \$4,500].
- (b) The Company incurred interest on promissory notes in the amount of \$3,848 [2006 - \$594] to directors of the Company as described in note 4.

13. NON-CASH TRANSACTIONS

The Company entered into the following non-cash transactions which are not reflected in the statements of cash flows:

Year ended October 31, 2007

- (a) Issued 130,000 Class A common shares and 65,000 common share purchase warrants on the conversion of \$60,000 notes and \$5,000 accrued interest as described in note 4.
- (b) Issued to the sponsor agent of the Company's initial public offering, 280,750 warrants at a price of \$0.50 per Unit for a period expiring December 28, 2008 as described in note 8. These warrants were valued at \$70,096.
- (c) The Company signed a lease agreement with Vencore. As part of the terms of the lease agreement, the Company issued to Vencore 66,000 warrants, exercisable at \$0.65 which expire May 15, 2009. These warrants were valued at \$18,945.

14. CREDIT RISK AND INTEREST RATE RISK

Credit risk

The amount recorded as accounts receivable on the Company's balance sheet represents its maximum exposure to credit risk. The Company's accounts receivable are primarily for government assistance holdbacks. Accordingly, the Company believes that there is a very low level of credit risk associated with these amounts.

Interest rate risk

The Company has fixed repayment terms on its obligations under capital lease and fixed interest rates on its notes payable and, accordingly, is not exposed to interest rate risk on its interest-bearing obligations.

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15. SUBSEQUENT EVENTS

Warrants

Subsequent to October 31, 2007, a total of 62,038 common share purchase warrants were exercised for gross proceeds to the Company of \$36,375 and a receivable from a shareholder of \$8,725. In addition, 613,055 warrants expired unexercised by January 31, 2008 and 2,000 new warrants were issued on the exercise of broker warrants.

Issuance of promissory notes

Subsequent to October 31, 2007, directors loaned the Company \$75,000. These promissory notes bear interest at 8% and are repayable on demand.

Options grant

On February 12, 2008, the Company granted 300,000 options to purchase common shares to officers and employees which vest over a two year period and are exercisable at \$0.78 per option.

Issuance of common shares for debt

On February 12, 2008, the Company issued 64,103 common shares to a supplier in satisfaction of a liability to that supplier incurred during December 2007. The issuance of these shares is subject to the approval of the TSX Venture Exchange.

Private placement

The Company has entered into an agreement with Paradigm Capital Inc. to act as an exclusive agent, on a "best efforts" basis, to undertake a private placement offering of Units, with each Unit consisting of one Class A common share and one-half of a common share purchase warrant. The Company wishes to raise up to \$5,000,000 from an offering of Units to be priced in the context of the market. Each whole share purchase warrant will entitle the holder to acquire one common share of the Company for a period of two years following the closing date at a price to be determined in context to the market.