

MANAGEMENT'S RESPONSIBILITY

The accompanying financial statements of Synodon Inc. (a development stage enterprise) are the responsibility of the management and have been approved by the Board of Directors on recommendation by the Audit Committee.

The financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. When alternative accounting methods exist, management has chosen those it deems most appropriate in the circumstances. Financial statements are not precise since they include certain amounts based on estimates and judgements. Management has determined such amounts on a reasonable basis in order to ensure that the financial statements are presented fairly, in all material respects. Management has prepared financial information presented elsewhere in the accompanying management discussion and analysis and has ensured that it is consistent with that in the financial statements. In support of its responsibility, management maintains a system of internal controls to provide reasonable assurance as to the reliability of financial information and the safeguarding of assets.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and is ultimately responsible for reviewing and approving the financial statements. The Board of Directors carries out this responsibility through its Audit Committee.

The Audit Committee is comprised of financially literate directors, appointed by the Board of Directors. The Audit Committee meets periodically with management and the external auditors to discuss internal controls over the financial reporting processes, auditing matters and financial reporting issues to satisfy itself that each party is properly discharging its responsibilities, and to review the financial statements and the external auditors' report. The Audit Committee reports its findings to the Board of Directors for consideration when approving the financial statements for issuance to the shareholders. The Audit Committee also considers, for review by the Board of Directors and approval by the shareholders, the engagement or re-appointment of the external auditors.

These financial statements have been audited by Ernst & Young LLP, the external auditors, in accordance with Canadian generally accepted auditing standards on behalf of the shareholders. Ernst & Young LLP has full and free access to the Audit Committee.

(signed) "*Adrian Banica*"

Adrian Banica, Director
Chief Executive Officer

(signed) "*Nimal Rodrigo*"

Nimal Rodrigo
Chief Financial Officer

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, 2009 and 2008 and the statements of 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, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Ernst & Young LLP

Edmonton, Canada,
February 17, 2010.

Chartered Accountants

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

As at October 31

	2009	2008
	\$	\$
ASSETS [note 12]		
Current		
Cash	994,198	32,476
Cash held in trust	—	111,683
Accounts receivable [note 12]	111,777	65,948
Prepaid expenses and deposits	45,989	39,675
	1,151,964	249,782
Property and equipment [note 3]	13,886	12,614
Intangible assets [note 4]	—	172
Long-term deposits	—	7,876
	1,165,850	270,444
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIENCY)		
Current		
Accounts payable and accrued liabilities	319,795	1,313,303
Deferred government assistance [note 12]	—	128,799
Notes payable [note 5]	—	32,500
Loans from Directors [note 6]	—	2,700
Current portion of obligations under capital lease [note 9]	—	38,086
Deposits on distribution rights option [note 7]	80,431	65,875
	400,226	1,581,263
Obligations under capital lease [note 9]	—	1,456
	400,226	1,582,719
Commitments and contingencies [notes 7, 8 and 12]		
Shareholders' equity (deficiency)		
Share capital [note 10]	6,529,182	4,845,322
Warrants on issue of note payable [note 10]	39,998	—
Warrants on issue of units [note 10]	1,346,044	528,743
Contributed surplus [note 10]	1,173,714	633,661
Deficit	(8,323,314)	(7,320,001)
	765,624	(1,312,275)
	1,165,850	270,444

See accompanying notes

On behalf of the Board:

(signed) "Adrian Banica"

Adrian Banica, Director
Chief Executive Officer

(signed) "John Pinsent, CA"

John Pinsent, Director
Audit Committee Chair

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

For the years ended October 31

	2009	2008
	\$	\$
EXPENSES		
Research and development, net of government assistance <i>[notes 12 and 13]</i>	(85,726)	599,469
Amortization	5,079	5,462
Sales and marketing <i>[note 12]</i>	57,139	71,798
Financing charges and interest <i>[notes 5 and 9]</i>	150,235	82,604
Foreign exchange losses (gains)	(103,822)	90,806
Stock-based compensation	287,259	95,413
Office, general and administrative	693,149	621,191
Net loss and comprehensive loss for the year	(1,003,313)	(1,566,743)
Deficit, beginning of year	(7,320,001)	(5,753,258)
Deficit, end of year	(8,323,314)	(7,320,001)
Loss per share - basic and diluted	\$(0.04)	\$(0.07)
Weighted average number of common shares outstanding	23,122,887	20,952,962

See accompanying notes

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

For the years ended October 31

	2009 \$	2008 \$
OPERATING ACTIVITIES		
Net loss for the year	(1,003,313)	(1,566,743)
Add charges to operations not requiring a current cash payment		
Stock-based compensation	287,259	95,413
Amortization	5,079	5,462
Non-cash interest expense [note 5]	40,658	5,560
	(670,317)	(1,460,308)
Changes in non-cash working capital balances related to operations		
Accounts receivable	(45,829)	48,879
Deposits on distribution rights option	80,431	—
Prepaid expenses and deposits	(6,314)	(18,068)
Accounts payable and accrued liabilities	(993,508)	637,466
Deferred government assistance	(128,799)	117,009
Cash used in operating activities	(1,764,336)	(675,022)
INVESTING ACTIVITIES		
Purchase of property and equipment	(6,179)	(2,278)
Cash used in investing activities	(6,179)	(2,278)
FINANCING ACTIVITIES		
Repayment of notes payable	(35,200)	—
Long-term deposits	7,876	—
Issuance of notes payable	—	134,600
Repayment of obligations under capital lease	(39,542)	(8,091)
Issuance of shares and warrants	2,918,765	683,034
Payment of share issuance costs	(231,345)	(25,127)
Exercise of warrants	—	32,100
Cash provided by financing activities	2,620,554	816,516
Net increase in cash during the year	850,039	139,216
Cash and cash held in trust, beginning of year	144,159	4,943
Cash and cash held in trust, end of year	994,198	144,159
Supplemental cash flow information		
Interest paid	121,500	73,134

Other non-cash transactions [notes 10 and 15]
See accompanying notes

Synodon Inc.

(a development stage enterprise)

NOTES TO FINANCIAL STATEMENTS

October 31, 2009 and 2008

1. NATURE OF BUSINESS AND GOING CONCERN COMMUNICATION**Nature of business**

Synodon Inc. (the "Company") is an advanced remote sensing technology company which has developed a proprietary platform technology called realSens™ capable of measuring small ground-level gas concentrations from an aircraft flying up to 300 metres in altitude. The Company is in the final stages of completing the prototype manufacturing of the realSens™ instrument and developing its plan for commercialization and as such is considered a development stage company.

Going concern communication

These financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles ("GAAP") 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 October 31, 2009, the Company has an accumulated deficit of \$8,323,314. The Company's ability to continue as a going concern is dependent upon achieving profitable operations 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. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the Company have been prepared by management in accordance with Canadian GAAP. 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, 2008, the Company adopted the following new accounting policy:

CICA 3064 – Goodwill and Intangible Assets

Effective November 1, 2008, the Company adopted CICA 3064 - Goodwill and Intangible Assets that supersedes CICA 3062 - Goodwill and Other Intangible Assets and CICA 3450 - Research and Development Costs. CICA 3064 provides additional guidance on when expenditures qualify for recognition as intangible assets and requires that costs be deferred only when relating to an item meeting the asset definition. This new accounting standard is effective for interim or annual financial statements relating to fiscal years beginning on or after October 31, 2008. As a result of the adoption of this standard, the Company has reclassified the amount of cost and accumulated amortization for computer software from property and equipment to intangible assets on its balance sheets effective November 1, 2007.

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NOTES TO FINANCIAL STATEMENTS

October 31, 2009 and 2008

Financial instruments

Under CICA 3855, Financial Instruments - Recognition and Measurement, all financial instruments are classified as 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 sheets 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.

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, loans from Directors and deposits on distribution rights option are classified as other financial liabilities, all of which are measured at amortized cost.

The carrying values of accounts receivable and accounts payable and accrued liabilities 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
Laboratory equipment	20% declining balance
Furniture and fixtures	20% declining balance

Intangible assets

Intangible assets are recorded at cost less accumulated amortization. Management assesses the carrying value of all fixed lived intangible assets 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 method and rate with half-year amortization provided in the year of acquisition:

Computer software	3 years straight-line
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Synodon Inc.

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NOTES TO FINANCIAL STATEMENTS

October 31, 2009 and 2008

Leases

The Company records its lease obligations as either operating or capital. Capital leases are those where the Company is transferred substantially all of the benefits and risks of ownership, whereas under operating leases the Company is not transferred substantially all of the benefits and risks of ownership. Capital lease obligations are accounted for as the acquisition of property and equipment or development expenditure and a related obligation measured at the present value of future minimum lease payments. The related assets, if capitalized, are amortized over their estimated useful lives and interest expense is recognized as a component of periodic lease payments. Operating leases are expensed as the payments are due.

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 currencies 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. Revenue 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 period that the related expenditure is incurred. Federal and provincial investment tax credits are accounted for as a reduction of expenditures in the period 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.

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NOTES TO FINANCIAL STATEMENTS

October 31, 2009 and 2008

Stock-based compensation

The Company utilizes the fair value 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 10, 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 10.

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 effect to potentially dilutive instruments. The dilutive effect of stock options and warrants is determined using the treasury stock method.

Recent accounting pronouncements issued but not yet adopted**Business Combinations, Consolidations and Non-controlling Interests**

In January 2009, the CICA issued CICA 1582, Business Combinations which requires that all assets and liabilities of an acquired business be recorded at fair value at acquisition. Obligations for contingent considerations will also be recorded at fair value at the acquisition date. CICA 1582 also states that acquisition-related costs be expensed as incurred and that restructuring charges be expensed in the periods after the acquisition date. CICA 1582 applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period on or after January 1, 2011. The Company does not expect that the adoption of this standard will have an effect on its financial statements.

In January 2009, the CICA issued CICA 1601, Consolidations and CICA 1602, Non-controlling Interests. CICA 1601 establishes standards for the preparation of consolidated financial statements. CICA 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards apply to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. The Company does not expect that the adoption of this standard will have an effect on its financial statements.

International Financial Reporting Standards

In February 2008, the Canadian Accounting Standards Board confirmed that Canadian public companies will be required to adopt International Financial Reporting Standards for fiscal years beginning on or after January 1, 2011. The Company is currently evaluating the effect of this change in standards on its financial statements. To date, no material differences have been identified.

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NOTES TO FINANCIAL STATEMENTS

October 31, 2009 and 2008

3. PROPERTY AND EQUIPMENT

	<u>2009</u>		<u>2008</u>	
	<u>Cost</u>	<u>Accumulated amortization</u>	<u>Cost</u>	<u>Accumulated amortization</u>
	\$	\$	\$	\$
Computer equipment	41,849	37,386	37,890	34,557
Laboratory equipment	10,268	4,685	8,048	3,567
Furniture and fixtures	12,873	9,033	12,873	8,073
	64,990	51,104	58,811	46,197
Net book value		13,886		12,614

During the year ended October 31, 2009, the Company recorded property and equipment amortization of \$4,907 (2008 - \$5,089).

4. INTANGIBLE ASSETS

	<u>2009</u>		<u>2008</u>	
	<u>Cost</u>	<u>Accumulated amortization</u>	<u>Cost</u>	<u>Accumulated amortization</u>
	\$	\$	\$	\$
Computer software	6,867	6,867	6,867	6,695
	6,867	6,867	6,867	6,695
Net book value		—		172

During the year ended October 31, 2009, the Company recorded intangible assets amortization of \$172 (2008 - \$373).

5. NOTES PAYABLE

	<u>2009</u>	<u>2008</u>
	\$	\$
Demand promissory notes		
Notes, bearing interest at 8% per annum	—	32,500
	—	32,500

On July 1, 2009, the Company issued (i) a promissory note for \$186,690 (U.S.\$200,000) bearing an annual rate of interest of 18% maturing on December 31, 2009 and (ii) share purchase warrants with a 24 month term and exercisable for 200,000 Class A common shares at \$0.39 per Class A common share, to settle a trade payable with a key long term supplier. The warrants have been valued at \$39,998 (note 10) and the note payable was being accreted over the term of the loan up to its maturity value of U.S. \$200,000. During the year ended October 31, 2009, the Company recorded accreted interest of \$40,568 related to these notes payable (2008 - \$5,560).

In October 2009, the Company repaid all outstanding notes payable.

Synodon Inc.

(a development stage enterprise)

NOTES TO FINANCIAL STATEMENTSOctober 31, 2009 and 2008

During the year ended October 31, 2008, the Company issued promissory notes with a face value of \$134,600.

During the year ended October 31, 2008, promissory notes, including loans from Directors, with a face value of \$132,400, plus accrued interest to October 8, 2008 totalling \$5,560, were exchanged for 306,578 Class A common shares and 306,578 common share purchase warrants as part of the private placement described in note 10. Each common share purchase warrant entitles the holder thereof to acquire one Class A common share at an exercise price of \$0.75 until October 7, 2010.

During the year ended October 31, 2009, interest expense of \$48,539 [2008 - \$9,357] was recorded on notes payable, of which \$198 [2008 - \$8,179] was payable to related parties. At October 31, 2008, unpaid interest of \$4,953 was included in accrued liabilities, of which \$3,732 was payable to related parties.

6. LOANS FROM DIRECTORS

	2009	2008
	\$	\$
Demand promissory notes		
Notes, bearing interest at 8% per annum	—	2,700
	—	2,700

7. DEPOSIT ON DISTRIBUTION RIGHTS OPTION

On May 10, 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. Both parties have agreed to extend the option until the realSens™ technology is commercialized. On November 15, 2008, the Company was notified by the third party that it had declined to exercise its option to become a distributor and accordingly has requested its original deposit of \$65,875 under the distribution rights option agreement to be converted into shares of the Company. On August 10, 2009, the distribution rights option was converted to 146,389 Class A common shares by the Company as part of a private placement (note 10).

On March 2, 2009 the Company signed a realSens™ service distribution option agreement with the U.S. subsidiary of an international services company and received the associated sign up fee of U.S. \$75,000 or Cdn. \$81,487. The agreement gives the option holder the option to purchase the realSens™ pipeline leak detection rights for Venezuela, Mexico, Colombia, Guatemala, Belize, Honduras, El Salvador, Nicaragua, Costa Rica, Panama and Ecuador. The distributorship will be for a period of three years which can be automatically renewed for a further five years upon successful completion of annual performance targets. The option holder also receives a first right of refusal on Argentina, Peru, Brazil, Bolivia, Chile, Spain and Portugal, if the first three years annual performance targets are met and an expanded territory fee is paid.

The original option expired August 30, 2009 and was extended under the same terms until March 31, 2010. In the event of expiry, the option holder can elect to receive Class A common shares of the Company at prevailing market prices by giving notice of such intention by March 31, 2010.

Synodon Inc.

(a development stage enterprise)

NOTES TO FINANCIAL STATEMENTS

October 31, 2009 and 2008

8. COMMITMENTS

The Company is committed to minimum lease payments on its premises to September 30, 2010 totalling \$59,400.

9. OBLIGATIONS UNDER CAPITAL LEASE

	2009	2008
	\$	\$
Vencore Solutions LLC, at 8.25%		
Lease contract #1, payable \$1,976 monthly, due October 10, 2009	—	25,669
Lease contract #2, payable \$600 monthly, due October 25, 2009	—	7,796
Lease contract #3, payable \$1,267 monthly, due November 25, 2009	—	20,652
	—	54,117
Less amounts representing interest and lease arrangement costs	—	(14,575)
	—	39,542
Less current portion of obligations under capital lease	—	(38,086)
	—	1,456

On June 23, 2009, the Company repaid the entire capital lease obligation.

Interest expense incurred on the capital lease obligations for the year was \$4,013 (2008 – \$7,702).

10. SHARE CAPITAL

	2009	2008
	\$	\$
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		
29,329,675 Class A common shares	6,529,182	—
22,697,143 Class A common shares	—	4,845,322

Synodon Inc.

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NOTES TO FINANCIAL STATEMENTS

October 31, 2009 and 2008

	Number of shares #	Total \$
Balance, October 31, 2007	20,746,571	4,239,464
Issued in private placement, net of costs of issuance of \$15,737 and net of fair value of warrants of \$284,589	1,517,853	382,708
Issued on exchange of notes payable and accrued interest	306,578	137,960
Issued for cash on the exercise of warrants	62,038	32,100
Transfer from warrants issued on issue of units on exercise of warrants	—	3,840
Issued on conversion of debt, net of costs of issuance of \$750	64,103	49,250
<hr/>		
Balance, October 31, 2008	22,697,143	4,845,322
Issued on conversion of distribution rights option <i>[note 7]</i>	146,389	65,875
Issued in private placement, net of costs of issuance of \$236,724 and net of fair value of warrants of \$1,204,000	6,486,143	1,617,985
Balance, October 31, 2009	29,329,675	6,529,182

During the year ended October 31, 2009, the Company closed two private placements, with one being closed in two tranches, for gross proceeds of \$2,984,640 by issuing 6,632,532 units at a price of \$0.45 per unit, which included conversion of an option for the issuance of 146,389 units (note 7). The units are comprised of one Class A common share and one half of a Class A common share purchase warrant. Each whole warrant entitles the holder to purchase one Class A common share of the Company at a price of \$0.75 per share for a period of two years, expiring August 10, 2011. The costs of issuance were \$236,724.

The details of the private placements are as follows:

On August 10, 2009, the Company closed a non-brokered private placement for gross cash proceeds of \$176,240. The closing was comprised of 538,032 units at \$0.45 per unit, which included conversion of an option for the issuance of 146,389 units (note 7). The units are comprised of one Class A common share and one half of a Class A common share purchase warrant. Each whole warrant entitles the holder to purchase one Class A common share of the Company at a price of \$0.75 per share for a period of two years, expiring August 10, 2011.

The warrants are subject to an acceleration right, such that if the closing price of the common shares is greater than \$1.05 on any day subsequent to August 10, 2009, the Company may give notice to the holders of the warrants that the expiry date for exercise has been accelerated and the warrants will expire on the 30th business day following the date of such notice.

The common shares and warrants issued pursuant to the private placement are subject to a four month statutory hold period which expires on December 11, 2009. The Company paid cash finder's fees totaling \$17,120 in connection with the sale of the units.

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The fair value of the warrants issued of \$0.16 per warrant was determined using the Black-Scholes option pricing model for warrants assuming a risk-free interest rate of 1.4%, a dividend yield of 0%, an expected volatility of 106.8% and an expected life of the warrants of two years. The resulting fair value of \$42,708 is included in the warrants on issue of units. Costs of issuance were allocated to these warrants in the amount of \$3,261.

On October 9, 2009, the Company closed a first tranche of another non-brokered private placement for gross cash proceeds of \$2,229,502. The closing was comprised of 4,954,449 units at \$0.45 per unit. The units are comprised of one Class A common share and one half of a Class A common share purchase warrant. Each whole warrant entitles the holder to purchase one Class A common share of the Company at a price of \$0.75 per share for a period of two years, expiring October 9, 2011.

The warrants are subject to an acceleration right, such that if the closing price of the common shares is greater than \$1.05 on any day subsequent to October 9, 2009, the Company may give notice to the holders of the warrants that the expiry date for exercise has been accelerated and the warrants will expire on the 30th business day following the date of such notice.

The common shares and warrants issued pursuant to the private placement are subject to a four month statutory hold period which expires on February 10, 2010. The Company issued 299,880 warrants and paid cash finder's fees totalling \$136,827 in connection with the sale of the units.

The fair value of the warrants issued of \$0.29 per warrant was determined using the Black-Scholes option pricing model for warrants assuming a risk-free interest rate of 1.7%, a dividend yield of 0%, an expected volatility of 100.9% and an expected life of the warrants of two years. The resulting fair value of \$730,113 is included in the warrants on issue of units. Costs of issuance were allocated to these warrants in the amount of \$56,261.

In connection with the private placement, the agent received 299,880 Class A common share warrants at an exercise price of \$0.45 for a period of 24 months, expiring October 9, 2011. The fair value of the warrants issued of \$0.37 per warrant was determined using the Black-Scholes option pricing model for warrants assuming a risk-free interest rate of 1.7%, a dividend yield of 0%, an expected volatility of 100.9% and an expected life of the warrants of two years.

On October 29, 2009 the Company closed the final tranche of its non-brokered private placement for gross cash proceeds of \$513,023. The closing was comprised of 1,140,051 units at \$0.45 per unit. The units are comprised of one Class A common share and one half of a Class A common share purchase warrant. Each whole warrant entitles the holder to purchase one Class A common share of the Company at a price of \$0.75 per share for a period of two years, expiring October 29, 2011.

The warrants are subject to an acceleration right, such that if the closing price of the common shares is greater than \$1.05 on any day subsequent to October 29, 2009, the Company may give notice to the holders of the warrants that the expiry date for exercise has been accelerated and the warrants will expire on the 30th business day following the date of such notice.

The common shares and warrants issued pursuant to the private placement are subject to a four month statutory hold period which expires on March 1, 2010. The Company issued 64,400 warrants and paid cash finder's fees totalling \$31,907 in connection with the sale of the units.

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October 31, 2009 and 2008

The fair value of the warrants issued of \$0.50 per warrant was determined using the Black-Scholes option pricing model for warrants assuming a risk-free interest rate of 1.47%, a dividend yield of 0%, an expected volatility of 106.8% and an expected life of the warrants of two years. The resulting fair value of \$283,055 is included in the warrants on issue of units. Costs of issuance were allocated to these warrants in the amount of \$22,015.

In connection with the private placement, the agent received 64,400 Class A common share warrants at an exercise price of \$0.45 for a period of 24 months, expiring October 29, 2011. The fair value of the warrants issued of \$0.59 per warrant was determined using the Black-Scholes option pricing model for warrants assuming a risk-free interest rate of 1.47%, a dividend yield of 0%, an expected volatility of 106.8% and an expected life of the warrants of two years.

During the year ended October 31, 2008, the Company closed a private placement, issuing 1,824,431 units at a price of \$0.45 per unit, each consisting of one Class A common share and one common share purchase warrant, for gross proceeds of \$820,995. The private placement included an exchange of notes payable and accrued interest [note 5]. Each warrant entitles the holder to acquire one common share at an exercise price of \$0.75 on or before October 7, 2010. The costs of issuance were \$24,377.

At October 31, 2008, \$111,683 from the proceeds was held in trust. Final amounts were disbursed to the Company totalling \$81,683 in November 2008 with the remaining \$30,000 being paid for share issue and other legal costs.

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.

Share options

Under the Company's incentive stock option plan (the "Plan"), options to purchase common shares may be granted by the Board of Directors to directors, officers, employees or consultants of the Company, or its subsidiaries. The Company has reserved up to 3,404,571 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, 2006 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, employees or consultants 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 ten years for options granted prior to April 30, 2006. There have not been any options granted in exchange for services after April 30, 2006. If an option has lapsed, the Board of Directors may grant new options covering the shares not purchased. If a participant is dismissed as an officer, employee or consultant by the Company for cause, all unexercised option rights of that participant under the Plan shall terminate immediately upon such dismissal. If a participant ceases to be an officer, employee or consultant of the Company as a result of reasons other than for cause (as set forth in the Plan) such participant shall have the right for a period not exceeding one year from the date of ceasing to be an officer, employee, consultant or director to exercise the option under the Plan with respect to all optioned shares of such participant to the extent they were exercisable on the date of ceasing to be an officer, employee, consultant or director.

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	2009		2008	
	Number of options	Weighted average exercise price \$	Number of options	Weighted average exercise price \$
Outstanding, beginning of year	2,060,000	0.5383	1,540,000	0.4513
Granted	955,000	0.4556	600,000	0.7650
Cancelled	(100,000)	0.5900	(80,000)	0.5500
Outstanding, end of year	2,915,000	0.5112	2,060,000	0.5383
Options exercisable at end of year	2,260,000	0.5040	1,275,000	0.4451

The following table summarizes information about share options outstanding at October 31, 2009:

Range of exercise prices \$	Year of grant	Number outstanding	Number exercisable	Weighted average remaining contractual life [years]	Weighted average exercise price \$
0.45	2005	400,000	400,000	0.2	0.450
0.40	2006	500,000	500,000	0.2	0.400
0.50	2006	100,000	100,000	1.6	0.500
0.50	2007	410,000	410,000	2.2	0.500
0.75-0.78	2008	550,000	400,000	3.5	0.764
0.30-0.61	2009	955,000	450,000	4.7	0.455
		2,915,000	2,260,000	2.6	0.511

On November 15, 2008, the Company cancelled 100,000 options to purchase common shares to employees of which 50,000 were exercisable at \$0.40 per option and 50,000 were exercisable at \$0.78.

On November 28, 2008, the Company issued 300,000 options to purchase common shares to officers and employees which vest over a thirteen month period and are exercisable at \$0.30 per option.

On September 30, 2009, the Company issued 605,000 options, of which 575,000 were issued to directors of the Company, to purchase common shares, exercisable at \$0.52 per option. The options will vest over a 15 month period.

On October 13, 2009, the Company issued 50,000 options to a director of the Company to purchase common shares exercisable at \$0.61 per option. The options vest immediately.

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.

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On August 1, 2008, the Company issued 300,000 options to CHF Investor Relations. The options are exercisable at \$0.75 for a period of five years and vest in four equal tranches over a period of 12 months (75,000 options every three months).

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, 2009, \$287,259 [2008 - \$95,413] 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:

	2009	2008
Weighted average exercise price	\$0.46	\$0.77
Expected dividend yield	0.00%	0.00%
Weighted average risk-free interest rate	2.5%	2.9%
Expected volatility	78%	94%
Weighted average expected life	5.0 years	5.0 years

Warrants

At October 31, 2009, the Company had 5,806,439 (2008 - 3,946,776) common share purchase warrants outstanding, as follows:

Exercise price	Expiry date	Number outstanding and exercisable
\$		\$
U.S. 0.65	December 31, 2009	98,500
0.45	October 7, 2010	2,961
0.75	October 7, 2010	1,824,431
0.39	July 1, 2011	200,000
0.75	August 10, 2011	269,016
0.45	October 9, 2011	299,880
0.75	October 9, 2011	2,477,225
0.45	October 29, 2011	64,400
0.75	October 29, 2011	570,026
		5,806,439

On December 28, 2008 1,708,750 warrants expired, resulting in a reclassification of \$192,192 from warrants issued on units to contributed surplus.

On May 15, 2009, 66,000 warrants expired.

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On July 1, 2009, the Company issued 200,000 warrants in connection with the conversion of a trade account payable into a note payable (note 5). These are classified as warrants on issue of notes payable on the balance sheet. The fair value of the warrants issued of \$0.20 per warrant was determined using the Black-Scholes option pricing model for warrants assuming a risk-free interest rate of 1.2%, a dividend yield of 0%, an expected volatility of 98.85% and an expected life of the warrants of two years. The resulting fair value of \$40,658 is included in the warrants on issue of units. Costs of issuance were allocated to these warrants in the amount of \$660.

On September 13, 2009, 246,134 warrants expired, resulting in a reclassification of \$46,952 from warrants issued on units to contributed surplus.

During the year ended October 31, 2008, the Company issued 1,824,431 common share purchase warrants from a private placement. The warrant holder is entitled to acquire one Class A common share at an exercise price of \$0.75 on or before October 7, 2010. The warrants have an accelerated exercise provision under which, if the volume weighted average closing price of the shares equals or exceeds \$1.05 per share, then the warrants must be exercised or will expire 30 calendar days after notice of such event is mailed to the warrant holders. The fair value of the warrants issued of \$0.16 per warrant was determined using the Black-Scholes option pricing model for warrants assuming a risk-free interest rate of 2.2%, a dividend yield of 0%, an expected volatility of 111% and an expected life of the warrants of two years. The resulting fair value of \$284,589 is included in the warrants on issue of units. Costs of issuance were allocated to these warrants in the amount of \$8,640.

In connection with the private placement, the agent received 2,961 Class A common share warrants at an exercise price of \$0.45 for a period of 24 months, expiring October 8, 2010. The fair value of the warrants issued of \$0.20 per warrant was determined using the Black-Scholes option pricing model for warrants assuming a risk-free interest rate of 2.2%, a dividend yield of 0%, an expected volatility of 111% and an expected life of the warrants of two years. The resulting fair value of \$586 is included in the private placement issuance costs.

Warrants on issue of units

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

	2009	2008
	\$	\$
Balance, beginning of year	528,743	256,634
Warrants issued on private placement units, net of issuance costs of \$130,905	1,070,095	275,949
Transfer to share capital on exercise of warrants	—	(3,840)
Expiry of warrants issued on IPO units	(239,144)	—
Expiry of warrants issued on conversion of promissory notes and accrued interest	(13,650)	—
Balance, end of year	1,346,044	528,743

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 loss per share. For the years ended October 31, 2009 and 2008, all outstanding options are considered anti-dilutive when the Company has recorded a loss available to common shareholders.

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Warrants on issue of note payable

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

	2009	2008
	\$	\$
Balance, beginning of year	—	—
Warrants issued on note payable, net of issuance costs of \$660	39,998	—
Balance, end of year	39,998	—

Contributed surplus

The following table sets out the change in contributed surplus:

	2009	2008
	\$	\$
Balance, beginning of year	633,661	538,248
Stock-based compensation	287,259	95,413
Expiry of warrants issued on IPO units	239,144	—
Expiry of warrants issued on conversion of promissory notes and accrued interest	13,650	—
Balance, end of year	1,173,714	633,661

11. INCOME TAXES

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

	2009	2008
	\$	\$
Combined statutory federal and provincial tax rate at 29.1% [2008 – 30.50%]	(291,800)	(478,000)
Adjusted for		
Stock-based compensation	83,600	29,200
Unrecognized losses	200,200	447,300
Other	8,000	1,500
Income tax expense	—	—

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Future tax assets

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

	2009	2008
	\$	\$
Non-capital loss carryforwards	1,600,000	1,498,900
SR&ED expense carryforwards	233,800	243,400
Equipment – differences in net book value and undepreciated capital costs	10,400	10,000
Cumulative eligible capital	13,000	14,200
Share issue costs	104,300	91,500
Deposits on distribution rights	10,300	—
	1,971,800	1,858,000
Less valuation allowance	(1,971,800)	(1,858,000)
	—	—

At October 31, 2009, the Company has approximately \$6,220,000 of non-capital losses available to reduce future years' taxable income, expiring between 2010 and 2028. The Company also has investment tax credits of \$175,800 available to reduce income taxes payable expiring between 2013 and 2028.

At October 31, 2009, the Company also has \$935,100 of SR&ED expenditures available to reduce 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.

12. GOVERNMENT ASSISTANCE**SDTC funding**

The Company has entered into a number of funding agreements since 2006 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. During the year ended October 31, 2009, the Company recorded \$204,302 as a reduction of research and development costs related to SDTC assistance earned during the year (2008 - \$182,523).

On December 12, 2008, the Company signed a contribution agreement with SDTC to receive \$110,000 of funding to be used towards the costs of environmental technology verification certification in Canada and the United States. On December 19, 2008, the Company received the first advance on the contract of

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\$38,000. The entire \$38,000 has been recorded as deferred government assistance and will be expensed as earned.

At October 31, 2009, included in accounts receivable are \$102,504 in holdbacks associated with all SDTC contracts signed since 2006. The required documentation for release of the holdbacks is in the process of being filed.

AVAC funding

On December 18, 2008, AVAC Ltd., through its Capacity Builder program, committed a \$1.3 million contribution to the realSens™ project. As part of the contribution, the Company signed a General Security Agreement with AVAC Ltd., giving AVAC Ltd. first right on all of the Company's assets in the event of default. The funds will be dispersed on a completed milestone basis over the next 12 months. The contribution will be used to support the deployment of the technology into the commercial marketplace.

The funding is milestone based and is received upon successful completion of technical and marketing milestones. The contribution is repayable by way of a royalty based on 1.5% of revenue earned, beginning in October 2009, up to a maximum of two times the contribution.

During the year ended October 31, 2009, the Company has received \$964,000 under this program, of which \$924,417 appears as a reduction to research and development expenses and \$39,583 appears as a reduction to sales and marketing expenses.

IERD funding

In 2004, the Company qualified for funding under the Industry Energy Research and Development Program ("IERD"). Under this government funding program, IERD advanced to the Company an amount equal to 28% of eligible costs incurred, up to a maximum of \$600,000. The advances were non-interest bearing and only repayable at an amount of 3% of revenue earned in connection with the project. As at October 31, 2009, the project has been completed and all monies owing have been received by the Company, totalling \$586,437. During the year ended October 31, 2009, nil [2008 - \$11,587] of IERD funding has been included as a reduction of research and development costs as a result of receiving payment for previously denied expense claims.

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.

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13. RESEARCH AND DEVELOPMENT

Since inception the Company has incurred \$6,041,769 of research and development expenses 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:

	2009	2008
	\$	\$
Research and development expenses	1,042,993	793,579
Less government assistance		
SDTC	(204,302)	(182,523)
IERD	—	(11,587)
AVAC	(924,417)	—
	(85,726)	599,469

14. RELATED PARTY TRANSACTIONS

Officers, directors and shareholders provided promissory notes [note 5] 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 established and agreed upon by the related parties.

- (a) The Company leased facilities from an officer who is also a shareholder. Total rental payments for fiscal 2009 were \$1,500 [2008 - \$4,500].
- (b) The Company incurred interest on promissory notes in the amount of \$198 [2008 - \$8,179] to directors of the Company as described in note 5.

15. 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, 2009

- (a) Issued warrants issued on issuance of promissory note as described in note 5. These warrants were valued at \$40,658.
- (b) Issued to the sales agents of the Company's private placement, 364,280 warrants at a price of \$0.45 as described in note 10. These warrants were valued at \$148,124.

Year ended October 31, 2008

- (a) Issued 64,103 Class A common shares to satisfy a \$50,000 supplier payable as described in note 10.
 - (b) Issued to the sponsor agent of the Company's private placement, 2,961 warrants at a price of \$0.45, expiring October 8, 2010 as described in note 10. These warrants were valued at \$586.
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16. MANAGEMENT OF RISKS

The Company manages various types of risk without the use of financial derivatives.

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. These holdbacks are expected to be released upon the Company filing appropriate final reports including external auditors' reports on certain financial information of the related program [note 12]. Accordingly, the Company believes that there is a very low level of credit risk associated with these amounts.

Interest rate risk

During the year the Company had fixed repayment terms on its obligations under capital lease and fixed interest rates on its notes payable and, accordingly, was not exposed to interest rate risk on its interest bearing obligations. The Company would have been exposed to interest rate price risk should interest rates have fallen while the Company was committed to a higher fixed rate.

Foreign exchange risk

The Company has accounts payable that are denominated in U.S. dollars. Accordingly, the Company is exposed to fluctuations in the Canadian/U.S. dollar exchange rate. The sensitivity of these liabilities to a 10% change in the exchange rate would result in a change in net loss for the year of \$3,132.

17. CAPITAL DISCLOSURES

The Company's objective in managing its capital is to ensure that it has appropriate financial resources to continue to further its technology toward commercialization. The Company's capital includes notes payable, obligations under capital lease and equity. The Company has been primarily dependent upon the issue of common shares and units comprising common shares and a common share purchase warrant as sources of capital as market conditions and the stage of the Company's technology development have allowed. During certain times when market conditions have not been suitable for issuing units or common shares, the Company has accessed lease financing and issued notes payable as short to medium term sources of capital.

The Company is not currently subject to any externally imposed capital requirements.

18. RECLASSIFICATION OF COMPARATIVE FIGURES

Certain comparative amounts have been reclassified to conform to the presentation adopted in the current year.

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19. SUBSEQUENT EVENTS

On December 2, 2009, the Company cancelled 900,000 share options previously granted to officers of the Company. These options were exercisable at an average price of \$0.42 per option and were set to expire on December 31, 2009.

On December 2, 2009, the Company issued to officers of the Company 1,150,000 share options to purchase common shares, exercisable at \$0.60 per option. The options have been issued pursuant to the Company's Share Option Plan and will vest immediately.

On December 8, 2009, 100,000 share options were exercised at \$0.30 per option.