

Synodon Inc.
Audited Financial Statements
October 31, 2010 and 2009

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, 2010 and 2009 and the statements of loss, 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, 2010 and 2009 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 24, 2011.

Chartered Accountants

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

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

As at October 31

	2010	2009
	\$	\$
ASSETS [note 10]		
Current		
Cash	49,893	994,198
Accounts receivable [note 10]	36,860	111,777
Unbilled revenue	32,610	—
Prepaid expenses and deposits	45,370	45,989
Work in progress	27,819	—
Current deferred charges [note 17]	19,727	—
	212,279	1,151,964
Equipment [note 3]	25,041	13,886
Intangible assets [note 4]	11,345	—
	248,665	1,165,850
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIENCY)		
Current		
Accounts payable and accrued liabilities	801,961	319,795
Deposits on distribution rights option [note 6, 17]	76,417	80,431
	878,378	400,226
Commitments and contingencies [notes 6, 7 and 10]		
Shareholders' equity (deficiency)		
Share capital [note 8]	6,730,692	6,529,182
Warrants on issue of note payable [note 8]	39,998	39,998
Warrants on issue of units [note 8]	1,153,281	1,346,044
Contributed surplus [note 8]	2,257,269	1,173,714
Deficit	(10,810,953)	(8,323,314)
	(629,713)	765,624
	248,665	1,165,850

See accompanying notes

On behalf of the Board:

(signed) "Adrian Banica"

Adrian Banica, Director
Chief Executive Officer

Synodon Inc.
(a development stage enterprise)

(signed) "John Pinsent, CA"

John Pinsent, Director
Audit Committee Chair

STATEMENTS OF LOSS, COMPREHENSIVE LOSS AND DEFICIT

For the years ended October 31

	2010	2009
	\$	\$
REVENUE	62,395	—
COST OF SALES	93,428	—
EXPENSES		
Research and development, net of government assistance <i>[notes 10 and 11]</i>	662,268	(85,726)
Amortization of intangibles <i>[note 4]</i>	2,269	172
Amortization of equipment <i>[note 3]</i>	6,151	4,907
Sales and marketing <i>[note 10]</i>	201,122	57,139
Financing charges and interest <i>[notes 5, 8 and 12]</i>	12,777	150,235
Foreign exchange losses (gains)	4,927	(103,822)
Stock-based compensation <i>[note 8]</i>	825,807	287,259
Office, general and administrative	741,963	693,149
Other income and expenses	(678)	—
Net loss and comprehensive loss for the year	(2,487,639)	(1,003,313)
Deficit, beginning of year	(8,323,314)	(7,320,001)
Deficit, end of year	(10,810,953)	(8,323,314)
Loss per share - basic and diluted	\$(0.08)	\$(0.04)
Weighted average number of common shares outstanding	30,049,402	23,122,887

See accompanying notes

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

For the years ended October 31

	2010 \$	2009 \$
OPERATING ACTIVITIES		
Net loss and comprehensive loss for the year	(2,487,639)	(1,003,313)
Add charges to operations not requiring a current cash payment		
Stock-based compensation	825,807	287,259
Amortization of intangibles	2,269	172
Amortization of equipment	6,151	4,907
Non-cash interest expense <i>[note 5]</i>	—	40,658
	(1,653,412)	(670,317)
Changes in non-cash working capital balances related to operations		
Accounts receivable	74,917	(45,829)
Unbilled revenue	(32,610)	—
Inventory	(27,819)	—
Deposits on distribution rights option	(4,014)	80,431
Prepaid expenses and deposits	619	(6,314)
Current deferred charges	(19,727)	—
Accounts payable and accrued liabilities	482,166	(993,508)
Deferred government assistance	—	(128,799)
Cash used in operating activities	(1,179,880)	(1,764,336)
INVESTING ACTIVITIES		
Purchase of equipment	(19,029)	(6,179)
Loss on disposal of equipment	1,723	—
Purchase of intangibles	(13,614)	—
Cash used in investing activities	(30,920)	(6,179)
FINANCING ACTIVITIES		
Repayment of notes payable	—	(35,200)
Long-term deposits	—	7,876
Repayment of obligations under capital lease	—	(39,542)
Issuance of shares and warrants	250,000	2,918,765
Payment of share and warrant issuance costs	(13,505)	(231,345)
Exercise of warrants	30,000	—
Cash provided by financing activities	266,495	2,620,554
Net increase (decrease) in cash during the year	(944,305)	850,039
Cash, beginning of year	994,198	144,159
Cash, end of year	49,893	994,198
Supplemental cash flow information		
Interest paid	5,082	121,500

Other non-cash transactions *[notes 8 and 13]*
See accompanying notes

Synodon Inc.

(a development stage enterprise)

NOTES TO FINANCIAL STATEMENTS

October 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 is in the final stages of early 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, 2010, the Company has an accumulated deficit of \$10,810,953. 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, 2009, the Company adopted the following new accounting policy, as a result of a new type of transaction:

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.

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

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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 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.

Equipment

Equipment is recorded at cost less accumulated amortization. Management assesses the carrying value of all 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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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

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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. As at October 31, 2010, all leases entered into by the Company were operating in nature.

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 on a percentage of completion basis. Contract revenue is recognized on the ratio of completed hours spent to estimated total hours for each contract. Unbilled revenue represents the revenue recognized on a percentage of completion basis for contracts in process. Provisions for estimated losses on all incomplete contracts are made in the period in which such losses are determined. The percentage of completion basis is based on management's best estimate of the total estimated costs to complete each contract, it is therefore possible that changes in future conditions could require a material change in the recognized amounts.

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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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 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.

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**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 commenced its conversion project in 2009 and is in the process of implementing the project plan that will enable the Company to begin reporting its financial statements in accordance with IFRS on a comparative basis beginning November 1, 2011. The IFRS conversion project consists of three phases: scoping and diagnostic; analysis and development; and implementation and review.

The first phase, which has been completed, involved project planning, a high level review of key accounting policy differences between Canadian GAAP and IFRS, as well as determining policy choices and elections allowed under IFRS. The areas identified to have the highest potential to significantly impact the Company are stock based compensation, equipment, intangible assets, the process for testing impairment of assets, and initial adoption of IFRS under the provisions of IFRS 1 "First Time Adoption of IFRS". The second phase, which involves detailed analysis and evaluation of options available under IFRS, the financial impact of these options, and the impact on internal controls over financial reporting is in progress. Policy choices are currently being reviewed and it is expected that the determination of policy choices will be completed in the third quarter of 2011.

Until the analysis is fully completed, the impact on the Company's future results of operations and financial position is not determinable. The Company anticipates that there will be a significant increase in disclosure resulting from the adoption of IFRS. The Company also expects the transition to IFRS to impact financial reporting, business processes, internal controls and information systems.

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3. EQUIPMENT

	<u>2010</u>		<u>2009</u>	
	<u>Cost</u>	<u>Accumulated amortization</u>	<u>Cost</u>	<u>Accumulated amortization</u>
	\$	\$	\$	\$
Computer equipment	22,468	6,038	41,849	37,386
Laboratory equipment	9,491	5,473	10,268	4,685
Furniture and fixtures	14,563	9,970	12,873	9,033
	46,522	21,481	64,990	51,104
Net book value		25,041		13,886

During the year ended October 31, 2010, the Company recorded equipment amortization of \$6,151 (2009 - \$4,907). Certain computer and laboratory asset costs that were no longer in use were relieved from the accounts at October 31, 2010 and a loss on disposal of those assets of \$1,722 was recorded.

4. INTANGIBLE ASSETS

	<u>2010</u>		<u>2009</u>	
	<u>Cost</u>	<u>Accumulated amortization</u>	<u>Cost</u>	<u>Accumulated amortization</u>
	\$	\$	\$	\$
Computer software	20,480	9,136	6,867	6,867
	20,480	9,136	6,867	6,867
Net book value		11,345		—

During the year ended October 31, 2010, the Company recorded intangible assets amortization of \$2,269 (2009 - \$172).

5. NOTES PAYABLE

	<u>2010</u>	<u>2009</u>
	\$	\$
Demand promissory notes		
Notes, bearing interest at 8% per annum	—	—
	—	—

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 October 2010, the Company repaid all outstanding notes payable.

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

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trade payable with a key long term supplier. The warrants have been valued at \$39,998 [note 8] 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.

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

During the year ended October 31, 2010, interest expense of \$888 [2009 - \$48,539] was recorded on notes payable, of which \$888 [2009 - \$198] was payable to related parties [note 12].

6. DEPOSITS 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. \$76,417. 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.

The option has been further 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 [note 17].

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 8].

7. COMMITMENTS

The Company is committed to minimum lease payments on its premises to September 30, 2012 totalling \$124,200. In addition to minimum lease payments, the lease requires payment of the Company's proportionate share of real estate taxes and common area maintenance expenses.

The Company has also entered into contracts for investor and public relations as well as a carbon monetization advisory contract to be delivered in 2011 at a cost of \$98,000.

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The commitments for each of the next five years for the lease and other contracts are as follows:

	\$
FY 2011	162,800
FY 2012	59,400
Subsequent Years	-
Total	222,200

8. SHARE CAPITAL

	2010 \$	2009 \$
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	6,730,692	—
29,329,675 Class A common shares	—	6,529,182
	Number of shares #	Total \$
Balance, October 31, 2008	22,697,143	4,845,322
Issued on conversion of distribution rights option <i>[note 6]</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
Issued on exercise of options	100,000	48,201
Issued in private placement, net of costs of issuance of \$13,596 and net of fair value of warrants of \$83,185	1,111,112	153,309
Balance, October 31, 2010	30,540,787	6,730,692

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

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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 4,581,118 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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	2010		2009	
	Number of options	Weighted average exercise price \$	Number of options	Weighted average exercise price \$
Outstanding, beginning of year	2,915,000	0.5112	2,060,000	0.5383
Granted	2,075,000	0.4639	955,000	0.4556
Exercised	(100,000)	0.3000	—	—
Cancelled	(900,000)	0.4222	(100,000)	0.5900
Outstanding, end of year	3,990,000	0.5119	2,915,000	0.5112
Options exercisable at end of year	2,950,000	0.5778	2,260,000	0.5040

The following table summarizes information about share options outstanding at October 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	0.6	0.500
0.50	2007	410,000	410,000	1.2	0.500
0.75-0.78	2008	550,000	550,000	2.5	0.764
0.30-0.61	2009	855,000	640,000	3.7	0.455
0.205-0.60	2010	2,075,000	1,250,000	4.6	0.464
		3,990,000	2,950,000	3.2	0.512

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 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.

On September 28, 2010, the Company issued to officers and employees of the Company 600,000 share options to purchase common shares, exercisable at \$0.205 per option. The options have been issued pursuant to the Company's Plan and vest over 3 months.

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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, 2010, \$825,807 [2009 - \$287,259] 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:

	2010	2009
Weighted average exercise price	\$0.46	\$0.46
Expected dividend yield	0.00%	0.00%
Weighted average risk-free interest rate	2.2%	2.5%
Expected volatility	111%	78%
Weighted average expected life	5.0 years	5.0 years

Warrants

At October 31, 2010, the Company had 4,436,103 (2009 - 5,806,439) common share purchase warrants outstanding, as follows:

Exercise price	Expiry date	Number outstanding and exercisable
\$		\$
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, 2010	555,556
		4,436,103

On December 31, 2009 98,500 warrants expired.

On October 7, 2010 1,827,392 warrants expired, resulting in a reclassification of \$275,949 from warrants issued on units to contributed surplus.

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Warrants on issue of units

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

	2010	2009
	\$	\$
Balance, beginning of year	1,346,044	528,743
Warrants issued on private placement units, net of issuance costs of \$4,632	83,186	—
Expiry of warrants issued on 2008 private placement units	(275,949)	—
Warrants issued on private placement units, net of issuance costs of \$130,905	—	1,070,095
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	1,153,281	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 years ended October 31, 2010 and 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:

	2010	2009
	\$	\$
Balance, beginning of year	39,998	—
Warrants issued on note payable, net of issuance costs of \$660	—	39,998
Balance, end of year	39,998	39,998

Contributed surplus

The following table sets out the change in contributed surplus:

	2010	2009
	\$	\$
Balance, beginning of year	1,173,714	633,661
Stock-based compensation	825,807	287,259
Expiry of warrants issued on 2008 private placement units	275,949	—
Exercise of Options	(18,201)	—
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	2,257,269	1,173,714

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9. INCOME TAXES

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

	2010	2009
	\$	\$
Combined statutory federal and provincial tax rate at 28.2% [2009 – 29.1%]	(700,200)	(291,800)
Adjusted for		
Stock-based compensation	231,100	83,600
Unrecognized losses	465,700	200,200
Other	3,400	8,000
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:

	2010	2009
	\$	\$
Non-capital loss carryforwards	2,024,900	1,600,000
SR&ED expense carryforwards	233,800	233,800
Equipment – differences in net book value and undepreciated capital costs	12,750	10,400
Cumulative eligible capital	13,000	13,000
Share issue costs	65,100	104,300
Deposits on distribution rights	9,600	10,300
	2,359,150	1,971,800
Less valuation allowance	(2,359,150)	(1,971,800)
	—	—

At October 31, 2010, the Company has approximately \$8,000,000 of non-capital losses available to reduce future years' taxable income, expiring between 2011 and 2029. The Company also has investment tax credits of approximately \$153,750 available to reduce income taxes payable expiring between 2013 and 2028.

At October 31, 2010, 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.

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10. 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 \$39,083 for the year ended October 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. During the year ended October 31, 2010, the Company recorded \$31,755 as a reduction of research and development costs related to SDTC assistance earned during the year (2009 - \$204,302). The \$31,755 represents the excess received over the \$102,504 holdback previously included in accounts receivable due to the final reconciliation of project based expenditures.

At October 31, 2010, accounts receivable related to all SDTC contracts signed was \$nil (2009 - \$102,504).

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, 2010, the Company has received \$180,000 (2009 - \$964,000) under this program which appears as a reduction to research and development expenses and paid \$447 in royalties (2009 - \$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, 2010, the project has been completed and all monies owing have been received by the Company, totalling

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\$586,437. During the year ended October 31, 2010, nil [2009 - nil] 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. For the year ended October 31, 2010, the Company paid \$894 in royalties [2009 - nil].

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.

11. RESEARCH AND DEVELOPMENT

Since inception the Company has incurred \$6,954,875 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:

	2010	2009
	\$	\$
Research and development expenses	913,106	1,042,993
Less government assistance		
SDTC	(31,755)	(204,302)
IERD	—	—
Alberta Ingenuity	(39,083)	—
AVAC	(180,000)	(924,417)
	662,268	(85,726)

12. 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 2010 were \$nil [2009 - \$1,500].
- (b) The Company incurred interest on promissory notes in the amount of \$888 [2009 - \$198] to directors of the Company in fiscal 2010.

13. NON-CASH TRANSACTIONS

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

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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.

14. 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 major pipeline companies that have issued purchase orders. 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 \$6,506.

15. 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 accounts payable 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.

16. RECLASSIFICATION OF COMPARATIVE FIGURES

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

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17. SUBSEQUENT EVENTS

On November 1, 2010, the Company issued 200,000 options to an investor relations firm. The options are exercisable at \$0.31 for a period of five years and vest in four equal tranches over a period of 12 months (50,000 options every three months).

On November 10, 2010, the Company announced that it has closed its brokered private placement for gross proceeds of \$2,000,000. The closing was comprised of 9,523,810 "Units" at \$0.21 per Unit. The Units are comprised of one Class A common share (a "Share") and one-half of one Share purchase warrant. Each whole warrant (a "Warrant") entitles the holder to purchase one Share of the Corporation at an exercise price of \$0.30 per Share until November 9, 2012.

The Warrants are subject to an accelerated exercise provision pursuant to which, in the event that the volume weighted average closing price of the Class A common shares, as traded on the TSX Venture Exchange, equals or exceeds \$0.50 per Share for a period of 20 consecutive trading days, then the Warrants must be exercised or will expire 30 calendar days after the notice of such event is mailed to the warrant holders.

The Shares and Warrants comprising the Units are subject to a four month statutory hold period which expires on March 10, 2011.

Synodon issued 625,000 broker warrants (the "Broker Warrants") and paid cash commissions totalling \$135,188 in connection with the sale of the Units. Each such broker warrant entitles Jacob Securities to subscribe for one Share and one-half of one Warrant of the Corporation at a price of \$0.21 for a period of two years from the date of issue. Each whole Warrant will entitle the holder to purchase one Share at a price of \$0.30 per Share until November 9, 2012. The Warrants underlying the broker warrants are not subject to an acceleration provision.

The proceeds will be used by Synodon for general working capital.

On January 4, 2011, 100,000 share options were exercised at \$0.30 per option.

Terms of an extension to the distribution rights option that expired on December 31, 2010 [note 6] are currently being negotiated.

In January 2011, 300,000 options expired.