

**Semcan Inc.
Consolidated Financial Statements
For the year ended December 31, 2008**

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Semcan Inc.
Consolidated Balance Sheets

As at December 31	2008	2007
Assets		
Current		
Cash and cash equivalents	\$ 425,410	\$ 3,619,119
Accounts receivable	6,463,659	3,727,370
Deferred contract costs and unbilled revenue (Note 5)	2,443,566	1,690,497
Inventory (Note 6)	806,463	432,912
Prepaid expenses and other assets	264,954	306,826
Current portion of intangible assets (Note 7)	44,251	-
Currents assets of discontinued operations (Note 17)	19,784,940	10,332,446
Total current assets	30,233,243	20,109,170
Goodwill and other intangible assets (Note 7)	8,098,090	8,268,074
Property and equipment (Note 8)	1,097,561	455,003
Long-lived assets of discontinued operations (Note 17)	12,854,836	-
	\$ 52,283,730	\$ 28,832,247
Liabilities and Shareholders' Equity		
Current		
Bank indebtedness (Note 9)	\$ 1,280,000	\$ 190,000
Accounts payable and accrued liabilities	7,523,187	3,156,877
Deferred revenue	1,297,871	1,312,607
Income taxes payable	193,392	127,652
Future income taxes (Note 10)	1,518,531	938,927
Due to vendor for working capital	288,557	1,669,609
Current portion of notes payable (Note 11)	5,082,196	-
Current portion of long-term debt (Note 11)	1,596,003	1,022,059
Current liabilities of discontinued operations (Note 17)	20,934,479	6,473,628
Total current liabilities	39,714,216	14,891,359
Notes payable (Note 11)	2,357,378	-
Long-term debt (Note 11)	7,702	1,601,239
Long-term liabilities of discontinued operations (Note 17)	27,480	-
Future income taxes (Notes 4 and 10)	1,331,575	1,726,962
Future income taxes of discontinued operations (Notes 4 and 17)	1,338,237	-
Minority interest	509	4,986
	44,777,097	18,224,546
Shareholder's Equity	7,506,633	10,607,701
	\$ 52,283,730	\$ 28,832,247
GOING CONCERN AND LIQUIDITY RISK (Note 1)		

Approved on behalf of the Board:

Director

Director

Semcan Inc.

Consolidated Statements of (Loss) Income and Comprehensive (Loss) Income

For the years ended December 31	2008	2007
Revenue	\$ 29,338,241	\$14,178,324
Cost of goods sold, excluding amortization	21,438,115	10,056,996
Amortization of acquired order backlog (Note 7)	1,198,749	-
Total cost of sales	22,636,864	10,056,996
Gross margin	6,701,377	4,121,328
Expenses		
Selling, general and administrative	6,034,004	3,233,258
(Gain) loss on foreign exchange	(8,794)	44,820
	6,025,210	3,278,078
Income before the following	676,167	843,250
Interest expense	1,343,077	210,648
Amortization	748,276	387,082
Stock compensation expense (Note 12)	599,390	486,203
	2,690,743	1,083,933
Loss before income taxes	(2,014,576)	(240,683)
Provision for (recovery of) income taxes (Note 10)		
Current	103,783	291,935
Future	184,217	(380,557)
	288,000	(88,622)
Net loss from continuing operations	(2,302,575)	(152,061)
(Loss) income from discontinued operations before non-controlling interest	(787,309)	539,332
Non-controlling interest relating to discontinued operations	4,967	397
(Loss) income from discontinued operations (Note 17)	(782,342)	539,729
Provision for loss on sale of discontinued operations	(5,176,863)	-
Net (loss) income from discontinued operations	(5,959,205)	539,729
Net (loss) income for the year	(8,261,780)	387,668
Other comprehensive income		
Currency translation adjustment	492,944	-
Comprehensive (loss) income for the year	\$ (7,768,836)	\$ 387,668

(Loss) earnings per share (Note 18)

Semcan Inc.
Consolidated Statements of Shareholders' Equity and
Accumulated Other Comprehensive Income

	Share Capital (Note 12)	Contributed Surplus (Note 12)	Deficit	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Balance, December 31, 2006	\$ 2,325,770	\$ -	\$ (435,928)	\$ -	\$ 1,889,842
Issuance of shares	7,843,988	-	-	-	7,843,988
Stock compensation expense	-	486,203	-	-	486,203
Net income for the year	-	-	387,668	-	387,668
Balance, December 31, 2007	<u>\$ 10,169,758</u>	<u>\$ 486,203</u>	<u>\$ (48,260)</u>	<u>\$ -</u>	<u>\$ 10,607,701</u>
Balance, December 31, 2007	\$ 10,169,758	\$ 486,203	\$ (48,260)	\$ -	\$ 10,607,701
Issuance of shares	4,068,378	-	-	-	4,068,378
Stock compensation expense	6,030	593,360	-	-	599,390
Net loss for the year	-	-	(8,261,780)	-	(8,261,780)
Other comprehensive income for the year					
Currency translation adjustment	-	-	-	492,944	492,944
Balance, December 31, 2008	<u>\$ 14,244,166</u>	<u>\$ 1,079,563</u>	<u>\$(8,310,040)</u>	<u>\$ 492,944</u>	<u>\$ 7,506,633</u>

Semcan Inc.
Consolidated Statements of Cash Flows

For the years ended December 31

2008

2007

Cash flows from operating activities

Net loss from continuing operations	\$(2,302,575)	\$ (152,061)
Items not affecting cash:		
Amortization of property, plant and equipment and intangible assets other than value of acquired order backlog	748,276	387,082
Amortization of intangible assets related to acquired order backlog	1,198,749	-
Future income taxes	184,217	(380,557)
Stock compensation expense	599,390	486,203
Net change in working capital balances other than cash and cash equivalents (continuing operations) (Note 13)	596,277	502,639
	<u>1,024,334</u>	<u>843,306</u>
Discontinued operations	(2,212,076)	920,110
Cash provided by (used in) operating activities	<u>(1,187,742)</u>	<u>1,763,416</u>

Cash flows from financing activities

Proceeds from long-term borrowings - net	6,729,981	4,708,491
Loan arrangement fee capitalized to principal	(310,000)	-
Borrowings from operating bank line	1,090,000	190,000
Issuance of capital stock - net of issuance costs	4,068,378	6,822,469
	<u>11,578,359</u>	<u>11,720,960</u>
Discontinued operations	1,583,636	(108,491)
Cash provided by (used in) financing activities	<u>13,161,995</u>	<u>11,612,469</u>

Cash flows from investing activities

Purchase of property, equipment and intangible assets	(2,016,468)	(122,315)
Business acquisitions - net of cash acquired (Note 4)	(448,259)	(3,053,766)
Payment of amounts due to vendors for working capital	(1,381,052)	(2,000,000)
	<u>(3,845,779)</u>	<u>(5,176,081)</u>
Discontinued operations	(8,969,380)	(5,606,396)
Cash provided by (used in) investing activities	<u>(12,815,159)</u>	<u>(10,782,477)</u>
Change in cash and cash equivalents during the year	(840,906)	2,593,408
Increase (decrease) in cash due to changes in foreign exchange rates	(80,328)	(151,000)
Cash and cash equivalents, beginning of year	<u>3,900,223</u>	<u>1,457,815</u>
Cash and cash equivalents, end of year	\$2,978,989	\$ 3,900,223
Cash and cash equivalents, end of year - discontinued operations	<u>\$2,553,579</u>	<u>\$ 281,104</u>
Cash and cash equivalents, end of year - continuing operations	<u>\$425,410</u>	<u>\$ 3,619,119</u>

Supplemental Cash Flow Information:

Interest paid - continuing operations	\$1,021,246	\$73,223
Income taxes paid - continuing operations	72,639	13,541
Interest paid - discontinued operations	383,126	242,521
Income taxes paid - discontinued operations	17,308	2,441

Non-cash transactions:

- The Company completed one acquisition where a promissory note valued at \$272,728 was issued as consideration in addition to the cash paid on closing (Note 4(a)).
- Under the terms of a private placement completed during the year, 338,320 broker warrants were issued as compensation to the underwriters (Note 12(b)).

Cash and cash equivalents of \$2,978,989 at December 31, 2008 (2007 - \$3,900,223) include terms deposits of \$nil (2007 - \$500,000).

As at December 31, 2007 and 2008

1. Going Concern and Liquidity Risk

The consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities in the normal course of business. Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they come due. During 2008, the Company entered into various financing agreements to fund the acquisitions (see Note 4) in the current year. The Company's original plan for the acquisitions was to refinance a substantial portion of the acquisition facilities prior to or shortly after closing of the transaction with various types of long-term debt and to repay the balance with cash flow from operating activities prior to the maturity of the term bank debt and notes payable (see Note 11). In the fourth quarter of 2008, conditions in the credit markets deteriorated substantially, effectively closing the credit markets to the Company. These credit market conditions had a serious impact on the global economy, which has contributed negatively to the Company's operations in 2008. Current weak global economic conditions make access to the credit and capital markets difficult for the Company, which may compromise the Company's ability to repay or refinance all or a portion of the acquisition loans as they come due. The Company has breached three of its financial covenants and also triggered cross-default provisions under the Company's credit agreements (see Note 11). At December 31, 2008, the Company has a working capital deficiency of \$9,480,973. The working capital deficiency for the continuing operations is \$8,331,434. Included in the continuing operation's working capital deficiency is \$6,966,949 of maturing debt and long-term debt obligations, including \$1,934,549 that is classified as current liabilities due to the covenant violations. Included in maturing debt obligations is a \$3,000,000 promissory note which is due May 12, 2009 (see Note 11) for which the Company currently does not have the ability to pay and the lender expects to be paid in full. In 2008, the Company's continuing operations generated operating cash flow of \$428,057, excluding changes in working capital. Based on expected cash flows from operations after satisfying working capital requirements, the Company will not generate sufficient funds from operations to repay the debt obligations that will come due in 2009, and will need to generate funds from other sources to do so, or will need an extension or refinancing of the loans.

The Company's plan to improve liquidity is to use the proceeds from selling the businesses classified as discontinued operations (see Note 17) to pay down the existing debt obligations. It is anticipated that the Company's ongoing operations will be comprised solely of the businesses reported in the Engineering & Design, North America segment (see Note 14) by the end of 2009. On April 27, 2009, the Company completed the sale of Nucleus Distribution Inc. (see Note 21(a)), the terms of which resulted in the assumption by the purchaser of \$6,477,084 of debt classified as current liabilities of discontinued operations at December 31, 2008.

It will be necessary for the Company to negotiate an extension with respect to repayment of the \$3,000,000 promissory note maturing May 12, 2009, and for the remaining divestitures to occur in 2009 as described in Note 17 for the Company to be in a position to retire the current obligations in a manner acceptable to its lenders. With respect to the repayment of the \$3,000,000 promissory note which is due in full on May 12, 2009, the Company currently does not have available cash flow to fund the repayment. It is critical for the Company to negotiate an extension with the current lender, refinance the outstanding amount with new lenders or consider other options to repay the promissory note. On April 30, 2009, the Company signed an agreement with the current lender which provided for a three month extension of the maturity date to August 12, 2009 (see Note 21(c)). The terms of the agreement are acceptable to the Company, and it is working toward a plan to repay or refinance this debt. If the \$3,000,000 promissory note is not repaid by August 12, 2009, it will have a material adverse effect on the financial position of the Company. Further, it is not possible to predict whether the actions taken in generating cash flow to repay the \$3,000,000 promissory note and other actions to generate additional cash flows to discharge other debt obligations will result in improvements to the financial condition of the Company in a sufficient manner to allow it to continue as a going concern.

As at December 31, 2008 and 2007

1. Going Concern and Liquidity Risk - continued

As disclosed in note 3(h), the preparation of the consolidated financial statements in conformity with Canadian generally accepted accounting principles (“GAAP”) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. The significant doubt on the Company’s ability to continue as a going concern materially affects the degree of uncertainty associated with the measurement of many amounts related to the Company in the consolidated financial statements. More specifically, it could impact the recoverability tests and fair value assumptions used in impairment testing of definite-lived intangible assets and goodwill.

There is no assurance that the Company will be able to execute these plans on a timely basis to repay the debt obligations. Due to material uncertainties related to negotiations with lenders and the sale of the businesses, they cast significant doubt upon the Company’s ability to continue as a going concern. As a result, there can be no assurances that expected future cash flows will be realized or will be sufficient for the Company to continue as a going concern. These financial statements do not reflect the adjustments to the carrying values of assets and liabilities, the reported expenses and balance sheet classifications that would be necessary should the going concern assumption become inappropriate. These adjustments could be material to the financial statements.

2. Nature of Operations

Semcan Inc. (“Semcan” or the “Company”) is continued under the Canada Business Corporations Act. On February 5, 2007, the Company changed its name to Semcan Inc. (from Semco Technologies Inc.). Its common shares trade on the TSX Venture Exchange under the symbol STT.

The Company operates two core businesses: engineering and design, and distribution and product development. The businesses are owned by subsidiaries: Semco Systems Limited (“Semco”) for the North American engineering and design business, Stanco Systems UK Limited and its subsidiary Naston Limited for the United Kingdom engineering and design business and Nucleus Distribution Inc. (formerly Nucleus Financial Network Inc.) (“Nucleus”) for the distribution and product development business. During the fourth quarter of 2008, the Company implemented a revised strategy in response to the deterioration of the credit and equity markets and decided to divest certain of its businesses (see Note 17).

3. Significant Accounting Policies

(a) Principles of consolidation

These consolidated financial statements include the accounts of the Company and its subsidiaries: Nucleus Distribution Inc., Semco Systems Limited, Stanco Systems UK Limited and ZMI Portec Inc.. The Company’s investment in Nucleus includes all of its shares aside from the Special Voting shares, which are owned by a company controlled by one of Semcan’s major shareholders. The results of Nucleus have been consolidated with those of Semcan as it qualifies as a variable interest entity under the CICA Handbook. The results of Burlington Business Forms Ltd. and TEC Automotive Industries Inc. (both of which are subsidiaries controlled by Nucleus) have also been consolidated in these financial statements.

As at December 31, 2008 and 2007

3. Significant Accounting Policies - continued

The Company has classified the following subsidiaries as discontinued operations: Nucleus Distribution Inc., Naston Limited and Enviro-Pro-Tech, Inc. (see Note 17). The operating results and balances relating to these businesses are reported as discontinued operations in these consolidated financial statements.

All significant inter-company accounts and transactions have been eliminated.

The Company uses the purchase method to account for all business acquisitions.

(b) Inventory

Inventory is valued at the lower of cost and net realizable value. The cost of purchased goods in the Nucleus distribution business is determined using a first-in, first-out basis. For purchased goods in the rest of the Company, cost is determined as material cost by specific identification.

(c) Property and equipment

Property and equipment are recorded at cost. Amortization of leasehold improvements is provided on a straight-line basis over their expected useful lives, which is five years. Amortization of all other property and equipment is provided on a declining balance basis at annual rates designed to amortize the cost of the assets less estimated residual value over their estimated useful lives as follows:

Buildings	4% - 5%
Machinery and equipment	20%
Furniture and fixtures	20%
Automotive equipment	30%
Computer equipment	30%
Test lab equipment	20%

(d) Foreign currency translation

Monetary assets and liabilities of the Company, its foreign operations and joint ventures, except those of self-sustaining foreign operations, are translated into Canadian dollars at exchange rates in effect at the consolidated balance sheet dates and non-monetary items are translated at rates of exchange in effect when the assets were acquired or obligations incurred. Revenues and expenses are translated at the average rate of exchange for the year. Foreign exchange gains and losses arising are included in net income for the year.

The assets and liabilities of the Company's self-sustaining foreign operations that have a measurement currency that is not in Canadian dollars are translated into Canadian dollars using the exchange rate in effect at the consolidated balance sheet date, and revenues and expenses are translated at the average rate during the year. Exchange gains or losses on translation of the Company's net equity investment in these operations are recorded as a separate component of accumulated other comprehensive income.

All other foreign exchange gains or losses are included in the consolidated statements of (loss) income.

As at December 31, 2008 and 2007

3. Significant Accounting Policies - continued

(e) Accounting for Contracts

Revenue and income from fixed-price construction contracts, including contracts in which the Company participates through joint ventures, are determined on the percentage of completion method, based on the ratio of costs incurred to date over estimated total costs. This method is used because management considers expended costs to be the best available measure of progress on these contracts. Contract costs include all direct material and labour costs and those indirect costs relating to contract performance such as indirect labour and supplies, tools and repairs. Consulting contracts to manage or supervise construction activity of others are recognized only to the extent of the fee revenue earned. Revenues from cost-plus-fee contracts are recognized on the basis of costs incurred. Provision is made for anticipated contract losses as soon as they are evident. Contract revenues and costs are adjusted to reflect change orders that have been approved as to both price and scope. For change orders that have not been approved as to price, contract revenues are recognized to the extent of costs incurred or, if lower, to the extent to which recovery is probable. Profit on unpriced change orders is not recognized until pricing has been agreed. If there are disputes regarding additional payments owing as a result of changes in contract specifications, delays, additional work or changed conditions, the Company's accounting policy is to expense all costs for these change orders but not to record any revenues anticipated from these disputes until actually resolved, even though the Company may believe that full compensation from clients is probable.

Deferred contract costs and unbilled revenues represent costs incurred and revenues earned in excess of amounts billed on uncompleted contracts. Deferred revenue represents the excess of amounts billed over costs incurred and revenue earned on uncompleted contracts. Contract advances are included in deferred revenue and represent advance payments received from clients for mobilization of project staff, equipment and services.

The operating cycle, or duration, of many of the Company's contracts exceeds one year. All contract-related assets and liabilities are classified as current as they are expected to be realized or satisfied within the operating cycle of the contract.

The Company will at times incur commissions to sales agents representing the Company. These commissions are treated as deferred contract costs and are amortized over the term of the related contract. Unamortized commissions at December 31, 2008 were \$424,019 (2007 - \$315,501).

The Company recognizes revenue in the distribution and product development business upon shipment of the goods to the customer.

(f) Income taxes

Income taxes are recorded using the asset and liability method of income tax allocation. Under this method, assets and liabilities are recorded for the future income tax consequences attributable to differences between the financial statement carrying values and their respective income tax bases. These future income tax assets and liabilities are recorded using substantively enacted income tax rates. The effect of a change in income tax rates on these future income tax assets or liabilities is included in income in the period in which the rate change occurs. Certain of these differences are estimated based on the current tax legislation and the Company's interpretation thereof. The Company records a valuation allowance when it is more likely than not that the future income tax assets will not be realized prior to their expiration.

(g) Cash and cash equivalents

Cash and cash equivalents consists of cash on hand, bank balances and term deposits.

As at December 31, 2008 and 2007

3. Significant Accounting Policies - continued

(h) Use of significant accounting estimates

The preparation of consolidated financial statements in conformity with Canadian generally accepted accounting principles ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as at the dates of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from those estimates. A certain amount of uncertainty is inherent in estimating the costs of completing construction projects and estimating amounts ultimately realizable on unpriced change orders. The impact on the consolidated financial statements of future changes in these estimates could be material. Significant estimates in these consolidated financial statements also include impairment analyses of goodwill and other intangible assets, going concern assumption and provision for loss on discontinued operations.

(i) Goodwill and other intangible assets

Goodwill represents the cost of investments in operating companies in excess of the fair value of the net identifiable assets acquired. The recoverability of goodwill is assessed annually or whenever events or changes in circumstances indicate that the carrying amount may not be appropriate. Impairment of goodwill is tested at the reporting unit level by comparing the carrying value of the reporting unit to its fair value. When the carrying value exceeds the fair value, impairment exists and is measured by comparing the carrying amount of goodwill to its fair value determined in a manner similar to a purchase price allocation.

Other intangible assets are recorded at their fair value at the date of acquisition of the operating company. Amortization is provided for intangible assets with finite useful lives on a straight-line basis over their estimated useful lives, which are re-evaluated on an annual basis. The amortization period used at December 31, 2008 is 10 years (2007 – 10 years). The Company reviews intangible assets with finite useful lives for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. If the total of the expected undiscounted future cash flows is less than the carrying amount of the asset, a loss is recognized for the excess of the carrying amount over the fair value of the asset.

(j) Stock-based awards

The value of all stock-based awards made to employees and non-employees are measured and recognized using a fair value based method whereby all awards are recorded at fair value and amortized over the vesting period. The Company estimates the fair value of each stock option at the date of grant using the Black-Scholes option pricing model. Upon exercise of the stock options, the consideration paid, together with the amount previously recognized in contributed surplus, is recorded as an increase in share capital.

(k) Financial instruments

The Company's financial assets and financial liabilities have been classified based on the purpose for which the consolidated financial instruments were acquired or issued, their characteristics and the Company's designation of such instruments. Loans and receivables and other liabilities are measured at amortized cost using the effective interest method. Held-for-trading ("HFT") financial instruments are measured at their fair value with changes in fair value recognized through earnings. The Company has designated each of its significant categories of financial instruments outstanding as of December 31, 2008 as follows:

Cash and cash equivalents - HFT
Accounts receivable - Loans and receivables
Bank indebtedness - HFT
Accounts payable and accrued liabilities - Other liabilities
Due to vendor for working capital - Other liabilities
Notes payable - Other liabilities
Long-term debt - Other liabilities

As at December 31, 2008 and 2007

3. Significant Accounting Policies - continued

(l) Changes in accounting policies

In 2008, the Company adopted The Canadian Institute of Chartered Accountants (“CICA”) Handbook Section 1535, “Capital Disclosures,” Section 3862, “Financial Instruments – Disclosures,” Section 3863, “Financial Instruments – Presentation, and Section 3031, “Inventories.” The principal changes due to the adoption of these accounting standards are described below:

Section 1535 establishes guidelines for the disclosure of information regarding a business’s capital and how it is managed. The standard requires enhanced disclosures with respect to: (i) an entity’s objectives, policies and processes for managing capital; (ii) quantitative data about what the entity regards as capital; and (iii) whether the entity has complied with any capital requirements, and if it has not complied, the consequences of such non-compliance. Disclosures required as a result of adopting this section can be found in Note 19.

Section 3862 and Section 3863 modified Section 3861, “Financial Instruments – Disclosure and Presentation.” Section 3862 requires increased disclosures regarding the risks associated with financial instruments such as credit risk, liquidity risk and market risks and the techniques used to identify, monitor and manage these risks. Section 3863 carries forward standards for presentation of financial instruments and non-financial derivatives and provides additional guidance for the classification of financial instruments, from the perspective of the issuer, between liabilities and equity. Disclosures required as a result of adopting this section can be found in Note 19.

The new Section 3031, “Inventories” provides guidance with respect to the determination of cost and requires inventories to be measured at the lower of cost and net realizable value. The cost of inventories includes the costs to purchase and other costs incurred in bringing the inventories to their present location. Costs such as storage costs and administrative overheads that do not contribute to bringing the inventories to their present location and condition are specifically excluded from the cost of inventories and expensed in the period incurred. Reversal of previous write-downs to net realizable value when there is a subsequent increase in the value of the inventories is now required. The new standard also requires additional disclosures including the accounting policies used in measuring inventories, the carrying amount of the inventories, amounts recognized as an expense during the period, write-downs and the amount of any reversal of any writedowns recognized as a reduction in expenses. The adoption of this section had no material effect on the consolidated financial statements.

CICA Handbook Section 1400, “General Standards on Financial Statement Presentation,” has been amended to include requirements that management assess and disclose an entity’s ability to continue as a going concern. The changes are effective for the Company for interim and annual financial statements beginning April 1, 2008. Disclosures required as a result of adopting this section can be found in note 1.

(m) Future accounting changes

In February 2008, the Canadian Accounting Standards Board (“AcSB”) confirmed that Canadian public entities will have to adopt International Financial Reporting Standards (“IFRS”) effective for fiscal years beginning on or after January 1, 2011. The Company will issue consolidated financial statements in accordance with IFRS commencing in the first quarter ending March 31, 2011, with comparative information. The impact of the adoption of IFRS on the consolidated financial statements of the Company will likely be significant and, as such, the Company has begun to develop its convergence plan in order to transition its financial statement reporting, presentation and disclosure for IFRS to meet the January 1, 2011 deadline. The Company continues the process of evaluating the potential impact of IFRS on its consolidated financial statements. The process will be ongoing as new standards and recommendations are issued by the International Accounting Standards Board and AcSB. It is not the Company’s intention to adopt IFRS prior to January 1, 2011.

As at December 31, 2008 and 2007

3. Significant Accounting Policies - continued

The CICA issued Handbook Section 3064, "Goodwill and Intangible Assets," which clarifies that costs can be capitalized only when they relate to an item that meets the definition of an asset. Section 1000, "Financial Statement Concepts," was also amended to provide consistency with this new standard. The new and amended standards will be effective on January 1, 2009 for the Company. The Company does not anticipate that the adoption of these standards will significantly impact its consolidated financial results.

The CICA has also issued Handbook Section 1582, "Business Combinations," which replaces Section 1581 and Section 1601, "Consolidated Financial Statements" and Section 1602, "Non-Controlling Interests," which together replace Section 1600. Under Section 1582, the purchase price used in a business combination is based on the fair value of shares exchanged at their market price at the date of exchange. Furthermore, virtually all acquisition costs will be expensed. In the existing standards these costs are capitalized as part of the purchase price. Contingent liabilities are to be recognized at fair value at the acquisition date and re-measured at fair value, with changes in value charged to earnings for each period until settled. Currently, only the contingent liabilities that are resolved and payable are included in the cost to acquire the business. In addition, negative goodwill will be recognized immediately in earnings, unlike the current requirement to eliminate it by deducting it from assets in the purchase price allocation. Sections 1601 and 1602 revise and enhance the standards for the preparation of consolidated financial statements subsequent to a business combination. All three sections come into effect for financial periods beginning January 1, 2011, with prospective application.

In January 2009, the CICA issued Handbook Section 1602, "Non-controlling Interests," which establishes standards for the accounting of non-controlling interests of a subsidiary in the preparation of consolidated financial statements subsequent to a business combination. This standard is equivalent to the IFRS guidance on consolidated and separate financial statements. The standard is effective for 2011, with early adoption permitted. The Company is currently evaluating the impact of adopting this standard.

In January 2009, the CICA issued Emerging Issues Committee Abstract 173, "Credit Risk and the Fair Value of Financial Assets and Liabilities," which clarifies that an entity's credit risk, and that of counterparties, should be taken into account in determining the fair value of financial assets and financial liabilities. This standard will be effective on January 1, 2009 for the Company. The Company is currently evaluating the impact of adopting this standard.

4. Acquisitions

(a) **Acquisition of Enviro-Pro-Tech, Inc.**

On January 31, 2008, the Company acquired the business of Enviro-Pro-Tech, Inc. ("EPT") by acquiring all of the outstanding shares. EPT provides soil and water testing and remediation services from its operational headquarters in Pensacola, Florida. Much of its work comes from cleaning up contaminated sites previously used as petroleum service stations. EPT is licensed to do work for the state governments of Florida and Alabama. The results from operations and corresponding cash flows related to EPT have been included in the Company's consolidated financial statements from the date of acquisition, January 31, 2008.

As at December 31, 2008 and 2007

4. Acquisitions - continued

The acquisition was accounted for by the purchase method and the final purchase price allocation is as follows:

<i>Net assets acquired:</i>	
Non-cash working capital	\$ 690,039
Property and equipment	161,771
Intangible asset – acquired order backlog ⁽¹⁾	191,726
Intangible asset – customer relationships ⁽¹⁾	749,838
Goodwill ⁽¹⁾	1,769,150
Future tax liability ⁽¹⁾	<u>(296,028)</u>
Net assets acquired	<u>\$ 3,266,496</u>

⁽¹⁾ The acquired order backlog will be amortized for accounting purposes over the life of the underlying orders. The customer lists will be amortized for accounting purposes over 10 years, which is their estimated useful life. Since the acquisition of EPT was a share purchase transaction, amortization of the intangible assets is not deductible for tax purposes. This non-deductibility gives rise to a future income tax liability of \$296,028, with a corresponding increase in goodwill of \$296,028. These amounts are included in the balances given above.

Consideration was comprised of:

Cash paid, net of cash acquired of \$147,581	\$ 2,993,768
US\$500,000 promissory note to the vendor, of which US\$200,000 is contingent (i)	272,728
Due to vendor for working capital adjustment (ii)	<u>-</u>
	<u>\$ 3,266,496</u>

- (i) The vendor is entitled to up to US\$500,000 of consideration over and above the cash paid at closing. This is evidenced by a promissory note for a total of US\$500,000, which includes both a committed portion (US\$300,000) and the contingent portion (US\$200,000). The contingent portion will be earned provided that the business achieves certain performance targets during the first two years of operation subsequent to the closing date. In accordance with Canadian GAAP, the contingent amount is not recorded until the contingent element has been resolved. This note, which is interest-free and unsecured, is repayable in two equal instalments on January 31, 2009 and January 31, 2010. The carrying value of the guaranteed portion of the note has been discounted using an interest rate of 7% per annum. Subsequent to year-end, the Company did not pay the instalment due on January 31, 2009 (see Notes 1 and 11).
- (ii) The terms of the purchase agreement required a minimum of US\$750,000 of working capital to be on hand at closing. The agreement requires that an assessment be made on April 30, 2008 as to whether the business can be effectively managed with US\$600,000 of working capital. If it is determined that the business can operate effectively with US\$600,000 of working capital, a payment of US\$150,000 is due to the vendor. The final determination of the working capital is outstanding; the Company will account for this portion of the transaction once the determination is complete. The Company intends to address this at the time of the divestiture of EPT, which has been classified as a discontinued operation in these consolidated financial statements (Note 17).

As at December 31, 2008 and 2007

4. Acquisitions - continued

(b) Acquisition of Naston Limited

On April 23, 2008, the Company completed the acquisition of Naston Limited (“Naston”) by acquiring all of the outstanding shares. Based in Weybridge, Surrey, England, Naston carries on the business of engineering and contracting services specializing in water and waste water treatment systems, sewage treatment package plants and solutions for sustainability and water re-use. Naston has been in business for 30 years and has long-term operating contracts with some of the major publicly traded water utility companies in the United Kingdom.

The acquisition was accounted for by the purchase method and the final purchase price allocation is as follows:

<i>Net assets acquired:</i>	
Non-cash working capital	\$ (5,310,052)
Property and equipment	94,486
Intangible asset – acquired order backlog ⁽¹⁾	885,664
Other Intangible assets ⁽¹⁾	3,665,097
Goodwill ⁽¹⁾	6,319,728
Future tax liability ⁽¹⁾	<u>(1,274,213)</u>
Net assets acquired	<u>\$ 4,380,710</u>

⁽¹⁾ The acquired order backlog will be amortized for accounting purposes over the life of the underlying orders. The other intangible assets, consisting primarily of customer relationships and trade name will be amortized for accounting purposes over 10 years, which is its estimated useful life. Since the acquisition of Naston was a share purchase, amortization of the intangible assets is not deductible for tax purposes. This non-deductibility gives rise to a future income tax liability of \$1,274,213, with a corresponding increase in goodwill of \$1,274,213. These amounts are included in the balances given above.

Consideration was comprised of:

Cash paid, net of cash acquired of \$5,948,610	\$ 4,380,710
Contingent consideration of up to £300,000 (i)	<u>-</u>
	<u>\$ 4,380,710</u>

(i) The vendors are entitled to up to £300,000 (approximately \$570,450) of consideration over and above the cash paid at closing. The contingent portion will be earned provided that the business achieves certain performance targets during the first two years of operation subsequent to the effective date. In accordance with Canadian GAAP, the contingent amount is not recorded until the contingent element has been resolved. Any additional consideration earned would become payable on June 30, 2009 and June 30, 2010, which is 90 days after the first and second anniversaries of the effective date. Naston has been classified as a discontinued operation in these consolidated financial statements (Note 17), and it is anticipated that the Company will remain liable for the contingent consideration in the event of a sale.

As at December 31, 2008 and 2007

4. Acquisitions - continued

(c) **Acquisition of Stanco Projects Ltd.**

During the current period, the Company finalized the purchase price allocation for the purchase of Stanco Projects Ltd. ("Stanco"), which closed on July 24, 2007. As a result of finalizing the allocation, a reclassification of \$1,243,000 to acquired order backlog was made from the original \$6,506,000 allocated to other intangible assets.

The acquisition was accounted for by the purchase method and the updated purchase price allocation is as follows:

<i>Net assets acquired:</i>	
Non-cash working capital	\$ 613,775
Property and equipment	261,569
Future income tax asset	199,437
Intangible assets – acquired order backlog	1,243,000
Intangible assets – customer relationships	5,263,000
Goodwill ⁽¹⁾	2,493,745
Assumption of long-term debt	(46,245)
Future income tax liability	<u>(2,117,858)</u>
Net assets acquired	<u>\$ 7,910,423</u>

Consideration was comprised of:

Cash paid, net of cash acquired of \$4,341,026	\$ 3,079,025
Contingent consideration (i)	423,000
Due to vendor for working capital adjustment	3,669,609
1,111,111 common shares issued to vendor	<u>738,789</u>
	<u>\$ 7,910,423</u>

- (i) On July 24, 2008, the Company paid \$423,000 of contingent consideration as a consequence of the business achieving certain performance targets. This amount was added to the goodwill recorded on the purchase. In addition, the vendor is entitled to additional consideration of up to \$477,000 provided that the business achieves certain performance targets. This is evidenced by a promissory note which bears interest at 6% per annum, and is repayable on July 24, 2009. In accordance with Canadian GAAP, this amount is not recorded until the contingent element has been resolved. The Company has accrued interest on this amount.

(d) **Acquisition of TEC Automotive Industries Inc.**

On July 2, 2008, the Company completed the acquisition of TEC Automotive Industries Inc. ("TEC") by acquiring all of the outstanding shares. TEC distributes automotive filters and is based in Concord, Ontario. The results from operations and corresponding cash flows related to TEC have been included in the Company's consolidated financial statements effective July 2, 2008.

As at December 31, 2008 and 2007

4. Acquisitions - continued

The acquisition was accounted for by the purchase method and the preliminary purchase price allocation is as follows:

<i>Net assets acquired:</i>	
Non-cash working capital	\$ (238,829)
Property and equipment	34,686
Intangible asset	204,144
Goodwill ⁽¹⁾	68,388
Future tax liability ⁽¹⁾	<u>(68,388)</u>
Net assets acquired	<u>\$ 1</u>

⁽¹⁾ The intangible asset of \$204,144 consisting of customer lists will be amortized for accounting purposes over 10 years, which is its estimated useful life. Since the acquisition of TEC was a share purchase transaction, the amortization of the intangible asset is not deductible for tax purposes. This non-deductibility gives rise to a future income tax liability of \$68,388, with a corresponding increase in goodwill of \$68,388. These amounts are included in the balances given above.

Consideration was comprised of:

Cash paid	<u>\$ 1</u>
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5. Deferred contract costs and unbilled revenue

Deferred contract costs and unbilled revenue of \$2,443,566 (December 31, 2007 - \$1,690,497) represents the value of work performed on engineering and design contracts for which the Company has not yet billed customers.

6. Inventory

Inventory is comprised of the following:

	December 31, 2008	December 31, 2007
Raw materials	\$ <u>38,558</u>	\$ -
Finished goods	149,475	172,049
Assembly parts	<u>618,430</u>	<u>260,863</u>
	<u>\$ 806,463</u>	<u>\$ 432,912</u>

The inventory value shown above is net of a provision for obsolescence of \$290,033. The amount of inventories expensed for the year, principally from operations classified as discontinued operations, is \$10,610,938.

Inventory does not include deferred contract costs and unbilled revenue related to engineering and design contracts.

Semcan Inc.
Notes to Consolidated Financial Statements

As at December 31, 2008 and 2007

7. Goodwill and Other Intangible Assets

The balance of goodwill and other intangible assets is comprised of the following:

	2008	2007
Backlog acquired		
Acquired order backlog	\$ 1,243,000	\$ -
Accumulated amortization	<u>(1,198,749)</u>	<u>-</u>
	<u>\$ 44,251</u>	<u>\$ -</u>
Goodwill	<u>\$ 2,493,745</u>	<u>\$ 2,045,486</u>
Other Intangible assets		
Customer relationships	5,263,000	6,506,000
Trademark	1,112,882	-
Accumulated amortization	<u>(771,537)</u>	<u>(283,412)</u>
	<u>5,604,345</u>	<u>6,222,588</u>
Total Goodwill and Other Intangible Assets	<u>\$ 8,098,090</u>	<u>\$ 8,268,074</u>

8. Property and Equipment

	Cost	Accumulated Amortization	2008 Net Book Value
Land	\$ -	\$ -	\$ -
Building	-	-	-
Leasehold improvements	51,141	5,114	46,027
Machinery and equipment	921,280	459,239	462,041
Furniture and fixtures	583,525	330,912	252,613
Automotive equipment	142,486	49,623	92,863
Computer equipment	678,465	441,272	237,193
Test lab equipment	105,076	98,252	6,824
	<u>\$ 2,481,973</u>	<u>\$ 1,384,412</u>	<u>\$ 1,097,561</u>
			2007
			Net Book Value
Land	\$ -	\$ -	\$ -
Building	-	-	-
Machinery and equipment	476,448	381,758	94,690
Furniture and fixtures	458,206	293,551	164,655
Automotive equipment	111,331	44,521	66,810
Computer equipment	483,658	363,338	120,320
Test lab equipment	105,076	96,548	8,528
	<u>\$ 1,634,719</u>	<u>\$ 1,179,716</u>	<u>\$ 455,003</u>

Semcan Inc.
Notes to Consolidated Financial Statements

As at December 31, 2008 and 2007

9. Bank Indebtedness

The Company's continuing operations have access to a line of credit limited to \$1,500,000 at December 31, 2008 (2007 - \$1,481,497), on which the drawn amount is \$1,280,000 (2007 - \$190,000). Amounts drawn are repayable on demand and bear interest at prime plus 0.5%. The line is secured by a general security agreement covering the Company and its Canadian and US subsidiaries, and is based on certain margin limits. The Company has a term loan with the same bank, and the Company is not in compliance with the debt service coverage covenants under the borrowing agreement which governs both the term loan and the line of credit (see Note 11(d)). As at the release date of the consolidated financial statements, the Company continues to have access to this line of credit.

The Company has outstanding letters of credit issued to customers as performance guarantees as at December 31, 2008 of US\$331,405 (2007 - US\$696,768), including US\$331,405 (2007 - US\$421,614) guaranteed by the Export Development Corporation.

The Company's discontinued operations have access to a line of credit limited to \$2,000,000 at December 31, 2008 (2007 - \$1,500,000), on which the drawn amount is \$1,340,000 (2007 - \$nil). The limit was reduced to \$1,600,000 subsequent to December 31, 2008. Amounts drawn are repayable on demand and bear interest at prime plus 0.5%. The line is secured by a general security agreement covering Nucleus and is based on certain margin limits.

10. Income Taxes

The reconciliation of the statutory income tax rate to the Company's effective tax rate is as follows:

	<u>2008</u>	<u>2007</u>
Loss from continuing operations before income taxes	\$ <u>(2,014,576)</u>	\$ <u>(240,683)</u>
Income tax provision at statutory rates	(674,883)	(86,935)
Increase (decrease) related to:		
Provision to return adjustment	(120,499)	-
Net change in valuation allowance for losses carried forward	292,378	(10,122)
Other permanent differences	759,919	276,812
Effect of change in future tax rates	3,216	(244,184)
Impact of multi- jurisdiction rates	7,756	(28,253)
Other	20,113	4,060
	<u>962,883</u>	<u>(1,687)</u>
Income tax expense (recovery)	\$ <u><u>288,000</u></u>	\$ <u><u>(88,622)</u></u>

Semcan Inc.
Notes to Consolidated Financial Statements

As at December 31, 2008 and 2007

10. Income Taxes - continued

The Company's future income tax liabilities are comprised of the following:

	2008	2007	2008	2007
	Continuing	Continuing	Discontinued	Discontinued
	Operations	Operations	Operations	Operations
<u>Current future tax liability:</u>				
Deferred revenue	\$ 1,518,531	\$ 938,927	\$ 153,929	\$ -
Total future tax liability, current	<u>\$ 1,518,531</u>	<u>\$ 938,927</u>	<u>\$ 153,929</u>	<u>\$ -</u>
<u>Future tax assets:</u>				
Share issuance costs and financing fees	\$ 606,383	\$ 178,572	\$ 4,605	\$ 7,584
Non capital loss carryforwards	<u>210,721</u>	<u>82,311</u>	<u>507,265</u>	<u>3,105,987</u>
	817,104	260,883	511,870	3,113,571
Valuation allowance	<u>805,831</u>	<u>253,210</u>	<u>507,265</u>	<u>3,105,987</u>
Total future tax assets	<u>11,273</u>	<u>7,673</u>	<u>4,605</u>	<u>7,584</u>
<u>Long-term future tax liability:</u>				
Intangible assets	(1,219,405)	(1,709,263)	(1,871,482)	(546,888)
Recovery due to sale of discontinued operations	-	-	874,786	-
Unrealized foreign exchange	(91,628)	-	-	-
Property and equipment	<u>(31,815)</u>	<u>(25,372)</u>	<u>(346,146)</u>	<u>(317,714)</u>
Total future tax liability, long-term	<u>(1,342,848)</u>	<u>(1,734,635)</u>	<u>(1,342,842)</u>	<u>(864,602)</u>
Net long-term future tax liability	<u>\$ (1,331,575)</u>	<u>\$ 1,726,962</u>	<u>\$ (1,338,237)</u>	<u>\$ (857,018)</u>

The Company has the following non-capital tax loss carry-forwards, the value of which has not been recorded in these consolidated financial statements:

Year of Expiry	Continuing	Discontinued
	Operations	Operations
2009	\$ -	\$ 1,487,312
2010	-	42,884
2025	37,384	-
2026	-	26,799
2027	253,636	-
2028	395,366	95,335
	<u>\$ 686,386</u>	<u>\$ 1,652,330</u>

Semcan Inc.
Notes to Consolidated Financial Statements

As at December 31, 2008 and 2007

11. Long-term Debt and Notes Payable

The Company has term loans and mortgages outstanding, which are summarized below:

Term Bank Debt	2008	2007
Committed reducing term facility, due July 2010, bearing interest at prime plus 1%, repayable in monthly principal payments of \$83,333 plus interest. Secured by a general security agreement provided by a subsidiary of the Company. (See Note 11(d)).	\$ 1,583,333	\$ 2,583,333
Loan payable, due August 2010, bearing interest at 2.9%. Repayable in monthly payments of principal and interest of \$1,056.	20,372	32,430
Loan payable, due September 2008, non-interest bearing. Repayable in monthly instalments of \$837.	-	7,535
Total	1,603,705	2,623,298
Less: Portion due within one year	1,596,003	1,022,059
	\$ 7,702	\$ 1,601,239

The Company also has the following promissory notes outstanding:

Notes Payable	2008	2007
Debenture owing to Philip Jamieson (Chairman & CEO), Tricaster Holdings Inc. and Combined Telecom Inc., due July 20, 2011, secured by a General Security Agreement and bearing interest at prime + 3%; issued in connection with the Naston acquisition (Notes 4(b) and 16(c)). The debenture is repayable in monthly principal payments of \$139,032 plus interest. The amounts due for January 2009 through March 2009 have not been paid (see Note 11(e)).	\$ 3,892,903	\$ -
Promissory note owing to Westdale Construction Co. Ltd., due May 12, 2009, secured by a General Security Agreement and bearing interest at 20% per annum. The proceeds of this loan were used to acquire proprietary assets relating to the ZMI slaker, a device used in many of the Company's engineered solutions.	3,000,000	-
Promissory note with face value of US\$300,000 owing to the previous owners of EPT, due in equal instalments on January 31, 2009 and January 31, 2010, unsecured and interest-free; issued as a result of the EPT acquisition (Note 4(a)). The carrying value of the note has been discounted using an interest rate of 7% per annum. The instalment due on January 31, 2009 has not been paid. As a result, the full amount of the promissory note is classified as a current liability.	351,216	-
Loan payable, due September 2011, bearing interest at prime plus 3%. Repayable in monthly payments of \$ 4,208 plus interest (Note 16(d)).	138,875	-
Loan payable, due August 2014, non-interest bearing. Repayable in monthly instalments of \$1,008. The carrying value of the note has been discounted using an interest rate of 7% per annum.	56,580	-
Total	7,439,574	-
Less: Portion due within one year	5,082,196	-
	\$ 2,357,378	\$ -

As at December 31, 2008 and 2007

11. Long-term Debt and Notes Payable - continued

- (a) Under the terms of the Stanco acquisition, the Company would be required to pay \$477,000 on July 24, 2009 upon Stanco meeting certain earnings targets. This contingent consideration will be recorded in the consolidated financial statements as additional goodwill when the contingent element is resolved.
- (b) Under the terms of the EPT acquisition, the Company would be required to pay US\$200,000 (approximately \$243,600) in two equal instalments (January 31, 2009 and January 31, 2010) upon EPT meeting certain earnings targets. This contingent consideration will be recorded in the consolidated financial statements as additional goodwill when the contingent element is resolved.
- (c) Under the terms of the Naston acquisition, the Company would be required to pay £300,000 (approximately \$550,290) in two equal instalments (June 30, 2009 and June 30, 2010) upon Naston meeting certain earnings targets. This contingent consideration will be recorded in the consolidated financial statements as additional goodwill when the contingent element is resolved.
- (d) The Company is required to be in compliance with certain covenants under the terms of its borrowing agreements. These covenants include tests related to minimum tangible net worth, ability to service interest and principal charges on the debt, and funded debt compared with operating profit. At December 31, 2008, the Company was not in compliance with the debt service coverage covenants under the borrowing agreements for subsidiaries Nucleus and Semco. Nucleus was sold subsequent to year-end (see Note 21(a)) and the Company did not incur any losses as a result of the covenant breach. The Company is engaged in negotiations with the bank concerning Semco's breach. Since these negotiations were not concluded at the date of release of these consolidated financial statements, the Company has classified the total \$1,583,333 outstanding on this loan as a current liability.
- (e) As a result of cross-default provisions in the terms of the Debenture owing to Philip Jamieson, Tricaster Holdings Inc. and Combined Telecom Inc., the Company was in breach of the debenture at December 31, 2008. Subsequent to that date, the Company has not made payments of principal and interest due under the debenture. The lenders have waived the Company's non-compliance at December 31, 2008 and have provided a waiver for the cross-default provision and any breach for non-payment of principal and interest for the year ending December 31, 2009.

The weighted average interest rate on the Company's long-term debt and notes payable is 8.20% (2007 – 6.71%).

12. Share Capital

- (a) Authorized:
Unlimited number of common shares.

Unlimited number of preferred shares issuable in series. No preferred shares of any series have been issued or are outstanding at December 31, 2008.

Semcan Inc.
Notes to Consolidated Financial Statements

As at December 31, 2008 and 2007

12. Share Capital - continued

(b) Issued:

	<u>Warrants</u> <u>Number</u>	<u>\$</u>	<u>Common Shares</u> <u>Number</u>	<u>\$</u>	<u>Total</u> <u>\$</u>
Balance, December 31, 2006	1,657,870	188,001	15,815,740	2,137,769	2,325,770
Issued in conjunction with the acquisition of Nucleus	-	-	942,433	282,730	282,730
Issued upon exercise of warrants on May 11, 2007	(12,500)	(1,417)	12,500	6,417	5,000
Issued in conjunction with the acquisition of Stanco	-	-	1,111,111	738,789	738,789
Issued between July 23, 2007 and August 23, 2007	4,166,667	1,175,480	8,333,333	5,116,989	6,292,469
Issuance of broker warrants	583,333	525,000	-	-	525,000
Balance, December 31, 2007	6,395,370	1,887,064	26,215,117	8,282,694	10,169,758
Issuance of common shares and warrants (i)	2,416,575	116,199	4,833,150	3,822,179	3,938,378
Issuance of broker warrants (ii)	338,320	118,000	-	-	118,000
Issued upon exercise of warrants on September 5, 2008	(10,000)	(1,134)	10,000	5,134	4,000
Issued upon exercise of warrants on November 10, 2008	(20,000)	(2,268)	20,000	10,268	8,000
Issued to employees on December 4, 2008 (iii)	-	-	20,100	6,030	6,030
Balance, December 31, 2008	9,120,265	2,117,861	31,098,367	12,126,305	14,244,166

- i. The Company completed a share issuance as a private placement in two tranches which closed on April 22, 2008 and May 30, 2008. A total of 4,833,150 units were issued, comprised of 4,833,150 common shares and 2,416,575 common share purchase warrants (the "Warrants"). Each Warrant is exercisable to acquire one share of the Company at \$1.35 per share, and expires after 18 months.

Total gross proceeds of the issuance were \$4,591,493, and net proceeds after deducting agent commissions and other costs were \$4,056,378. Both the shares and Warrants issued through the private placement are subject to statutory resale restrictions expiring four months plus one day after the closing date. A full valuation allowance has been recorded against the tax benefit of the issuance costs. The estimated value of this tax benefit is \$162,000.

As at December 31, 2008 and 2007

12. Share Capital - continued

- ii. A total of 338,320 broker warrants (the “Broker Warrant(s)”) were issued to the investment dealer which handled the private placement as partial compensation for underwriting the equity offering. Each Broker Warrant entitles the holder to acquire a unit comprised of one common share and one-half of a Warrant. The exercise price is \$0.95 per unit, and the Broker Warrants expire after 18 months from date of issuance.
- iii. These shares were issued as 100-share lots and were given to non-management employees. The fair value assigned to these shares is based on the prevailing market price of the Company’s shares on the date of issuance.

The fair value assigned to the Warrants issued as part of the private placement was \$116,199 (net of issuance costs) and the fair value assigned to the Broker Warrants was \$118,000, both using the following assumptions under the Black-Scholes option pricing model:

Risk-free interest rate	4.00%	Annualized volatility	38.18%
Expected life of warrants	18 months	Dividends	0.00%

Stock Option Plan

On March 7, 2007, the Company introduced a stock option plan under which 1,200,000 stock options (the “March 2007 Options”) were granted to directors and officers of the Company and its operating subsidiaries. The March 2007 Options are exercisable for a period of five years from the date of vesting at an exercise price of \$0.65 per share; those granted to directors (500,000 options) vested immediately, while those granted to management (700,000 options) vest over a period of two years.

The Company recorded stock compensation expense of \$187,128 during the year (2007 - \$423,273) in relation to the March 2007 Options. The following weighted average assumptions were used for the Black-Scholes valuation of the Options:

Risk-free interest rate	4.00%	Annualized volatility	115.54%
Expected life of options	5 years	Dividends	0.00%

The fair value of the unamortized March 2007 Options at December 31, 2008 is \$31,198. This amount is being amortized on a straight-line basis over the vesting period. The amount expensed to date has been recorded as contributed surplus.

On November 1, 2007, the Company granted an additional 1,085,000 stock options (the “November 2007 Options”) to employees of the Company and its operating subsidiaries. The November 2007 Options are exercisable for a period of five years from the date of vesting at an exercise price of \$1.11 per share, with vesting occurring over a period of two to three years, depending on seniority.

Semcan Inc.
Notes to Consolidated Financial Statements

As at December 31, 2008 and 2007

12. Share Capital - continued

The Company recorded stock compensation expense of \$377,580 during the year (2007 – \$62,930) in relation to the November 2007 Options. The following weighted average assumptions were used for the Black-Scholes valuation of the Options:

Risk-free interest rate	4.00%	Annualized volatility	104.00%
Expected life of options	5 years	Dividends	0.00%

The fair value of the unamortized November 2007 Options at December 31, 2008 is \$503,440. This amount is being amortized on a straight-line basis over the vesting period. The amount expensed to date has been recorded as contributed surplus.

On November 3, 2008, the Company granted an additional 250,000 stock options (the “November 2008 Options”) to directors and employees of the Company and its operating subsidiaries. The November 2008 Options are exercisable for a period of five years from the date of vesting at an exercise price of \$0.59 per share; those granted to directors (100,000 options) vested immediately, while those granted to employees (150,000 options) vest over a period of three years.

The Company recorded stock compensation expense of \$28,652 during the year (2007 – \$nil) in relation to the November 2008 Options. The following weighted average assumptions were used for the Black-Scholes valuation of the Options:

Risk-free interest rate	4.00%	Annualized volatility	45.00%
Expected life of options	5 years	Dividends	0.00%

The fair value of the unamortized November 2008 Options at December 31, 2008 is \$37,468. This amount is being amortized on a straight-line basis over the vesting period. The amount expensed to date has been recorded as Contributed Surplus.

A summary of the status of the Company’s option plan as at December 31, 2008 and December 31, 2007 is as follows:

	<u>December 31, 2008</u>		<u>December 31, 2007</u>	
	<u>Shares</u>	<u>Weighted Average Exercise Price</u>	<u>Shares</u>	<u>Weighted Average Exercise Price</u>
Outstanding at beginning of year	2,285,000	\$0.87	nil	n/a
Granted	250,000	\$0.59	2,285,000	\$0.87
Exercised	-	n/a	nil	n/a
Cancelled	(50,000)	\$1.11	nil	n/a
Expired	-	n/a	nil	n/a
Balance at end of year	2,485,000	\$0.84	2,285,000	\$0.87
Options exercisable at beginning of year	500,000	\$0.65	-	-
Vested during the year	100,000	\$0.59	500,000	\$0.65
Options exercisable at end of year	600,000	\$0.64	500,000	\$0.65
Weighted average fair value of options granted during the year		\$0.59		\$0.69

Semcan Inc.
Notes to Consolidated Financial Statements

As at December 31, 2008 and 2007

12. Share Capital - continued

The following table summarizes information about stock options outstanding at December 31, 2008:

Exercise Price	Options Outstanding		Options Exercisable		Fair Value at Time of Issue	Amount Amortized to December 31, 2008 (Contributed Surplus)	Unamortized Amount at December 31, 2008
	Number Outstanding	Weighted Average Remaining Contractual Life	Number Exercisable	Weighted Average Remaining Contractual Life			
\$0.65	1,200,000	38 months	500,000	38 months	\$641,599	\$610,401	\$31,198
\$1.11	1,035,000	46 months	-	46 months	943,950	440,510	503,440
\$0.59	250,000	58 months	100,000	58 months	66,120	28,652	37,468
	<u>2,485,000</u>				<u>\$1,651,669</u>	<u>\$1,079,563</u>	<u>\$572,106</u>

Stock Compensation Expense

The following table summarizes the stock compensation expense for the year:

	2008	2007
March 2007 Options	\$187,128	\$423,273
November 2007 Options	377,580	62,930
November 2008 Options	28,652	-
Common shares	6,030	-
	<u>\$599,390</u>	<u>\$486,203</u>

Warrants

The terms of the Company's warrants are as follows:

Warrants	Number Outstanding	Price per Common Share	Expiry Date
Issued on December 21, 2006	1,615,370	\$0.40	December 21, 2009 (i)
Issued on July 23, 2007	2,960,300	\$1.25	January 23, 2009
Issued on August 15, 2007	1,150,750	\$1.25	February 15, 2009
Issued on August 23, 2007	55,617	\$1.25	February 23, 2009
Issued on April 22, 2008	2,198,775	\$1.35	October 22, 2010
Issued on May 30, 2008	217,800	\$1.35	November 30, 2010
Total outstanding	<u>8,198,612</u>		

- i. These warrants were originally issued with an expiry date of December 21, 2008. The Company extended the expiry to December 21, 2009 after receiving regulatory approval.

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12. Share Capital - continued

	Number Outstanding	Price per Unit (Common Share + ½ Warrant)	Expiry Date
Broker Warrants			
Issued on July 23, 2007	414,442	\$0.90	January 23, 2009
Issued on August 15, 2007	161,105	\$0.90	February 15, 2009
Issued on August 23, 2007	7,786	\$0.90	February 23, 2009
Issued on April 22, 2008	307,828	\$0.95	October 22, 2010
Issued on May 30, 2008	30,492	\$0.95	November 30, 2010
Total outstanding	<u>921,653</u>		
Grand total outstanding	<u>9,120,265</u>		

13. Net Change in Working Capital Balances Other than Cash and Cash Equivalents

For the years ended December 31	2008	2007
Changes in working capital balances other than cash and cash equivalents (continuing operations):		
Accounts receivable	\$ (2,736,289)	1,593,915
Inventory	(373,551)	94,275
Prepaid expenses and other assets	41,872	(445,269)
Deferred contract costs and unbilled revenue	(753,069)	(1,226,388)
Accounts payable and accrued liabilities	4,366,310	79,147
Deferred revenue	(14,736)	878,552
Income taxes	65,740	(471,593)
	<u>596,277</u>	<u>502,639</u>

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14. Segmented Information

The Company's core businesses fall into two categories: Engineering & Design, and Distribution & Product Development. The Engineering & Design segment derives the majority of its revenue from system design and provision of equipment for bulk materials handling systems used primarily in water treatment and emission control applications. This segment has operations in North America and the United Kingdom, and segmented information is given for each of these markets. Engineering & Design North America includes the operations of Semco, Transfer Bulk Systems, Inc. and EPT. Since the latter has been classified as a discontinued operation held for sale as at December 31, 2008 (see Note 17), its results are shown as a new segment, Soil Remediation. Engineering & Design United Kingdom is comprised of the operations of Naston, which is classified as a discontinued operation held for sale as at December 31, 2008 (see Note 17).

The Distribution & Product Development segment derives the majority of its revenue from the sale of after-market automobile parts and precision machinery and equipment through the company's subsidiary, Nucleus. This subsidiary was sold subsequent to December 31, 2008 (see Note 21(a)).

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Company eliminates intersegment revenues and expenses. Segment profit (loss) is measured prior to the consideration of amortization, interest, minority interest and stock compensation expense.

Year ended December 31, 2008	Continuing Operations		Discontinued Operations			Corporate	Consolidated
	Engineering & Design, North America	Engineering & Design, United Kingdom	Soil Remediation	Distribution & Product Development			
Revenue from external customers	29,338,241	29,958,644	8,534,093	16,111,824	-	83,942,802	
Segment profit (loss) before amortization, interest, income taxes and stock compensation expense	3,566,451	(838,676)	684,188	1,043,897	(1,691,535)	2,764,325	
Amortization:							
Amortization of intangible asset relating to acquired order backlog	1,198,749	632,630	138,483	-	-	1,969,862	
Other amortization	729,278	491,833	113,243	219,974	18,998	1,573,326	
Interest expense	703,538	8,489	2,373	305,631	639,538	1,659,570	
Stock compensation expense	-	-	-	-	599,390	599,390	
Segment profit (loss) before income taxes	934,886	(1,971,628)	430,089	518,292	(2,949,461)	(3,037,823)	
Income tax provision (recovery)	288,000	(349,762)	97,986	15,838	-	52,062	
Net income before provision for loss on sale of discontinued operations	646,886	(1,621,866)	332,103	502,454	(2,949,461)	(3,089,884)	
Non-controlling interest	-	-	-	4,967	-	4,967	
Provision for loss on sale of discontinued operations	-	-	-	(5,176,863)	-	(5,176,863)	
Net income (loss)	646,886	(1,621,866)	332,103	(4,669,442)	(2,949,461)	(8,261,780)	
Property and equipment additions	917,143	627,244	62,247	1,873,871	15,859	3,496,364	
Goodwill and intangible assets	8,098,090	9,709,941	2,454,551	-	-	20,262,582	
Total assets	19,548,151	19,697,413	5,243,502	7,698,861	95,803	52,283,730	

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14. Segmented Information - continued

Year ended December 31, 2007	Continuing	Discontinued Operations					Consolidated
	Operations	Engineering & Design, North America	Engineering & Design, United Kingdom	Soil Remediation	Distribution & Product Development	Corporate	
Revenue from external customers	14,164,839	-	-	11,284,656	13,484	25,462,979	
Segment profit (loss) before amortization, interest, income taxes and stock compensation expense	1,645,758	-	-	1,079,131	(802,509)	1,922,380	
Amortization	377,988	-	-	271,980	9,094	659,062	
Interest expense	57,602	-	-	249,130	153,046	459,778	
Stock compensation expense and minority interest	-	-	-	-	485,806	485,806	
Segment profit (loss) before income taxes	1,210,168	-	-	558,021	(1,450,455)	317,734	
Income tax provision (recovery)	(88,622)	-	-	18,688	-	(69,934)	
Net income	1,298,790	-	-	539,333	(1,450,455)	387,668	
Property and equipment additions	83,380	-	-	42,846	56,769	182,995	
Goodwill and intangible assets	8,268,074	-	-	3,455,540	-	11,723,614	
Total assets	18,408,140	-	-	10,332,446	91,661	28,832,247	

The sales revenue of the Engineering & Design North America segment includes sales of \$10,940,068 (2007 - \$1,534,861) in the United States by the Company's subsidiaries, Semco, ZMI Portec Inc., Transfer Bulk Systems, Inc. and EPT. All other sales are Canada-based.

The total assets of the Engineering & Design North America segment includes assets of \$8,944,014 (2007 - \$311,197) in the United States owned by the Company's subsidiaries ZMI Portec Inc., Transfer Bulk Systems, Inc. and EPT. All other assets are Canada-based.

At December 31, 2008, the Company had accounts receivable from six customers (2007 – one customer) each of which represents greater than 10% of its total accounts receivable. The balances relating to two of these customers are included in amounts classified as discontinued operations.

During the year, the Company earned revenues from one customer (2007 – nil) which represented greater than 10% of its total revenues. This customer is served by one of the businesses classified as discontinued operations.

As at December 31, 2008 and 2007

15. Commitments

The Company's minimum commitments, principally under leases for its premises, are as follows:

	Total	Discontinued Operations	Continuing Operations
2009	\$ 723,010	\$ 230,622	\$ 492,388
2010	644,027	200,838	443,189
2011	396,557	194,721	201,836
2012	378,501	194,721	183,780
2013	155,984	62,360	93,624
Thereafter	-	-	-
	<u>\$ 2,298,079</u>	<u>\$ 883,262</u>	<u>\$ 1,414,817</u>

The Company has the following commitments noted in Note 11:

- (i) The vendor of Stanco Projects Ltd. is entitled to additional consideration of up to \$477,000 provided that the business achieves certain yearly performance targets. If these performance targets are met, the Company will be obliged to pay a total of \$477,000 plus interest at 6% per annum on July 24, 2009.
- (ii) The vendor of EPT is entitled to additional consideration of up to US\$200,000 provided that the business achieves certain yearly performance targets. If these performance targets are met, the Company will be obliged to pay a total of US\$200,000 in equal instalments on January 31, 2009 and January 31, 2010. The determination of the amount payable on January 31, 2009 has not been completed; therefore no amount has been accrued at December 31, 2008. EPT has been classified as a discontinued operation in these consolidated financial statements (Note 17), and it is anticipated that the Company will remain liable for the contingent consideration in the event of a sale.
- (iii) The vendor of Naston is entitled to additional consideration of up to £300,000 provided that the business achieves certain yearly performance targets. If these performance targets are met, the Company will be obliged to pay a total of £300,000 in equal instalments on June 30, 2009 and June 30, 2010. Naston has been classified as a discontinued operation in these consolidated financial statements (Note 17), and it is anticipated that the Company will remain liable for the contingent consideration in the event of a sale.

Prior to the acquisition of Stanco by the Company, Stanco purchased a performance bond of \$168,227 to secure a one-year warranty commitment expiring in January 2009 related to a municipal project. This bond is guaranteed by the former principals of Stanco.

Prior to the acquisition of Naston by the Company, Naston purchased the following performance bonds which are guaranteed by the former principal of Naston:

- (i) £67,780 (approximately \$137,431), expiring February 28, 2010; and
- (ii) €14,922 (approximately \$171,498), expiring upon the customer's operational acceptance of the facility.

Upon the purchase of Naston, the Company agreed to indemnify the former principal of Naston for any claim against the performance bonds.

As at December 31, 2008 and 2007

16. Related Party Transactions

Related party transactions during the year were:

- (a) During 2008, the Company paid or accrued a total of \$542,596 (2007 - \$490,000) to a shareholder for services provided, comprised of \$99,996 (2007 - \$90,000) as a retainer for advisory services (including strategic and legal advice) and \$442,600 (2007 - \$400,000) of fees earned with respect to representation and completion of the Company's acquisition of EPT, Naston, TEC Automotive Industries Inc., certain assets of 600 Equipment Group Limited, and certain assets of ZMI Portec.
- (b) During 2008, the Company paid rent of \$98,400 (2007 - \$41,000) for its corporate office at 365 Adelaide Street East, Toronto. The landlord is a company controlled by the Company's chairman.
- (c) During 2008, the Company obtained a loan of \$4,000,000 maturing July 20, 2008 from the Company's chairman and two companies controlled by a director. The Company incurred an arrangement fee of \$200,000 upon the completion of the loan, which was added to the principal owing under the loan. The proceeds of the loan were used to complete the acquisition of Naston Limited. Effective July 20, 2008, the Company exercised its right to convert the loan to a three year term in exchange for a further fee of \$110,000. During the initial term expiring July 20, 2008, the interest rate was 7.75% per annum, payable monthly. Upon conversion, the interest rate became prime plus 3% per annum, payable monthly. The loan is secured by a General Security Agreement granted by Semcan and Naston. The Company accrued or paid interest of \$219,635 on the loan during the year.
- (d) During 2008, the Company obtained a three-year term loan of \$150,000 from a company controlled by the spouse of the Company's Chief Financial Officer. The Company incurred an arrangement fee of \$1,500 upon the completion of the loan, which was added to the principal amount owing under the loan. The proceeds of the loan were used to fund capital expenditures. The interest rate is prime plus 3% per annum, and principal is payable in equal monthly instalments of \$4,208. The Company accrued or paid interest of \$2,607 on the loan during the year.

17. Discontinued Operations

In November 2008, the Company decided to pursue the sale of certain of its operating businesses in order to focus its efforts on the core environmental engineering business and also to reduce its debt load. The assets, liabilities and operations of these businesses are classified as discontinued operations in these consolidated financial statements. The businesses so identified and the related circumstances are as follows:

(i) Nucleus

The Company announced the sale of this subsidiary, which constitutes the Distribution & Product Development segment in Note 14, on November 28, 2008. The decision to sell Nucleus was made for three reasons: i) Nucleus' business does not fit with the Company's core engineering business; ii) the current state of the credit markets are such that the Company believed it prudent to reduce its debt load by the approximately \$6,500,000 being assumed by the purchaser, of which approximately \$2,480,000 was classified as current at December 31, 2008, and iii) due to the state of the credit markets, the Company could not refinance the \$2,000,000 promissory note due to the former owners of Ken-Co Industries Ltd., which came due on February 28, 2009.

The sale of Nucleus was completed on April 27, 2009. Accordingly, its assets and liabilities have been classified as current.

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As at December 31, 2008 and 2007

17. Discontinued Operations - continued

(ii) Naston

The Company began pursuing the sale of this subsidiary in November 2008, and is actively working on the consummation of a sale.

Naston constitutes the Engineering & Design, United Kingdom segment in Note 14. The decision to sell Naston has been made to allow the Company to realize cash which will be used to pay down debt.

(iii) EPT

The Company began pursuing the sale of this subsidiary in November 2008, and listed it for sale with an agent on January 19, 2009.

As a consequence of the decision to sell EPT, its results have been reported as a separate segment in Note 14. The decision to sell EPT was made in order to generate cash to pay down debt.

The following chart shows the details of the amounts shown in the assets and liabilities of discontinued operations on the consolidated balance sheet as at December 31, 2008:

As at December 31, 2008	Nucleus	Naston	EPT	Total
Current assets:				
Cash and cash equivalents	\$105,719	\$1,934,713	\$513,147	\$2,553,579
Accounts receivable	1,732,600	5,620,211	538,555	7,891,366
Work in progress	-	1,637,669	1,184,444	2,822,113
Inventory	2,827,454	-	-	2,827,454
Prepaid expenses and other assets	393,571	55,134	185,511	634,216
Current portion of intangible assets	-	253,034	163,661	416,695
Property and equipment	2,639,517	-	-	2,639,517
Current assets of discontinued operations	7,698,861	9,500,761	2,585,318	19,784,940
Long-lived assets:				
Goodwill and other intangible assets	-	9,709,941	2,454,551	12,164,492
Property and equipment	-	486,711	203,633	690,344
Long-lived assets of discontinued operations	-	10,196,652	2,658,184	12,854,836

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As at December 31, 2008 and 2007

17. Discontinued Operations - continued

As at December 31, 2008	Nucleus	Naston	EPT	Total
Current liabilities:				
Bank indebtedness	1,340,000	-	-	1,340,000
Accounts payable and accrued liabilities	975,386	10,738,964	786,407	12,500,757
Deferred revenue	-	1,223,271	4,798	1,228,069
Income taxes payable	246,308	-	199,147	445,455
Future income taxes	-	153,929	-	153,929
Due to vendor for working capital	-	-	111,371	111,371
Current portion of notes payable	2,718,423	-	17,815	2,736,238
Long-term debt	2,418,660	-	-	2,418,660
Current liabilities of discontinued operations	<u>7,698,777</u>	<u>12,116,164</u>	<u>1,119,538</u>	<u>20,934,479</u>
Long term liabilities:				
Notes payable	-	-	27,480	27,480
Long-term liabilities of discontinued operations	<u>-</u>	<u>-</u>	<u>27,480</u>	<u>27,480</u>
Future income taxes of discontinued operations	<u>84</u>	<u>1,020,099</u>	<u>318,054</u>	<u>1,338,237</u>
Net assets of discontinued operations	<u>\$ -</u>	<u>\$6,561,150</u>	<u>\$3,778,430</u>	<u>\$10,339,580</u>

The following chart shows the details of the amounts shown in the assets and liabilities of discontinued operations on the consolidated balance sheet as at December 31, 2007:

As at December 31, 2007	Nucleus	Naston	EPT	Total
Current assets:				
Cash and cash equivalents	\$281,104	-	-	\$281,104
Accounts receivable	1,420,464	-	-	1,420,464
Inventory	2,031,954	-	-	2,031,954
Prepaid expenses and other assets	29,740	-	-	29,740
Property and equipment	3,113,643	-	-	3,113,643
Goodwill and other intangible assets	3,455,541	-	-	3,455,541
Current assets of discontinued operations	<u>10,332,446</u>	<u>-</u>	<u>-</u>	<u>10,332,446</u>
Current liabilities:				
Accounts payable and accrued liabilities	765,699	-	-	765,699
Income taxes payable	184,244	-	-	184,244
Future income taxes	857,018	-	-	857,018
Current portion of notes payable	2,000,000	-	-	2,000,000
Long-term debt	2,666,667	-	-	2,666,667
Current liabilities of discontinued operations	<u>6,473,628</u>	<u>-</u>	<u>-</u>	<u>6,473,628</u>
Net assets of discontinued operations	<u>\$3,858,818</u>	<u>-</u>	<u>-</u>	<u>\$3,858,818</u>

Semcan Inc.
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As at December 31, 2008 and 2007

17. Discontinued Operations - continued

The following balances relating to the results of operations of the discontinued operations have been segregated and presented separately as discontinued in the consolidated statements of (loss) income and comprehensive (loss) income for the years ended December 31, 2008 and December 31, 2007:

For the year ended December 31, 2008	Nucleus	Naston	EPT	Total
Revenue	\$16,111,824	\$29,958,644	\$8,534,093	\$54,604,561
Income (loss) before income taxes	\$443,170	\$(1,896,506)	\$430,089	\$(1,023,247)
Provision for (recovery of) income taxes				
Current	66,372	(95,648)	159,953	130,677
Future	(50,534)	(254,114)	(61,967)	(366,615)
	15,838	(349,762)	97,986	(235,938)
Income (loss) from discontinued operations before non-controlling interest	427,332	(1,546,744)	332,103	(787,309)
Non-controlling interest	4,967	-	-	4,967
(Loss) income from discontinued operations	432,299	(1,546,744)	332,103	(782,342)
Provision for loss on sale of discontinued operations	(5,176,863)	-	-	(5,176,863)
(Loss) income from discontinued operations	\$(4,744,564)	\$(1,546,744)	\$332,103	\$(5,959,205)
For the year ended December 31, 2007	Nucleus	Naston	EPT	Total
Revenue	\$11,284,655	-	-	\$11,284,655
Income (loss) before income taxes	558,020	-	-	558,020
Provision for (recovery of) income taxes				
Current	184,244	-	-	184,244
Future	(165,556)	-	-	(165,556)
	18,688	-	-	18,688
Income from discontinued operations before non-controlling interest	539,332	-	-	539,332
Non-controlling interest	397	-	-	397
Income from discontinued operations	\$539,729	-	-	\$539,729

Semcan Inc.
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17. Discontinued Operations - continued

The Company's discontinued operations have term loans and mortgages outstanding, which are summarized below:

Term Bank Debt	<u>2008</u>	<u>2007</u>
Committed reducing term facility, bearing interest at prime plus 1%, repayable in monthly principal payments of \$12,500 plus interest. This facility is due in March 2012 and is secured by land and buildings at 1070 Heritage Road, Burlington, Ontario, 1150 Heritage Road, Burlington, Ontario and 96 Queen Street, Langton, Ontario (see Note 11(d)).	\$ 1,000,330	\$ 2,125,000
Committed reducing term facility, bearing interest at prime plus 1%, repayable in monthly principal payments of \$6,667 plus interest. This facility is due in January 2013 and is secured by land and buildings at 5220 General Road, Mississauga, Ontario (see Note 11(d)).	1,126,663	-
Committed reducing term facility, due March 2010, bearing interest at prime plus 1%, repayable in monthly principal payments of \$20,833 plus interest. Secured by a general security agreement provided by a subsidiary of the Company (see Note 11(d)).	<u>291,667</u>	<u>541,667</u>
	\$ 2,418,660	\$ 2,666,667

The Company's discontinued operations also have the following outstanding notes payable:

Notes Payable	<u>2008</u>	<u>2007</u>
Promissory notes owing to the previous owners of Ken-Co Industries Ltd. ("Ken-Co"), due February 28, 2009, secured by the non-voting shares of Nucleus and bearing interest at 6%; issued as a result of the Ken-Co acquisition. Under the terms of the sale of Nucleus (see Note 21(a)), this obligation was assumed and paid by the purchaser.	\$ 2,000,000	\$ 2,000,000
Promissory notes with face value of \$725,000 owing to 600 Group Equipment Limited, due January 31, 2009, unsecured and interest-free; issued as a result of the purchase of certain assets. The carrying value of the notes has been discounted using an interest rate of 7% per annum.	718,423	-
Automobile loan due September 22, 2011, secured, bearing interest at 7% per annum, repayable in monthly instalments of principal and interest of US\$1,319.	45,295	-
Total	<u>2,763,718</u>	<u>2,000,000</u>
Less: Portion due within one year	<u>2,736,238</u>	<u>-</u>
	\$ 27,480	\$ 2,000,000

As at December 31, 2008 and 2007

18. (Loss) Earnings Per Share

The calculation of basic (loss) earnings per share is based on the weighted average number of shares outstanding. The number of shares for the diluted earnings per share was calculated as follows:

	2008	2007
Weighted average number of shares used in basic earnings per share	<u>29,527,355</u>	<u>20,617,071</u>
Dilutive potential of Standard Warrants	-	1,000,127
Dilutive potential of Broker Warrants	-	122,807
Dilutive potential of options	-	212,389
Weighted average number of shares used in dilutive earnings per share	<u>29,527,355</u>	<u>21,952,394</u>
Net income (loss) for the year from continuing operations	\$ (2,302,575)	\$ (152,061)
Net income (loss) for the year from discontinued operations	\$ (5,959,205)	\$ 539,729
Net income (loss) for the year	\$ (8,261,780)	\$ 387,668
Earnings (loss) per share – Basic		
Continuing operations	\$ (0.078)	\$ (0.007)
Discontinued operations	\$ (0.202)	\$ 0.026
Earnings (loss)	\$ (0.280)	0.019
Earnings (loss) per share – Diluted		
Continuing operations	\$ (0.078)	\$ (0.007)
Discontinued operations	\$ (0.202)	\$ 0.025
Earnings (loss)	\$ (0.280)	\$ 0.018

19. Financial Risk Management

(a) Overview

The Company has exposure to credit risk, liquidity risk and market risk. The Company's board of directors has overall responsibility for the establishment and oversight of the Company's risk management framework.

(b) Credit risk

Credit risk is the risk of financial loss to the Company if a customer fails to meet its contractual obligations. This risk arises from the following sources:

- i. The Company's accounts receivable. The carrying amount of this financial asset represents the maximum credit exposure; and
- ii. In the Engineering & Design segment, from the possibility that a customer might cancel a contract on which the Company has started work. The amount of work performed or goods provided which have not been paid for at the time of cancellation represents the maximum credit exposure.

As at December 31, 2008 and 2007

19. Financial Risk Management - continued

To minimize the risk related to accounts receivable, the Company has adopted a credit policy under which each new customer is analyzed individually for creditworthiness before the Company's standard payment terms and conditions are offered. The Company's exposure to credit risk with its customers is influenced mainly by the individual characteristics of each customer. When available, the Company reviews credit bureau ratings and financial information for each new customer. The majority of the Company's customers have been long-standing customers of the operating divisions and those divisions have suffered minimal losses from bad debts in the past.

In the Engineering & Design segment, the Company invoices customers regularly to convert deferred contract costs and unbilled revenue to accounts receivable as quickly as possible, based on the terms of the contracts.

The Company establishes an allowance for doubtful accounts which represents its estimate of incurred losses in respect of trade receivables. This allowance relates to individual account exposures. The allowance for doubtful accounts at December 31, 2008 is \$14,533 (2007 - \$11,422).

Accounts receivable are non-interest bearing and are due within periods of 30 to 60 days, although Engineering & Design contracts occasionally allow the customer to hold back 10% of the contract value for one year after the completion of the contract. At December 31, 2008, the Company's accounts receivable were as follows:

Gross accounts receivable, including holdbacks of \$142,328	\$ 6,478,192
Allowance for doubtful accounts	<u>14,533</u>
Net accounts receivable	\$ <u>6,463,659</u>
Portion over 90 days	\$ 685,073
Portion over 90 days for which the vendor of Stanco remains responsible. If uncollectible, this amount reduces the amount due to the vendor for working capital.	<u>201,541</u>
Net exposure to over-90 days accounts receivable	\$ <u>483,532</u>

To minimize the risk related to contract cancellation, the Company negotiates progress payments from customers based on the achievement of milestones, and requests payment for major components prior to the shipping of the components. In addition, most contracts contain specific contract cancellation provisions which protect the Company in the event that a customer cancels a project.

(c) **Liquidity risk**

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity is to ensure that it will have sufficient liquidity to meet its liabilities when due without incurring unacceptable losses or risking damage to the Company's reputation. In the current year, the Company has defaulted on repayment of certain of its debt obligations (see Note 11). The Company has a plan in place to address liquidity risks, which is disclosed in Note 1 of the consolidated financial statements.

Semcan Inc.
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19. Financial Risk Management - continued

A summary of the maturities of the Company's obligations relating to ongoing operations is as follows:

All in \$000s	During 2009	During 2010	During 2011	During 2012	During 2013	Total
<u>Continuing Operations:</u>						
Bank indebtedness	\$1,280	-	-	-	-	\$1,280
Accounts payable and accrued liabilities	7,523	-	-	-	-	7,523
Income taxes payable	193	-	-	-	-	193
Due to vendor for working capital	289	-	-	-	-	289
Notes payable	4,907	1,907	606	12	8	7,440
Long- term debt	1,596	8	-	-	-	1,604
Total for continuing operations	\$15,788	\$1,915	\$606	\$12	\$8	\$18,329

A summary of the maturities of the Company's obligations relating to discontinued operations is as follows:

All in \$000s	Gross During 2009	Assumed by Purchaser of Nucleus (see Note 21(a))	Net During 2009	During 2010	Total
<u>Discontinued Operations:</u>					
Bank indebtedness	\$1,340	\$1,340	-	-	\$1,340
Accounts payable and accrued liabilities	12,501	975	11,526	-	12,501
Income taxes payable	445	246	199	-	445
Due to vendor for working capital	111	-	111	-	111
Current portion of notes payable	2,736	2,718	18	-	2,736
Long-term portion of notes payable	-	-	-	27	27
Current portion of long-term debt	480	480	-	-	480
Long-term portion of long-term debt	1,939	1,939	-	-	1,939
Total for discontinued operations	\$19,552	\$5,698	\$11,854	\$27	\$19,579

As at December 31, 2008 and 2007

19. Financial Risk Management - continued

The Company currently has a working capital deficiency of \$9,480,973. The Company's current liabilities for continuing operations include the following balances which do not represent an immediate cash requirement:

- (a) Deferred revenue of \$1,297,871; and
- (b) Future income tax liabilities of \$1,518,531.

The Company is working to improve this situation through the following initiatives:

- (a) Sale of Naston Limited and Enviro-Pro-Tech, Inc. (see Note 17); and
- (b) Seeking to refinance and/or renegotiate the maturity date of the \$3,000,000 demand loan due on May 12, 2009 owing to Westdale Construction Co. Ltd. with alternative financing and/or repayment arrangements.

(d) Market risk

- (i) Foreign exchange risk

Market risk is the risk that changes in market prices, such as foreign exchange rates and interest rates will affect the Company's income or the value of its financial instruments. Two of the Company's segments (Engineering & Design North America and Distribution & Product Development) market services and products in both Canada and the United States, and source inputs both from Canada and the United States. It is often possible to hedge the Company's position by sourcing products used in US dollar-denominated contracts from US suppliers. On a net basis, these segments are typically net accumulators of US dollars. To date, the Company has not entered into any currency hedging transactions, but will consider doing so if significant losses on foreign exchange fluctuations are foreseen.

The Engineering & Design United Kingdom segment markets services and products in both the United Kingdom and other countries, and sources inputs primarily from the United Kingdom. Most of its revenues and inputs are denominated in pounds sterling, hence it normally has a natural hedge against fluctuations in exchange rates. This segment also generates some revenue in US dollars and euros; to date, the Company has not entered into any currency hedging transactions for contracts denominated in these currencies.

At December 31, 2008 the Company's consolidated financial statements include the Canadian dollar equivalent of the following US dollar-denominated financial instrument balances:

Cash and cash equivalents	\$ 1,239,257
Accounts receivable	<u>7,096,234</u>
Total assets	<u>8,335,491</u>
Accounts payable and accrued liabilities	4,118,149
Notes payable	<u>396,512</u>
Total liabilities	<u>4,514,661</u>
Net exposure to US dollars	\$ <u><u>3,820,830</u></u>

If these balances had remained consistent throughout the year, a 10% strengthening (weakening) of the Canadian dollar against the US dollar would have decreased (increased) earnings for the year by \$382,048.

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19. Financial Risk Management - continued

At December 31, 2008 the Company's financial statements included the Canadian equivalent of the following pounds Sterling-denominated financial instrument balances:

Cash and cash equivalents	\$ 1,934,713
Accounts receivable	<u>5,620,211</u>
Total assets	<u>7,554,924</u>
Accounts payable	<u>10,738,964</u>
Total liabilities	<u>10,738,964</u>
Net exposure to pounds Sterling	\$ <u>(3,184,040)</u>

If these balances had remained consistent throughout the year, a 10% strengthening (weakening) of the Canadian dollar against pounds Sterling would have decreased (increased) earnings for the year by \$318,404.

(ii) Interest rate risk

The Company's revolving bank debt and term debt from continuing operations includes floating rate loans and fixed rate notes payable which arose from business acquisitions. The Company's position at December 31, 2008 is as follows:

Floating rate term loans	\$ 5,615,111
Floating rate operating loans	<u>1,280,000</u>
Total floating rate debt	<u>6,895,111</u>
Fixed-rate loans and notes payable	<u>3,020,372</u>
Interest-free loans and notes payable	<u>407,796</u>
Total term debt and operating loans	\$ <u>10,323,279</u>

If these balances had remained consistent throughout the year, an increase (decrease) of one percentage point in the interest rate (for example, a change in the prime lending rate from 3.50% to 4.50%) would decreased (increased) earnings for the year by \$68,951. This analysis assumes that all other variables, such as the amounts outstanding, remain constant.

(e) Fair value of financial instruments

The fair values of the financial assets and financial liabilities are determined as follows:

- (i) For cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, carrying amounts approximate fair value due to their short-term maturities;
- (ii) The fair value of long-term debt and notes payable approximate their carrying values because they bear interest at floating rates. The fair value of the fixed-rate promissory note owing to Westdale Construction Co. Ltd. approximates its carrying value. The fair value of the promissory note owing to the former owner of EPT approximates its carrying value due to its short maturity.

As at December 31, 2008 and 2007

20. Capital Management

The Company's objective is to maintain access to diverse and cost-effective sources of capital with which to finance its operations and its growth program. The Company seeks to maintain a balanced and flexible capital structure composed of the following elements:

- (i) Permanent equity to fund long-term assets and refinance vendor take-back notes upon their maturity;
- (ii) Term bank debt to fund property and equipment and business acquisitions. Term loans used to fund acquisitions are typically amortized over three years;
- (iii) Vendor take-back notes, which are important strategically as they focus vendors on performance of the acquired business over the initial one to two-year period;
- (iv) Revolving credit facilities, used to finance day-to-day working capital needs. The Company will occasionally use these facilities to help complete acquisitions, with the permission of the lender.

The Company manages its capital structure and makes changes to it in light of changes in economic conditions and the risk characteristics of the underlying assets. The Company will balance its overall capital structure through equity issues, issuance of debt, repayment of debt or by undertaking other activities as deemed appropriate in the specific circumstances. Current market conditions preclude further issues of equity, and the Company has suspended its acquisition program. At present, the Company's financing is structured such that a disproportionate amount of short-term debt is financing long-term assets. The Company is working to correct this situation, which has placed strain on working capital, through divestitures and refinancing of short-term obligations (see Notes 1 and 19(c)).

The terms of the Company's credit facilities include customary positive and negative covenants that can be categorized as externally imposed capital requirements. As at December 31, 2008, the Company was not in compliance with its obligations under the bank credit facilities (see Note 11).

21. Subsequent Events

a) Closing of Sale of Nucleus Distribution Inc.

On April 27, 2009, the Company closed the sale of Nucleus. The total proceeds were approximately \$6,500,000, comprised of the assumption of all of Nucleus' existing debt, as well as a \$2,000,000 promissory note owed by the Company to the former owners of Ken-Co Industries Ltd. The loss on the sale of Nucleus was \$5,176,863.

b) Claim against former owner of Naston

On March 20, 2009, the Company gave notice to the former owner of Naston of its intention to seek £365,026 under specific indemnities given under the original purchase agreement.

As at December 31, 2008 and 2007

21. Subsequent Events - continued

c) Loan from Westdale Construction Co. Ltd. (“Westdale”)

The Company has advised Westdale of its desire to extend the maturity date of the \$3,000,000 promissory note from May 12, 2009 to November 12, 2009. Westdale took the position that the Company did not provide the adequate notice required under the terms of the loan to exercise the extension privilege, and indicated that it requires repayment on May 12, 2009. On April 30, 2009, the Company signed an agreement with Westdale which provides a 3 month extension of the maturity date to August 12, 2009 in exchange for a \$50,000 fee, interest payable at 30% per annum for the extended period, and agreement by the Company that any cash available in Semcan Inc. is paid on a monthly basis toward the outstanding principal and interest of the promissory note..

22. Comparative Figures

Certain prior year comparative figures have been reclassified to conform to the current year’s consolidated financial statement presentation.