

Synodon Inc.
Interim Financial Statements
For the Quarter Ended July 31, 2010 and 2009
Unaudited

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

Synodon Inc.

(a development stage enterprise)

BALANCE SHEETS

[see note 1 – going concern communication]

As at

	July 31, 2010 \$	October 31, 2009 \$
ASSETS [note 5]		
Current		
Cash	11,976	994,198
Accounts receivable [note 6, 8]	123,854	111,777
Work in progress	8,164	—
Prepaid expenses and deposits	27,204	45,989
	171,198	1,151,964
Property and equipment	27,508	13,886
Intangible assets	12,244	—
	210,950	1,165,850
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIENCY)		
Current		
Accounts payable and accrued liabilities	450,408	319,795
Deposits on distribution rights option [note 3]	77,400	80,431
	527,808	400,226
Commitments and contingencies [note 5]		
Shareholders' equity (deficiency)		
Share capital [note 4]	6,731,012	6,529,182
Warrants on issue of note payable [note 4]	39,998	39,998
Warrants on issue of units [note 4]	1,429,230	1,346,044
Contributed surplus [note 4]	1,898,431	1,173,714
Deficit	(10,415,529)	(8,323,314)
	(316,858)	765,624
	210,950	1,165,850

See accompanying notes

Synodon Inc.

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STATEMENTS OF LOSS AND DEFICIT

	Three months ended		Nine months ended	
	July 31,		July 31,	
	2010	2009	2010	2009
	\$	\$	\$	\$
REVENUE	—	—	14,280	—
Cost of Sales	—	—	7,166	—
	—	—	7,114	—
EXPENSES				
Research and development costs, net of government assistance [notes 5&6]	231,437	(197,662)	671,568	(66,896)
Sales and marketing	60,863	(27,200)	141,811	22,547
Amortization	2,475	1,284	6,776	3,981
Financing charges and interest	1,533	53,934	7,047	101,281
Foreign exchange (gains) losses	(1,055)	(91,152)	5,426	(56,458)
Stock-based compensation	42,728	39,762	742,919	155,546
Office and general administrative	169,662	164,199	523,782	508,574
	507,643	(56,835)	2,099,329	668,575
Loss from operations	(507,643)	56,835	(2,092,215)	(668,575)
NET LOSS AND COMPREHENSIVE				
LOSS FOR THE PERIOD	(507,643)	56,835	(2,092,215)	(668,575)
Deficit, beginning of the period	(9,907,886)	(8,045,411)	(8,323,314)	(7,320,001)
Deficit, end of the period	(10,415,529)	(7,988,576)	(10,415,529)	(7,988,576)
Loss per share				
- basic and diluted	(0.02)	—	(0.07)	(0.03)
Weighted average number of				
shares outstanding	30,540,787	22,697,143	29,883,806	22,697,143

See accompanying notes

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(a development stage enterprise)
STATEMENTS OF CASH FLOWS

	Three months ended		Nine months ended	
	July 31,		July 31,	
	2010	2009	2010	2009
	\$	\$	\$	\$
OPERATING ACTIVITIES				
Net loss for the period	(507,643)	56,835	(2,092,215)	(668,575)
Add charges to operations not requiring a current cash payment:				
Stock-based compensation	42,728	39,762	742,919	155,545
Accretion of notes payable	—	8,019	—	8,019
Amortization	2,475	1,284	6,776	3,981
	(462,440)	105,900	(1,342,520)	(501,030)
Net change in non-cash working capital balances related to operations:				
Accounts receivable	(3,338)	(1,275)	(12,077)	(327)
Work in Progress	(8,164)	—	(8,164)	—
Deposit on distribution option	1,982	(9,302)	(3,031)	81,487
Prepaid expenses	14,406	16,722	18,785	9,722
Accounts payable and accrued liabilities	248,170	(87,421)	130,613	370,281
Deferred government assistance	—	—	—	(49,225)
Cash used in operating activities	(209,384)	24,624	(1,216,394)	(89,092)
INVESTING ACTIVITIES				
Purchase of property and equipment	(2,480)	(2,220)	(19,029)	(4,873)
Purchase of intangible assets	(720)	—	(13,614)	—
Cash used in investing activities	(3,200)	(2,220)	(32,643)	(4,873)
FINANCING ACTIVITIES				
Repayment of obligations under capital lease	—	(22,931)	—	(39,542)
Long-term deposits	—	—	—	7,876
Repayment of notes payable	—	—	—	(5,000)
Deposit on share subscriptions	—	166,634	—	166,634
Issuance of shares	—	—	162,183	—
Share issuance costs	—	—	(13,185)	—
Issuance of warrants	—	—	87,817	—
Exercise of Options	—	—	30,000	—
Cash provided by (used in) financing activities	—	143,703	266,815	129,968
Net increase (decrease) in cash during the period	(212,584)	166,107	(982,222)	36,003
Cash, beginning of period	224,560	14,055	994,198	144,159
Cash, end of period	11,976	180,162	11,976	180,162
Supplemental cash flow information				
Interest paid	—	57,917	2,485	63,755

See accompanying notes

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NOTES TO FINANCIAL STATEMENTS

July 31, 2010 and 2009

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 has completed the prototype manufacturing of the realSens™ instrument, has initiated its plan for commercialization and continues to be 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, on August 14, 2000, and as at July 31, 2010, the Company has an accumulated deficit of \$10,415,529. 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

These unaudited interim financial statements should be read in conjunction with the October 31, 2009 annual financial statements as disclosures provided in the interim financial statements do not conform in all respects to the requirements of GAAP for annual financial statements. In management's opinion, the interim financial statements include all adjustments necessary to present fairly such interim financial statements. The same accounting policies and methods are used as in the 2009 financial statements except for the new accounting standard adopted during the quarter, as a result of a new type of transaction as noted below.

Work in progress

Work in progress, which is comprised of costs of labour and expenses incurred during the execution of customer contracts and prior to the completion of the contracts, is recorded at the lower of cost and net realizable value.

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 in the process of completing the scoping phase of its IFRS conversion plan that includes analyzing key differences and providing training to all finance and accounting staff. The Company is in the process of developing a conversion plan and preparing a detailed

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timeline assessing: further training requirements, the impact on current accounting policies, information systems, internal controls over financial reporting and business activities.

3. DEPOSIT ON DISTRIBUTION RIGHTS OPTION

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. \$77,400. 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 option has been extended under the same terms until December 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 December 31, 2010.

4. SHARE CAPITAL

	July 31, 2010	October 31, 2009
	\$	\$
<hr/>		
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		
30,540,787 Class A common shares	6,731,012	—
29,329,675 Class A common shares	—	6,529,182

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	Number of shares #	Total \$
Balance, October 31, 2008	22,697,143	4,845,322
Issued on conversion of distribution rights option	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
Issued on exercise of stock options	100,000	48,201
Issued in private placement, net of costs of issuance of \$8,554 and net of fair value of warrants of \$87,817	1,111,112	153,629
Balance, July 31, 2010	30,540,787	6,731,012

On December 8, 2009, 100,000 share options were exercised at \$0.30 per option. The amounts transferred from contributed surplus related to these options were \$18,201.

On April 13, 2010, the Company closed a non-brokered private placement for gross proceeds of \$250,000. The closing was comprised of 1,111,112 units at a price of \$0.225 per unit. Each Unit is comprised of one Class A common share and one half of a Class A common share purchase warrant (the "Warrants"). Each full Warrant entitles the holder to purchase one additional Class A common share of the Corporation at a price of \$0.3375 per share up to April 8, 2012.

The Warrants have an accelerated exercise provision under which, if the volume weighted average closing price of the Shares, as traded on the TSX Venture Exchange, equals or exceeds \$1.05 per Share for a period of 10 trading days, then the warrants must be exercised or will expire 30 calendar days after notice of such event is mailed to the warrant-holders. Both the common shares issued as part of the Units and any common shares issued upon exercise of the Warrants are subject to a hold period, which expires on August 9, 2010 and, such common shares may not be traded until August 9, 2010. The Corporation has not paid any commissions or finder fees for this transaction.

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 1.85%, a dividend yield of 0%, an expected volatility of 105.7% and an expected life of the warrants of two years. The resulting fair value of \$87,817 is included in the warrants on issue of Units. Costs of issuance were allocated to these warrants in the amount of \$4,631.

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 up to three years. The option period for options granted as

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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. Options granted in exchange for services after April 30, 2006, have generally vested in under two years. 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.

	<u>Nine Months Ended</u>		<u>Year Ended</u>	
	<u>July 31, 2010</u>		<u>October 31, 2009</u>	
	Number of options	Weighted average exercise price \$	Number of options	Weighted average exercise price \$
Outstanding, beginning of period	2,915,000	0.511	2,060,000	0.538
Granted	1,475,000	0.569	955,000	0.456
Exercised	(100,000)	0.300	—	—
Cancelled	(900,000)	0.422	(100,000)	0.590
Outstanding, end of period	3,390,000	0.566	2,915,000	0.511
Options exercisable at end of period	2,950,000	0.578	2,260,000	0.504

The following table summarizes information about share options outstanding at July 31, 2010:

Range of exercise prices \$	Year of grant	Number outstanding	Number exercisable	Weighted average remaining contractual life [years]	Weighted average exercise price \$
0.50	2006	100,000	100,000	1.0	0.500
0.50	2007	410,000	410,000	1.7	0.500
0.75-0.78	2008	550,000	550,000	2.9	0.764
0.30-0.61	2009	2,005,000	1,790,000	4.5	0.546
0.46	2010	325,000	100,000	4.8	0.460
		3,390,000	2,950,000	3.8	0.566

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.

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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 Plan and vest immediately.

On February 19, 2010, the Company issued to officers and employees of the Company 325,000 share options to purchase common shares, exercisable at \$0.46 per option. The options have been issued pursuant to the Company's Plan and vest over 11 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 three month period ended July 31, 2010, \$42,728 [2009 - \$39,762] has been recorded as compensation expense with an equal amount reflected in contributed surplus.

Warrants

At July 31, 2010, the Company had 6,263,495 (October 31, 2009 - 5,707,938) common share purchase warrants outstanding, as follows:

Exercise price \$	Expiry date	Number outstanding and exercisable \$
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
0.34	April 8, 2012	555,556
		6,263,495

On December 31, 2009 98,500 warrants expired.

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Warrants on issue of units

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

	Nine months ended July 31, 2010	Year ended October 31, 2009
	\$	\$
Balance, beginning of period	1,346,044	528,743
Warrants issued on private placement units, net of issuance costs of \$4,631	83,186	—
Warrants issued on private placement units, net of issuance costs of \$130,905	—	1,070,095
Transfer to share capital on exercise of warrants	—	—
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 period	1,429,230	1,346,044

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 nine month period ended July 31, 2010 and the year ended October 31, 2009, all outstanding options are considered anti-dilutive when the Company has recorded a loss available to common shareholders.

Warrants on issue of note payable

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

	Nine months ended July 31, 2010	Year ended October 31, 2009
	\$	\$
Balance, beginning of period	39,998	—
Warrants issued on note payable, net of issuance costs of \$660	—	39,998
Balance, end of period	39,998	39,998

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Contributed surplus

The following table sets out the change in contributed surplus:

	Nine months ended July 31, 2010	Year ended October 31, 2009
	\$	\$
Balance, beginning of period	1,173,714	633,661
Stock-based compensation	742,919	287,259
Exercise of options	(18,202)	—
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 period	1,898,431	1,173,714

5. GOVERNMENT ASSISTANCE**Government of Alberta**

On April 12, 2010, the Company was notified that it had been awarded a two year grant through the Alberta Innovates Technology Futures (“Alberta Ingenuity”) program. The grant is designed to fund research and development wages to help bring technical solutions to commercialization. The total grant of \$124,000 has two components. The first is \$110,000 to be paid in 24 monthly instalments and \$14,000 to be paid annually on April 1, 2010 and 2011. The Company recorded \$13,750 in the quarter ended July 31, 2010 and \$25,333 for the nine month period ended July 31, 2010, as a reduction of research and development expenses and will continue to record the monies when received as a reduction of research and development expenses.

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. For the nine months ended July 31, 2010, the Company recorded \$nil as a reduction of research and development costs related to SDTC assistance earned during the year.

As at July 31, 2010, included in accounts receivable are \$102,504 (representing the minimum 10% of project funds required by contract) in holdbacks associated with all SDTC contracts signed since 2006. The required documentation for release of the holdbacks has been filed and the final project audit has been completed.

AVAC funding

On December 18, 2008, AVAC Ltd. (“AVAC”), 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

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Security Agreement with AVAC, giving AVAC 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.

For the nine month period ended July 31, 2010, the Company has received nil under this program and paid \$214 in royalties.

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 \$600,000. For the nine month period ended July 31, 2010, the Company paid \$428 in royalties.

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.

6. RESEARCH AND DEVELOPMENT

Since inception the Company has incurred \$6,713,337 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:

	Nine months ended July 31, 2010	Nine months ended July 31, 2009
	\$	\$
Research and development expenses	696,259	944,746
Add royalty expense		
IERD	428	—
AVAC	214	—
Less government assistance		
Alberta Ingenuity	(25,333)	—
SDTC	—	(87,225)
IERD	—	—
AVAC	—	(924,417)
	671,568	(66,896)

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7. RELATED PARTY TRANSACTIONS

Officers, directors and shareholders provided promissory notes 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 in 2009. Total rental payments for the three and nine months ended July 31, 2010 were \$nil [2009 - \$nil & \$1,500 respectively].
- (b) The Company incurred interest on promissory notes in the amount of \$nil during the three and nine months ended July 31, 2010 [2009 - \$55 & \$162 respectively] to directors of the Company.

8. SUBSEQUENT EVENTS

In August 2010, the Company issued demand promissory notes with an aggregate face value of \$50,000 and bearing interest at 8% per annum to directors of the Corporation.

In August 2010, the Company received \$180,000 from AVAC as a partial Milestone payment.

In September 2010, the Company received confirmation from SDTC that a payment of \$204,259 will be disbursed in the last week of September to close out the project. This amount is in excess of the \$102,504 holdback included in accounts receivable due to the final reconciliation of project based expenditures.