

TSXV: CST

CONDENSED INTERIM CONSOLIDATED  
FINANCIAL STATEMENTS,  
AS AT DECEMBER 31, 2011

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# ENZYMATIC POWER FOR CARBON CAPTURE































## INTERNAL CONTROL OVER FINANCIAL REPORTING

Internal control over financial reporting (“ICFR”) is designed to provide reasonable assurance regarding the reliability of the Company’s financial reporting and its compliance with IFRS in its financial statements. The Company’s Chief Executive Officer and Chief Financial Officer are responsible for establishing and maintaining disclosure controls over financial reporting to the issuers. They established the internal control over financial reporting or had it established under their supervision in order to obtain reasonable assurance about the reliability of the financial reporting and to make sure that the financial statements were being prepared accordingly with IFRS.

The Chief Executive Officer and the Chief Financial Officer have evaluated whether there were changes to its ICFR during the quarter ended December 31, 2011 that have materially affected, or that are reasonably likely to materially affect its ICFR. No such changes were identified through their evaluation.

## AUDITORS

This Management’s Discussion and Analysis and the condensed interim consolidated financial statements for the three and six month periods ended December 31, 2011 and 2010 have not been audited nor reviewed by the external auditors.

## ADDITIONAL AND CONTINUOUS DISCLOSURE

This analysis was prepared on February 8, 2012. Additional disclosure is provided on the SEDAR Web site at: [www.sedar.com](http://www.sedar.com).

On behalf of management,



Thom Skinner, CA  
Senior Vice President, Finance  
and Chief Financial Officer



Glenn R. Kelly  
President and Chief Executive Officer

February 8, 2012

**CO<sub>2</sub> Solutions Inc.**  
**Condensed Interim Consolidated**  
**Financial Statements**  
**(Unaudited)**  
**December 31, 2011 and 2010**  
**(expressed in Canadian dollars)**

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**CO<sub>2</sub> Solutions Inc.**  
**Condensed Interim Consolidated Statement of Financial Position**  
**(Unaudited)**

	As at <u>December 31, 2011</u> \$	As at <u>June 30, 2011</u> \$	As at <u>July 1, 2010</u> \$
<b>ASSETS</b>			
<b>Current assets</b>			
Cash	4,009,666	133,113	372,180
Term deposits (note 6)	-	187,628	2,010,025
Accounts receivable (note 7)	208,196	665,515	86,333
Tax credits receivable	1,398,854	1,220,797	709,866
Prepaid expenses	12,867	52,685	22,354
	<u>5,629,583</u>	<u>2,259,738</u>	<u>3,200,758</u>
<b>Non-current assets</b>			
Property, plant and equipment (note 8)	216,245	234,289	247,113
Patents (note 9)	515,598	418,410	317,942
	<u>6,361,426</u>	<u>2,912,437</u>	<u>3,765,813</u>
<b>LIABILITIES</b>			
<b>Current liabilities</b>			
Accounts payable and accrued liabilities	529,830	459,573	343,700
Advance from a shareholder with significant influence (note 13)	-	-	475,000
	<u>529,830</u>	<u>459,573</u>	<u>818,700</u>
<b>Non-current liabilities</b>			
Refundable contribution (note 11)	101,526	99,055	-
Advance from a shareholder with significant influence (note 13)	475,000	475,000	-
Deferred credits (note 12)	34,533	35,367	37,973
	<u>1,140,889</u>	<u>1,068,995</u>	<u>856,673</u>
<b>SHAREHOLDERS' EQUITY</b>			
Capital Stock (Note 14)	18,771,401	15,684,667	15,675,834
Stock options (Note 15)	633,314	608,713	460,844
Warrants (Note 14)	868,547	79,028	37,796
Contributed surplus	2,776,992	2,718,295	2,714,374
Deficit	(17,829,717)	(17,247,261)	(15,979,708)
	<u>5,220,537</u>	<u>1,843,442</u>	<u>2,909,140</u>
	<u>6,361,426</u>	<u>2,912,437</u>	<u>3,765,813</u>

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

Approved by the Board of Directors



Evan Price  
Director



Glenn Kelly  
Director

**CO<sub>2</sub> Solutions Inc.**  
**Condensed Interim Consolidated Statement of Changes in Equity**  
**For the six-month periods ended December 31, 2011 and 2010**  
**(Unaudited)**

	Capital Stock	Stock options	Warrants	Contributed surplus	Deficit	Total
	\$	\$	\$	\$	\$	\$
<b>Balance at June 30, 2011</b>	15,684,667	608,713	79,028	2,718,295	(17,247,261)	1,843,442
Stock based compensation	-	83,298	-	-	-	83,298
Stock options forfeited	-	(58,697)	-	58,697	-	-
Consultant fees in consideration for warrants	-	-	20,616	-	-	20,616
Share capital issuance (Private Placement)	4,347,391	-	-	-	-	4,347,391
Brokers fees in consideration for warrants (Private Placement)	(120,007)	-	120,007	-	-	-
Share issue expenses	(491,754)	-	-	-	-	(491,754)
Warrants attached to new shares (Private Placement)	(648,896)	-	648,896	-	-	-
Loss for the period	-	-	-	-	(582,456)	(582,456)
<b>Balance at December 31, 2011</b>	<b><u>18,771,401</u></b>	<b><u>633,314</u></b>	<b><u>868,547</u></b>	<b><u>2,776,992</u></b>	<b><u>(17,829,717)</u></b>	<b><u>5,220,537</u></b>

**CO<sub>2</sub> Solutions Inc.**  
**Condensed Interim Consolidated Statement of Changes in Equity (continued)**  
**For the six-month periods ended December 31, 2011 and 2010**  
**(Unaudited)**

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	<b>Capital Stock</b>	<b>Stock options</b>	<b>Warrants</b>	<b>Contributed surplus</b>	<b>Deficit</b>	<b>Total</b>
	\$	\$	\$	\$	\$	\$
<b>Balance at July 1, 2010</b>	15,675,834	460,844	37,796	2,714,374	(15,979,708)	2,909,140
Stock based compensation	-	52,086	-	-	-	52,086
Consultant fees in consideration for warrants	-	-	20,616	-	-	20,616
Loss for the period	-	-	-	-	(957,230)	(957,230)
<b>Balance at December 31, 2010</b>	<u>15,675,834</u>	<u>512,930</u>	<u>58,412</u>	<u>2,714,374</u>	<u>(16,936,938)</u>	<u>2,024,612</u>

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The accompanying notes are an integral part of these condensed interim consolidated financial statements.

**CO<sub>2</sub> Solutions Inc.**  
**Condensed Interim Consolidated Statement of Loss and**  
**Comprehensive Loss**  
**For the three and six-month periods ended December 31, 2011 and 2010**  
**(Unaudited)**

	Three-month periods ended December 31		Six-month periods ended December 31	
	2011 \$	2010 \$	2011 \$	2010 \$
<b>Revenues</b>	<b>148,576</b>	243,075	<b>1,010,860</b>	334,287
Cost of revenues	-	-	-	28,701
<b>Gross profit</b>	<b>148,576</b>	243,075	<b>1,010,860</b>	305,586
<b>Costs and operating expenses:</b>				
Research and development expenses, net	156,346	123,938	650,012	202,109
Business development expenses	126,726	236,137	265,394	396,821
General and administrative expenses	421,807	350,104	716,811	664,493
Financial expenses and interest income	(4,440)	362	(38,901)	(607)
	<b>700,439</b>	710,541	<b>1,593,316</b>	1,262,816
<b>Net loss and comprehensive loss for the period</b>	<b>551,863</b>	467,466	<b>582,456</b>	957,230
<b>Basic and diluted net loss per share (note 16)</b>	<b>0.01</b>	0.01	<b>0.01</b>	0.02

The accompanying notes are an integral part of these condensed interim consolidated financial statements and Note 19 provides other information on net loss.

**CO<sub>2</sub> Solutions Inc.****Condensed Interim Consolidated Statement of Cash Flows****For the three and six-month periods ended December 31, 2011 and 2010****(Unaudited)**

	Three-month periods ended		Six-month periods ended	
	2011	December 31 2010	2011	December 31 2010
	\$	\$	\$	\$
<b>OPERATING ACTIVITIES</b>				
Loss for the period	(551,863)	(467,466)	(582,456)	(957,230)
Adjustments				
Amortization	20,092	25,083	38,443	41,651
Consultant fees in consideration for warrants	10,308	10,308	20,616	20,616
Stock-based compensation cost	52,323	26,043	83,298	52,086
	<u>(469,140)</u>	<u>(406,032)</u>	<u>(440,099)</u>	<u>(842,877)</u>
Change in non-cash working capital items				
Accounts receivable	248,749	96,449	457,319	(8,376)
Tax credits receivable	(195,370)	(84,502)	(178,057)	(154,934)
Prepaid expenses	13,628	(24,721)	39,818	(20,849)
Accounts payable and accrued liabilities	(145,008)	88,362	70,257	27,835
Deferred revenue from collaborative research and development	-	484,992	-	484,992
	<u>(78,001)</u>	<u>560,580</u>	<u>389,337</u>	<u>328,668</u>
Cash flows from operating activities	<u>(547,141)</u>	<u>154,548</u>	<u>(50,762)</u>	<u>(514,209)</u>
<b>INVESTING ACTIVITIES</b>				
Term deposits	-	798,583	187,628	1,096,233
Amounts capitalized to patents	(71,675)	(38,213)	(113,592)	(83,521)
Additions to property, plant and equipment	(3,301)	(5,047)	(8,073)	(7,175)
Cash flows from investing activities	<u>(74,976)</u>	<u>755,323</u>	<u>65,963</u>	<u>1,005,537</u>
<b>FINANCING ACTIVITIES</b>				
Deferred credits	905	2,883	3,244	2,883
Deferred financing - refundable contribution	1,235	-	2,471	-
Shares issued	-	-	4,347,391	-
Insurance fee - Shares	(1,661)	-	(491,754)	-
Cash flows from financing activities	<u>479</u>	<u>2,883</u>	<u>3,861,352</u>	<u>2,883</u>
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>(621,638)</b>	<b>912,754</b>	<b>3,876,553</b>	<b>494,211</b>
Cash and cash equivalents -Beginning of period	<u>4,631,304</u>	<u>(46,363)</u>	<u>133,113</u>	<u>372,180</u>
Cash and cash equivalents -End of period	<u>4,009,666</u>	<u>866,391</u>	<u>4,009,666</u>	<u>866,391</u>
<b>Interest income received</b>	<b>9,363</b>	<b>1,418</b>	<b>14,408</b>	<b>3,778</b>
<b>Income taxes paid</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

**CO<sub>2</sub> Solutions Inc.**  
**Notes to Condensed Interim Consolidated Financial Statements**  
**(Unaudited)**  
**For the three and six-month periods ended December 31, 2011**

**1- GOVERNING STATUTE AND NATURE OF OPERATIONS**

CO<sub>2</sub> Solutions Inc. (The "Company"), incorporated under Part 1A of the Companies Act (Quebec) and now governed by the Business Corporation Act (Quebec), is a high technology enterprise involved in the capture and management of carbon dioxide (CO<sub>2</sub>). More specifically, the Company is currently focused on commercializing an enzyme based enabling technology for efficient CO<sub>2</sub> capture from fossil fuel power plants and other large emitters of CO<sub>2</sub>. The Company intends to continue its research and development and commercialization efforts. The Company's operations are subject to all the inherent risks related to running an emerging high technology company, such as successfully completing its research and development activities, negotiating collaborative working agreements and commercialization of its enzyme technology and obtaining the required financing.

The Company is listed on the TSX Venture Exchange (TSXV:CST) and is incorporated and domiciled in Canada.

The Company's registered head office is located at 2300 Rue Jean-Perrin, Québec, Quebec, Canada, G2C 1T9.

**2- BASIS OF PREPARATION AND ADOPTION OF IFRS**

The condensed interim consolidated financial statements of CO<sub>2</sub> Solutions Inc. for the second quarter ended December 31, 2011 as well as the corresponding comparative data have not been subject to review by the Company's independent auditors.

The Company prepares its financial statements in accordance with Canadian generally accepted accounting principles as set out in the Handbook of the Canadian Institute of Chartered Accountants ("CICA Handbook"). In 2010, the CICA Handbook was revised to incorporate International Financial Reporting Standards ("IFRS"), and require publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, the Company is reporting on this basis in these condensed interim consolidated financial statements. In the financial statements, the term "Canadian GAAP" refers to Canadian GAAP before the adoption of IFRS.

These condensed interim consolidated financial statements have been prepared in accordance with IFRS applicable to the preparation of interim financial statements, including IAS 34 "Interim Financial Reporting" and IFRS 1 "First-time Adoption of International Financial Reporting Standards". Subject to certain transition elections disclosed in Note 18, the Company has consistently applied the same accounting policies in its opening IFRS statement of financial position at July 1, 2010 and throughout all periods presented, as if these policies had always been in effect. As disclosed in Note 18, there is no impact of transition to IFRS on the Company's reported financial position, financial performance and cash flows, including the nature and effect of significant changes in accounting policies from those used in the company's consolidated financial statements for the year ended June 30, 2011.

The policies applied in these condensed interim consolidated financial statements are based on IFRS effective for the year ending June 30, 2012 as issued and outstanding as of February 8, 2012, which is the date of approval of the condensed interim consolidated financial statements by the Company Board of Directors. Any subsequent changes to IFRS that are given effect in the Company's annual consolidated financial statements for the year ending June 30, 2012 could result in restatement of these condensed interim consolidated financial statements, including transition adjustments recognized on change-over to IFRS.

These condensed interim consolidated financial statements should be read in conjunction with the Company's Canadian GAAP annual statements for the year ended June 30, 2011.

### **3- SIGNIFICANT ACCOUNTING POLICIES**

#### **Basis of presentation**

These condensed interim consolidated financial statements have been prepared under the historical cost convention, except for certain financial instruments that are recognized at fair value.

#### **Basis of consolidation**

The condensed interim consolidated financial statements include the accounts of CO<sub>2</sub> Solutions Inc. and those of CO<sub>2</sub> Solution Technologies Inc., 9157-4400 Québec Inc., 9157-4426 Québec Inc., 9157-4475 Québec Inc., and Fiducie Financière CO<sub>2</sub> Solution. All intercompany accounts and transactions have been eliminated.

#### **Segment reporting**

The Company manages its business on the basis of one reportable segment. This single reportable segment derives its income from the sale of procedures and services relating to the management and elimination of CO<sub>2</sub> using an enzyme conversion-based technology.

The Company earns its income essentially from clients based in the United States and uses its assets in Canada.

#### **Financial assets**

##### *Classification under IAS 39*

Financial assets and financial liabilities are recognized when the Company becomes a party to the contractual provision of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership.

The Company classifies its financial assets in the following categories: financial assets at fair value through profit or loss (fair value option), loans and receivables and available-for-sale. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition:

##### a) Loans and receivables

Loans and receivables would include any non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and for which there is no intention of trading. They are included in current assets, except for maturities greater than 12 months after

the balance sheet date which would be classified as non-current assets. Loans and receivables comprise cash, term deposits, accounts receivable and tax credits receivable.

b) Available-for-sale

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless the investment matures or management intends to dispose of it within 12 months of the end of the reporting period. Available-for-sale financial assets are comprised of cash equivalents and short-term investments in the form of actively traded securities.

*Recognition and measurement under IAS 39*

Loans and receivables are initially recognized at fair value plus transaction costs and subsequently carried at amortized cost using the effective interest method.

Available-for-sale investments are recognized initially at fair value plus transaction costs and are subsequently carried at fair value. Gains or losses arising from changes in fair value are recognized in other comprehensive income.

Regular purchases and sales of financial assets are recognized on the trade date – the date on which the Company commits to purchase or sell the asset.

Interest on available-for-sale investments, calculated using the effective interest method, is recognized in the statement of loss as part of interest income. When an available-for-sale investment is sold or impaired, the accumulated gains or losses are moved from accumulated other comprehensive income to the statement of loss and included in other gains and losses.

**Financial liabilities**

Financial liabilities at amortized cost include an advance from a shareholder with significant influence which is initially recognized at fair value, net of transaction costs incurred, and is subsequently carried at amortized cost. Any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the statement of earnings over the period of the debt using the effective interest method.

Financial liabilities are classified as current liabilities unless the Company has an unconditional right to defer settlement of the liabilities for at least 12 months after the balance sheet date.

**Impairment of financial assets**

At each reporting date, the Company assesses whether there is objective evidence that a financial asset is impaired. If such evidence exists, the Company recognizes an impairment loss, as follows:

- a) Financial assets carried at amortized cost: The loss is the difference between the amortized cost of the loan or receivable and the present value of the estimated future cash flows, discounted using the instrument's original effective interest rate. The carrying amount of the asset is reduced by this amount either directly or indirectly through the use of an allowance account.
- b) Available-for-sale financial assets: The impairment loss is the difference between the original cost of the asset and its fair value at the measurement date, less any impairment losses previously recognized in the statement of loss. This amount represents the cumulative loss in accumulated other comprehensive income that is reclassified to net loss.



Impairment losses on financial assets carried at amortized cost are reversed in subsequent periods if the amount of the loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized. Impairment losses on available-for-sale equity instruments are not reversed. As at December 31, 2011, there were no assets that were deemed to be impaired.

### **Cash and cash equivalents**

Cash and cash equivalents consist of cash on hand and balances with banks and any highly liquid short-term investments having a term of less than three months at the acquisition date.

### **Property, plant and equipment**

Property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost can be measured reliably. The carrying amount of a replaced asset is derecognized when replaced. Repairs and maintenance costs are charged to the statement of earnings during the period in which they are incurred.

The major categories of property, plant and equipment are depreciated over their estimated useful lives as follows:

	<u>Methods</u>	<u>Rates and period</u>
Laboratory equipment and layout and office equipment	Diminishing balance	20%
Computer equipment	Diminishing balance	30%
Leasehold improvements	Straight-line	10 years

### **Patents**

Patents, obtained or pending, are recorded at cost and amortized on a straight-line basis over 20 years.

### **Impairment of non-financial assets**

Property, plant and equipment and intangible assets are tested for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units – "CGUs"). The recoverable amount is the higher of an asset's fair value less costs to sell and values in use (being the present value of the expected future cash flows of the relevant assets of the CGU). An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount.

The Company evaluates impairment losses for potential reversals when events or circumstances require such consideration.

### **Research and development expenses**

Expenses related to research and development are expensed as incurred, except for development expenses which meet generally accepted capitalization criteria are deferred and amortized. As at December 31, 2011, June 30, 2011 and July 1, 2010, no development costs have been deferred.

## **Share issue expenses**

Share issue expenses are applied against share capital.

## **Research and development tax credits and receivables**

The Company is entitled to scientific research and experimental development ("SR&ED") tax credits granted by the Canadian federal government and the government of the Province of Quebec.

SR&ED tax credits and grants are accounted for using the cost reduction method. Accordingly, tax credits and grants are recorded as a reduction of the related expenses or capital expenditures in the year in which those expenses are incurred, provided there is reasonable assurance that the credits and grants will be realized. The tax credits must be reviewed and approved by the tax authorities, accordingly, the amounts granted may differ from the amounts recorded.

## **Foreign currency translation**

### *Functional and presentation currency*

Items included in the financial statements of each of the Company's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The condensed interim consolidated financial statements are presented in Canadian dollars, which is also the Company's functional currency.

The financial statements of entities that would have a functional currency different from that of the Company ("foreign operations") are translated into Canadian dollars as follows: assets and liabilities – at the closing rate at the date of the statement of financial position, and income and expenses – at the average rate of the period (as this is considered a reasonable approximation to actual rates). All resulting changes are recognized in other comprehensive income as cumulative translation adjustments.

### *Transactions and balances*

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Generally, foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at the period-end exchange rates of monetary assets and liabilities denominated in currencies other than an operation's functional currency are recognized in the statement of income.

## **Employee future benefits**

The Company has set up a simplified defined contribution pension plan. The Company's contribution is limited to the amount provided under the plan, which is equal to the employee's contribution up to 2% of gross earnings. Pension expense is recognized in earnings for the year during which the amounts are due.

## **Revenue recognition**

The Company's revenue is derived from research contracts, design, development and marketing of goods and services related to the management and elimination of CO<sub>2</sub>.

The Company recognizes revenue from research contracts when the research activities under the contract are carried out, the contract amount is fixed and collection is reasonably assured.

These contracts usually provide for one-time payments (upfront payments) and payments for research services in the form of cost reimbursements and milestone payments.

The Company entered into certain research and development agreements comprising several components. Such arrangements are divided into separate units of accounting provided that the delivered item has stand-alone value and there is objective and reliable evidence of the fair value of the undelivered items. When the arrangements cannot be divided into separate units of accounting, the arrangements are considered arrangements with a single deliverable.

If reliable and objective evidence of fair value for each deliverable is available, the total arrangement consideration is allocated to the units of accounting based on their relative fair value. However, if evidence of fair value is only available for undelivered items, the arrangement consideration is allocated first to the undelivered items based on their fair value, with the remainder being allocated to the delivered items, using the residual method.

Revenue for each unit of accounting or arrangement with a single deliverable is recognized according to the Company's revenue recognition policies as previously disclosed. When recognition criteria are not respected, deferred revenue is recognized for the amounts received.

Investment income is recognized using the accrual method. Interest income is recognized according to the number of days the investment is held during the year.

### **Earnings per share**

Basic earnings per common share are calculated by dividing net earnings available for common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share are calculated taking into account the potential dilution that would result if the common share stock options and warrants were exercised or converted into common shares at the later of the beginning of the period or their issue date. The dilution effect is determined using the treasury stock method for the stock options and the warrants.

### **Share-based payments**

The Company grants stock options to certain employees. Stock options vest over a maximum of three years and expire after a maximum of five years. Each award is considered as separate with its own vesting period and grant date fair value. Fair value of each award is measured at the date of grant using the Black-Scholes option pricing model. Compensation expense is recognized over the award's vesting period based on the number of options expected to vest, by increasing stock options within shareholders' equity. The number of awards expected to vest is reviewed at least annually, with any impact being recognized immediately.

The impact of any service condition is excluded from the fair value calculation. The total expense is recognized over the vesting period, which is the period over which all of the specified vesting conditions are to be satisfied. At the end of each reporting period, the entity revises its estimates of the number of options that are expected to vest. It recognizes the impact of the revision to original estimates, if any, in the statement of income, with a corresponding adjustment to equity.

The cash subscribed for the shares issued when the options are exercised is credited, together with the related compensation costs, to share capital (nominal value), net of any directly attributable transaction costs.

#### **4- ACCOUNTING STANDARDS ISSUED BUT NOT YET APPLIED**

The IASB issued the following standards which are relevant but have not yet been adopted by the Company: IFRS 9, Financial instruments, IFRS 10, Consolidated Financial Statement, IFRS 13, Fair Value Measurement and amended IAS 1 Presentation of Financial Statements. Each of the new standards is effective for annual periods beginning on or after January 1, 2013 with early adoption permitted except for the amendment to IAS 1 which is effective for annual periods beginning on or after July 1, 2012. The Company has not yet begun the process of assessing the impact that the new and amended standards will have on its financial statements or whether to early adopt any of the new requirements.

The following is a brief summary of the new standards and amendment:

##### **IFRS 9 – Financial instruments**

IFRS 9 was issued in November 2009. It addresses classification and measurement of financial assets and replaces the multiple category and measurement models in IAS 39, Financial Instruments – Recognition and Measurement, for debt instruments with a new mixed measurement model with only two categories: amortized cost and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments and such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where such equity instruments are measured at fair value through other comprehensive income, dividends, to the extent not clearly representing a return of investment, are recognized in profit or loss; however, other gains and losses (including impairments) associated with such instruments remain in accumulated comprehensive income indefinitely.

Requirements for financial liabilities were added in October 2010 and they largely carried forward existing requirements in IAS 39, except that fair value changes due to credit risk for liabilities designated at fair value through profit and loss would generally be recorded in other comprehensive income.

##### **IFRS 10 – Consolidation**

IFRS 10 was issued in May 2011. It requires an entity to consolidate an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12 Consolidation—Special Purpose Entities and parts of IAS 27 Consolidated and Separate Financial Statements.

##### **IFRS 13 – Fair Value Measurement**

IFRS 13 was issued in May 2011. It is a comprehensive standard for fair value measurement and disclosure requirements for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. It also establishes disclosures about fair value measurement. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and in many cases does not reflect a clear measurement basis or consistent disclosures.

##### **IAS 1 – Presentation of Financial Statements**

Amendment to IAS 1 – Presentation of Items of other comprehensive Income: IAS 1 has been amended to change the disclosure of items presented in Other Comprehensive Income ("OCI"),

including a requirement to separate items presented in OCI into two groups based on whether or not they may be recycled to profit or loss in the future.

## **5- SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATES**

The estimates and assumptions that have a significant risk of causing material adjustments to the company's financial statements are listed below.

Significant estimates are generally made in connection with the calculation of revenues, research and development expenses, stock-based compensation expense, as well as in determining future income tax assets and liabilities, impairment of property, plant and equipment and intangible assets. Estimates are based on historical experience, where relevant, and on various other assumptions that we believe to be reasonable under the circumstances. Actual results could differ from those estimates.

### **Revenue recognition**

The nature of the Company's business is such that many revenue transactions do not have a simple structure. Revenue agreements may consist of multiple components occurring at different times. The Company is also party to agreements which can involve upfront and milestone payments that may occur over several periods. These agreements may also involve certain future obligations. Revenue is only recognized when, in management's judgment, the significant risks and rewards of ownership have been transferred or when the obligation has been fulfilled. For some transactions this can result in cash receipts being initially recognized as deferred income and then released to income over subsequent periods on the basis of the performance of the conditions specified in the agreement.

### **Research and development expenses**

Research and development expenditures consist of direct and indirect expenses. All expenses related to development activities which do not meet generally accepted criteria for deferral, and research activities are expensed as incurred. Development expenses which meet generally accepted criteria for deferral are capitalized and amortized against earnings over the estimated period of benefit. As at December 31, 2011, June 30, 2011 and July 1, 2010, no development costs have been deferred.

### **Stock-based compensation and other stock-based payments**

The Company has a stock option plan which is described in note 15 of the condensed interim consolidated financial statements. As regards stock options granted, the Company uses the fair value based method of accounting. The fair value of stock options is determined using the Black-Scholes option pricing model, which requires the use of certain assumptions, including future stock price volatility and expected life of the instruments.

The expected life is estimated using the contractual life of the instrument. The expected volatility is estimated using the historical volatility of the Company's stock over the same period as the contractual life.

### **Income taxes, government assistance and tax credits**

Income taxes are accounted for using the asset and liability method. Future income tax assets and liabilities are recognized in the balance sheet to account for the future tax consequences attributable to temporary differences between the respective accounting and taxable value of balance sheet assets and liabilities. Future income tax assets and income tax liabilities are measured using the income tax rates that are most likely to apply when the asset is realized or the liability is settled. The

effect of changes in income tax rates is recognized in the year during which these rates change. As appropriate, a valuation allowance is recognized to decrease the value of tax assets to an amount that is more likely than not to be realized. In estimating the realization of future income tax assets, management considers whether a portion or all future tax assets are more likely than not to be realized. Realization is subject to future taxable income.

In the event the Company determines that it can realize its tax assets, it will readjust them for the amount and adjust the income in the period for which such determination is made.

Moreover, the Company is entitled to government assistance in the form of research tax credits and grants. These are applied against related expenses and the cost of the asset acquired. Tax credits are available based on eligible research and development expenses consisting of direct and indirect expenditures and including a reasonable allocation of overhead expenses. Grants are subject to compliance with terms and conditions of the related agreements. Government assistance is recognized when there is reasonable assurance that the Company has met the requirements of the approved grant program or, with regard to tax credits, when there is reasonable assurance that they will be realized.

### **Impairment of assets with definite useful lives**

Assets are reviewed for an indication of impairment at each statement of financial position date. If indication of impairment exists, the asset's recoverable amount is estimated. Factors such as changes in the planned use of production unit, laboratory equipment, or the presence or absence of technical obsolescence could result in shortened useful lives or impairment. An impairment loss is recognized, if any, for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less cost to sell and value in use.

As of July 1, 2010, June 30, 2011, and December 31, 2011, management determined that there was no need for impairment.

### **Government grants**

Grants are accounted for using the cost reduction method. Accordingly, grants are recorded as a reduction of the related expenses or capital expenditures in the period in which those expenses are incurred, provided there is reasonable assurance that the grants will be realized.

If a grant is received and expenses related to this grant are not yet incurred, the grant is recorded as a deferred grant until expenses are incurred

The cash flows related to grants received are classified as operating activities unless they are related to capital expenditures in which case they are classified as investing activities.

**6- TERM DEPOSITS**

	<b>December 31 2011</b>	June 30 2011	July 01 2010
	\$	\$	\$
Term deposits, 0,50% maturing August 28th 2011 for 61 282\$ and 0.12% maturing June 1st 2012 for 126 346\$	-	187,628	2,010,025
	<u>-</u>	<u>187,628</u>	<u>2,010,025</u>

**7- ACCOUNTS RECEIVABLE**

	<b>December 31 2011</b>	June 30 2011	July 01 2010
	\$	\$	\$
Trade accounts	<b>159,225</b>	619,716	54,513
Commodity taxes	<b>48,971</b>	45,799	31,820
	<u><b>208,196</b></u>	<u>665,515</u>	<u>86,333</u>

**8- PROPERTY PLANT AND EQUIPMENT**

	<b>Laboratory equipment and lay out</b>	<b>Office equipment</b>	<b>Computer equipment</b>	<b>Leasehold Improvements</b>	<b>Total</b>
	\$	\$	\$	\$	\$
<b>Cost</b>					
Balance as at July 1st, 2010	711,016	131,458	49,490	31,674	923,638
Acquisitions	24,963	-	17,180	-	42,143
Disposals	-	-	-	-	-
Balance as at June 30, 2011	<u>735,979</u>	<u>131,458</u>	<u>66,670</u>	<u>31,674</u>	<u>965,781</u>
Acquisitions	4,772	-	3,301	-	8,073
Disposals	-	-	-	-	-
Balance as at December 31, 2011	<u>740,751</u>	<u>131,458</u>	<u>69,971</u>	<u>31,674</u>	<u>973,854</u>
<b>Amortization</b>					
Balance as at July 1st, 2010	(540,864)	(95,274)	(24,891)	(15,496)	(676,525)
Amortization expense	(35,176)	(7,237)	(9,387)	(3,167)	(54,967)
Disposals	-	-	-	-	-
Balance as at June 30, 2011	<u>(576,040)</u>	<u>(102,511)</u>	<u>(34,278)</u>	<u>(18,663)</u>	<u>(731,492)</u>
Amortization expense	(16,455)	(2,895)	(5,183)	(1,584)	(26,117)
Disposals	-	-	-	-	-
Balance as at December 31, 2011	<u>(592,495)</u>	<u>(105,406)</u>	<u>(39,461)</u>	<u>(20,247)</u>	<u>(757,609)</u>
<b>Book value</b>					
July 1st ,2010	170,152	36,184	24,599	16,178	247,113
June 30, 2011	159,939	28,947	32,392	13,011	234,289
December 31, 2011	148,256	26,052	30,510	11,427	216,245



**9- PATENTS**

	<b>Patents</b>	<b>\$</b>
<b>Cost</b>		
Balance as at July 1st,2010	576,588	
Acquisitions	142,080	
Disposals	-	
Balance as at June 30, 2011	<u>718,668</u>	
Acquisitions	113,592	
Disposals	-	
Balance as at December 31, 2011	<u>832,260</u>	
<b>Amortization:</b>		
Balance as at July 1st, 2010	(258,646)	
Amortization expense	(41,612)	
Disposals	-	
Balance as at June 30, 2011	<u>(300,258)</u>	
Amortization expense	(16,404)	
Disposals	-	
Balance as at December 31, 2011	<u>(316,662)</u>	
<b>Book value:</b>		
July 1st, 2010	317,942	
June 30, 2011	418,410	
December 31, 2011	515,598	

**10- BANK LOAN**

As of December 31, 2011, the Company has an available unused authorized line of credit of \$150,000, bearing interest at the prime rate plus 2% and secured by a universal charge on the Company's assets to a maximum of \$225,000. The Company must comply with certain financial ratios and the agreement is renewable annually. The company complies with these ratios as at December 31, 2011.

## 11- REFUNDABLE CONTRIBUTION

The Company obtained from Economic Development of Canada a refundable contribution of up to \$250,000 of which as at December 31, 2011, \$111,820 was received. This contribution is refundable starting January 2014 with annual payments representing 4% of the Company's total income. The loan was accrued to a present value of \$97,820 as at March 31 2011, (\$101,526 as at December 31, 2011), using an estimated capitalization rate of 5%. The difference between the present value and the principal amount of the loan was included with revenues shown in the consolidated statement of loss for fiscal 2011.

## 12- DEFERRED CREDITS

### Government assistance and tax credits on property, plant and equipment

	<b>Government Assistance</b>	<b>Tax Credits</b>	<b>Total</b>
	\$	\$	\$
<b>Cost</b>			
Balance as at July 1st 2010	33,485	164,211	197,696
Acquisitions	-	6,851	6,851
Disposals	-	-	-
Balance as at June 30 2011	<u>33,485</u>	<u>171,062</u>	<u>204,547</u>
Acquisitions	-	3,244	3,244
Disposals	-	-	-
Balance as at December 31 2011	<u>33,485</u>	<u>174,306</u>	<u>207,791</u>
<b>Amortization</b>			
Balance as at July 1st 2010	(27,972)	(131,751)	(159,723)
Amortization expense	(1,103)	(8,354)	(9,457)
Disposals	-	-	-
Balance as at June 30 2011	<u>(29,075)</u>	<u>(140,105)</u>	<u>(169,180)</u>
Amortization expense	(441)	(3,637)	(4,078)
Disposals	-	-	-
Balance as at December 31 2011	<u>(29,516)</u>	<u>(143,742)</u>	<u>(173,258)</u>
<b>Book value</b>			
July 1st 2010	5,513	32,460	37,973
June 30 2011	4,410	30,957	35,367
December 31 2011	3,969	30,564	34,533

### 13- ADVANCE FROM A SHAREHOLDER WITH SIGNIFICANT INFLUENCE

As at December 31, 2011, the Company has recorded a \$475,000 advance from a shareholder with significant influence, bearing no interest and payable under certain conditions (\$475,000 for the same period in 2010). Pursuant to the extension of the agreement with that shareholder in January 2011, repayment of this advance has now effectively been deferred indefinitely or until certain subsequent agreements may be negotiated between the parties. The amount outstanding is classified as a long-term debt.

### 14- CAPITAL STOCK

#### Authorized

Unlimited number of common shares, without par value, voting and participating

#### Issued and fully paid

The following table shows the changes in the Company's capital stock during the six-month period ended December 31, 2011 and the year ended June 30, 2011

	December 31 2011		June 30 2011	
	number	\$	number	\$
Beginning balance	60,286,136	15,684,667	60,261,136	15,675,834
Share issue from				
Private Placement	18,901,700	3,086,734	25,000	8,833
Ending balance	<u>79,187,836</u>	<u>18,771,401</u>	<u>60,286,136</u>	<u>15,684,667</u>

The following table shows the changes in the Company's warrants during the six-month period ended December 31, 2011 and the year ended June 30, 2011.

	December 31 2011		June 30 2011	
	number	Average Strike price	number	Average Strike price
Outstanding at beginning	1,000,000	0.24	1,000,000	0.24
Granted	10,773,968	0.28	-	-
Outstanding at end	<u>11,773,968</u>	<u>0.28</u>	<u>1,000,000</u>	<u>0.24</u>

The outstanding warrants as at June 30, 2011 are those issued in connection with an agreement concluded in December 2009 with a Consultant. They have a fair value of \$123 700, give the right to acquire one common share for \$0.24 and expire in August 2013. Related expense is amortized over 36 months as research and development fees. On August 31, 2011, the Company closed a brokered private placement of 18,901,700 units at a price of \$0.23 per unit. Each unit was comprised of one common share of the Company and one-half share purchase warrant. Each whole warrant entitles the

holder to acquire one additional common share of the Company at a price of \$0.28 per common share until August 31, 2013. Expenses related to the issue of these warrants were accounted for as a reduction to the net proceeds of the private placement.

### **15- STOCK OPTIONS**

The Company has a stock option plan for directors, executives, employees and consultants. All the options granted under the terms of the plan may be exercised within a maximum five year period commencing on the date of grant. The Board of Directors designates the optionees and determines the number of common shares involved in each of these options, the vesting date, the exercise price, the expiry date, the terms of acquisition and any restrictions on the exercise of the options. The share acquisition price must not be less than the closing price on the day prior to the date of grant of these shares.

Under the terms of the plan, the maximum number of common shares available to be issued under the plan cannot exceed 10% of the issued and outstanding shares of capital stock. As at December 31, 2011, this amount is currently established at 7,918,784. The maximum number that may be granted to a director, executive or employee of the Company or to a consultant cannot exceed 5% of all the outstanding common shares.

The following table summarizes information about outstanding and exercisable stock options for the six-month period ended December 31, 2011 and the year ended June 30, 2011:

	<b>For the six-month period December 31 2011</b>		<b>For the year ended June 30 2011</b>	
	<b>number</b>	<b>Weighted average exercise price</b>	<b>number</b>	<b>Weighted average exercise price</b>
		<b>\$</b>		<b>\$</b>
Outstanding, beginning of period	<b>4,830,840</b>	<b>0.22</b>	3,955,440	0.22
Granted	<b>957,890</b>	<b>0.21</b>	920,000	0.19
Expired	-	-	(17,900)	0.35
Exercised	-	-	(25,000)	0.20
Forfeited	<b>(324,200)</b>	<b>0.32</b>	(1,700)	0.20
Outstanding, end of period	<b>5,464,530</b>	<b>0.25</b>	4,830,840	0.22
Exercisable, end of period	<b>3,834,439</b>	<b>0.22</b>	3,879,506	0.23

As at December 31, 2011, the following outstanding stock options had been granted:

Outstanding options			Exercisable options	
number	Weighted average exercise price	Weighted average remaining contractual life (years)	number	Weighted average exercise price
	\$	\$		\$
611,000	0.17	1.33	488,800	0.17
10,000	0.30	1.67	10,000	0.30
1,769,140	0.18	1.67	1,769,140	0.18
10,000	0.19	1.83	10,000	0.19
439,800	0.52	0.42	439,800	0.52
300,900	0.16	2.83	300,900	0.16
450,000	0.17	4.17	225,000	0.17
350,000	0.18	3.17	174,999	0.18
150,000	0.20	3.33	150,000	0.20
25,000	0.31	4.42	25,000	0.31
25,000	0.24	4.58	-	0.24
932,890	0.21	4.92	-	0.21
390,800	0.20	3.92	240,800	0.20
<u>5,464,530</u>	<u>0.22</u>	<u>2.68</u>	<u>3,834,439</u>	<u>0.22</u>

Options issued prior to November 2009 vest as follow: 20% upon signature and the remaining 80% is gradually acquired at the rate of 20% per year, over 4 years, except for the President & CEO whose vesting period was 100% upon the date of the grant, as well as for consultants for which the expenses are recognized when services are rendered.

Options issued after November 2009 vest gradually at the rate of 25,000 options every 6 months, up to a maximum period of 3 years, except for the President & CEO whose vesting period is 58,333 every 6 months for the February 2010 award and 85,498 every six months for the November 2011 award, from the date of the grant up to a maximum period of 3 years, and, for the Senior Vice-President Finance and CFO whose vesting period was 112,500 options vested immediately at the date of the grant and 112,500 every 6 months thereafter up to a maximum period of 3 years in regards to the March 2011 award.

The fair value of the options is determined according to the Black-Scholes option pricing model based on the following weighted average assumptions:

	<b><u>Employees, directors and executives</u></b>	
	<b>For the six-month period ended <u>December 31, 2011</u></b>	<b>For the year ended <u>June 30, 2011</u></b>
Risk-free interest rate	<b>1.78%</b>	2.31%
Expected volatility	<b>99.17%</b>	103.76%
Annual dividend yield	<b>Nil</b>	Nil
Expected life of each option granted	<b>5 years</b>	5 years
Fair value of each option granted	<b>\$0,1675</b>	\$0,1400

The following table presents changes in stock options at the end of the six-month period ended December 31, 2011 and for the twelve-month period ended June 30, 2011.

	<b>For the six-month period ended <u>December 31, 2011</u></b>	<b>For the year ended <u>June 30, 2011</u></b>
	<b>\$</b>	<b>\$</b>
Balance, beginning of period	<b>608,713</b>	460,844
Stock-based compensation	<b>83,298</b>	155,623
Stock options exercised	-	(3,833)
Stock options forfeited	<b>(58,697)</b>	(260)
Stock options expired	-	(3,661)
Balance, end of period	<b><u>633,314</u></b>	<u>608,713</u>

## 16- EARNINGS PER SHARE

The following table summarizes the basic and fully diluted weighted average number of shares outstanding used in the basic and diluted loss per share calculations.

	Three-month periods ended		Six-month periods ended	
	2011	December 31 2010	2011	December 31 2010
Basis and fully diluted weighted average number of shares outstanding	<b>66,655,187</b>	60,261,136	<b>72,921,512</b>	60,261,136

For the periods ended December 31, 2011 and 2010, the basic weighted average number of shares outstanding was the same as the diluted weighted average number of shares since the effect of stock options and warrants described in Notes 15 and 14 would have been anti-dilutive because the Company has incurred a loss. Accordingly, the fully diluted loss per share for these three-month and six-month periods was calculated using the basic weighted average number of shares outstanding.

## 17- TRANSACTIONS WITH DIRECTORS AND EXECUTIVE OFFICERS

The following table sets out the remuneration paid for the period to Directors and Executive Officers of the Company that are considered as key personnel:

	Six-month periods ended December 31	
	2011	2010
Base remuneration	\$ <b>371,434</b>	\$ 306,953
Directors fees and payments for attendance at Board meetings	<b>33,624</b>	33,030
Stock based compensation	<b>71,260</b>	46,719
Pension plan contributions	<b>5,717</b>	4,470
Benefit from use of Company automobile	<b>1,909</b>	2,022
	<b>483,944</b>	393,194

## 18- TRANSITION TO IFRS

The Company's condensed interim consolidated financial statements have been prepared in accordance with IFRS. The consolidated financial statements prepared under IAS 34 and IFRS 1, "First-time Adoption of IFRS", has been applied. The company's transition date is July 1, 2010, ("transition date"). The Company prepared its opening IFRS statement of financial position at that date.

As at July 1, 2010, December 31, 2010 and June 30, 2011 and for the six-month period ended December 31, 2011 and the year ended June 30, 2011, there is no effect on equity or on the statement of loss and comprehensive loss and on cash flows arising from the transition to IFRS.

The company has applied the following transition exceptions and exemptions to full retrospective application:

<b>Topic</b>	<b>International standards</b>	<b>Management's election</b>
Business combinations	IFRS 1 permits entities to elect not to restate business combinations which occurred prior to Transition date.	Management has taken this IFRS election. There is no financial impact at transition date due to this choice
Stock option costs	IFRS 1 provides alternatives that permit an entity to apply IFRS 2 share-based payments in a prospective manner	Management has elected to apply IFRS 2 prospectively on July 1, 2003. There is no financial impact at transition date due to this choice



**19- LOSS**

	Three-month periods ended December 31		Six-month periods ended December 31	
	2011	2010	2011	2010
	\$	\$	\$	\$
<b>Revenues</b>	<b>148,576</b>	243,075	<b>1,010,860</b>	334,287
Cost of revenues	-	-	-	28,701
<b>Gross Profit</b>	<b>148,576</b>	243,075	<b>1,010,860</b>	305,586
<b>Costs and operating expenses</b>				
Research and development expenses, net				
Salaries and employee benefits	<b>317,392</b>	280,884	<b>941,648</b>	491,843
Laboratory and other supplies	<b>33,419</b>	34,775	<b>89,714</b>	62,253
	<b>350,811</b>	315,659	<b>1,031,362</b>	554,096
Tax credit	<b>(194,465)</b>	(81,620)	<b>(381,350)</b>	(152,051)
Government assistance	-	(110,101)	-	(199,936)
	<b>156,346</b>	123,938	<b>650,012</b>	202,109
Business development expenses				
Salaries and employee benefits	<b>99,786</b>	85,727	<b>197,130</b>	180,557
Professional fees	<b>10,509</b>	127,753	<b>25,945</b>	162,546
Travel, entertainment and advertising	<b>15,986</b>	22,657	<b>41,865</b>	52,865
Offices expenses	<b>445</b>	-	<b>454</b>	853
	<b>126,726</b>	236,137	<b>265,394</b>	396,821
General and administrative expenses				
Salaries and employee benefits	<b>196,906</b>	108,740	<b>286,677</b>	178,708
Rent, electricity, taxes and insurance	<b>46,615</b>	45,930	<b>92,360</b>	91,720
Office expenses	<b>19,470</b>	23,300	<b>35,136</b>	38,789
Travel, entertainment and advertising	<b>27,038</b>	19,768	<b>47,986</b>	38,316
Tax on capital	<b>2,125</b>	511	<b>3,254</b>	1,842
Directors' fees	<b>16,151</b>	21,780	<b>33,624</b>	33,030
Professional fees	<b>93,410</b>	104,992	<b>179,331</b>	240,437
Amortization of property, plant and equipment	<b>13,221</b>	13,577	<b>26,117</b>	26,680
Amortization of patents	<b>8,978</b>	13,876	<b>16,404</b>	19,279
Amortization of deferred credits	<b>(2,107)</b>	(2,370)	<b>(4,078)</b>	(4,308)
	<b>421,807</b>	350,104	<b>716,811</b>	664,493
Financial expenses and interest income				
Other financial expenses	<b>2,597</b>	1,780	<b>5,508</b>	3,171
Interest and other income	<b>(7,037)</b>	(1,418)	<b>(44,409)</b>	(3,778)
	<b>(4,440)</b>	362	<b>(38,901)</b>	(607)
	<b>700,439</b>	710,541	<b>1,593,316</b>	1,262,816
<b>Net loss and comprehensive loss for the period</b>	<b>551,863</b>	467,466	<b>582,456</b>	957,230