

**Semcan Inc.**  
**Consolidated Financial Statements**  
**For the interim three month and six month**  
**period ended June 30, 2008**  
**(Unaudited – Prepared by Management)**

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## **Notice to Reader**

The management of Semcan Inc. is responsible for the preparation of the accompanying interim consolidated financial statements. The interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada and are considered by management to present fairly the financial position, operating results and cash flows of the Company.

These interim financial statements have not been reviewed by an auditor. These interim consolidated financial statements are unaudited and include all adjustments, consisting of normal and recurring items, that management considers necessary for a fair presentation of the consolidated financial position, results of operations and cash flows.

“Signed”

Philip M. Jamieson  
Chairman and Chief Executive Officer

“Signed”

John Wilby  
Chief Financial Officer

September 15, 2008

**Semcan Inc.**  
**Consolidated Balance Sheets**

	<b>June 30, 2008 (Unaudited)</b>	December 31, 2007
<b>Assets</b>		
<b>Current</b>		
Cash and cash equivalents (Note 4)	\$ 4,220,951	\$ 3,900,223
Accounts receivable	14,220,747	5,701,504
Accounts receivable - holdbacks	506,055	-
Work in progress (Note 5)	6,090,272	1,374,996
Inventory (Note 6)	3,960,885	2,464,866
Backlog acquired (Note 7)	1,703,866	-
Prepaid expenses and other assets	1,953,507	659,112
<b>Total current assets</b>	<b>32,656,283</b>	<b>14,100,701</b>
<b>Goodwill</b> (Note 7)	7,826,476	3,652,935
<b>Other intangible assets</b> (Note 7)	13,694,561	8,070,680
<b>Property and equipment</b> (Note 8)	<b>5,897,624</b>	<b>3,568,646</b>
	<b>\$ 60,074,944</b>	<b>\$ 29,392,962</b>
<b>Liabilities and Shareholders' Equity</b>		
<b>Current</b>		
Bank indebtedness (Note 9)	\$ 1,980,000	\$ 190,000
Accounts payable and accrued liabilities	12,445,824	3,922,576
Deferred revenue	9,459,400	1,873,322
Income taxes payable	1,282,834	311,896
Future income taxes	1,499,041	938,927
Due to vendor for working capital	623,130	1,669,609
Current portion of long-term debt (Note 11)	1,497,202	1,422,055
Current portion of notes payable (Note 11)	3,258,761	-
<b>Total current liabilities</b>	<b>32,046,192</b>	<b>10,328,385</b>
<b>Long-term debt</b> (Note 11)	4,248,399	3,867,910
<b>Notes payable</b> (Note 11)	4,339,299	2,000,000
<b>Future income taxes</b>	4,637,564	2,583,980
<b>Non-controlling interest</b>	15,524	4,986
	<b>45,286,978</b>	<b>18,785,261</b>
<b>Shareholders' Equity</b>	<b>14,787,966</b>	<b>10,607,701</b>
	<b>\$ 60,074,944</b>	<b>\$ 29,392,962</b>

Approved on behalf of the Board:

\_\_\_\_\_  
Director

\_\_\_\_\_  
Director

**Semcan Inc.**

**Consolidated Statements of Income (Loss) and Comprehensive Income (Expense)**  
**(Unaudited)**

	For the three month period ended June 30, 2008	For the three month period ended June 30, 2007	For the six month period ended June 30, 2008	For the six month period ended June 30, 2007
<b>Revenue</b>	<b>\$ 24,426,046</b>	\$ 5,629,600	<b>\$ 34,617,535</b>	\$ 8,851,496
<b>Cost of sales</b>	<b>18,125,976</b>	3,692,363	<b>24,897,679</b>	5,894,143
<b>Amortization of acquired backlog (Note 2(d))</b>	<b>1,309,064</b>	-	<b>1,309,064</b>	-
<b>Total cost of sales</b>	<b>19,435,040</b>	3,692,363	<b>26,206,743</b>	5,894,143
<b>Gross margin</b>	<b>4,991,006</b>	1,937,237	<b>8,410,792</b>	2,957,353
<b>Expenses</b>				
Selling, general and administrative	4,575,104	1,203,602	6,819,127	1,929,854
Loss (gain) on foreign exchange	(37,098)	76,520	(128,441)	66,483
	<b>4,538,006</b>	1,280,122	<b>6,690,686</b>	1,996,337
<b>Income (loss) before the following:</b>	<b>453,000</b>	657,115	<b>1,720,106</b>	961,016
Interest expense	437,467	141,950	619,768	169,047
Amortization	434,746	48,910	726,176	72,224
Stock compensation expense	141,177	37,428	282,354	317,243
	<b>1,013,390</b>	228,288	<b>1,628,298</b>	558,514
<b>Income (loss) before income taxes and minority interest</b>	<b>(560,390)</b>	428,827	<b>91,808</b>	402,502
<b>Provision for (recovery of) income taxes</b>				
Current	496,206	249,143	806,206	249,143
Future	(485,596)	-	(552,579)	-
	<b>10,610</b>	249,143	<b>253,627</b>	249,143
Non-controlling interest	7,049	-	10,701	-
<b>Net income (loss) for the period</b>	<b>(578,049)</b>	\$ 179,684	<b>(172,520)</b>	\$ 153,359
<b>Other comprehensive income (expense):</b>				
Currency translation adjustments	14,053	-	14,053	-
<b>Comprehensive income (expense)</b>	<b>\$ (563,996)</b>	\$ 179,684	<b>\$ (158,467)</b>	\$ 153,359

**Semcan Inc.**

**Consolidated Statement of Shareholders' Equity and Comprehensive Earnings**  
**(Unaudited)**

<b>Six months ended June 30, 2008</b>	<b>Share Capital (Note 12)</b>	<b>Contributed Surplus (Note 12)</b>	<b>Retained Earnings (Deficit)</b>	<b>Accumulated Other Comprehensive Earnings</b>	<b>Total Shareholders' Equity</b>
<b>Balance, December 31, 2006</b>	\$ 2,325,770	\$ -	\$ (435,928)	\$ -	\$ 1,889,842
Issue of shares	287,730	-	-	-	287,730
Stock options	-	317,243	-	-	317,243
Net income for the period	-	-	153,359	-	153,359
<b>Balance, June 30, 2007</b>	<b>\$ 2,613,500</b>	<b>\$ 317,243</b>	<b>\$ (282,569)</b>	<b>\$ -</b>	<b>\$ 2,648,174</b>
<b>Balance, December 31, 2007</b>	\$ 10,169,758	\$ 486,203	\$ (48,260)	\$ -	\$ 10,607,701
Issue of shares	4,056,378	-	-	-	4,056,378
Stock options	-	282,354	-	-	282,354
Net income (loss) for the period	-	-	(172,520)	-	(172,520)
Other comprehensive income (expense) for the period:					
Currency translation adjustments	-	-	-	14,053	14,053
<b>Balance, June 30, 2008</b>	<b>\$ 14,226,136</b>	<b>\$ 768,557</b>	<b>(220,780)</b>	<b>14,053</b>	<b>\$ 14,787,966</b>

**Semcan Inc.**  
**Consolidated Statements of Cash Flows**  
**(Unaudited)**

	For the three month period ended June 30, 2008	For the three month period ended June 30, 2007	For the six month period ended June 30, 2008	For the six month period ended June 30, 2007
<b>Cash flows from operating activities</b>				
Net income (loss) for the period	(578,049)	\$ 179,684	(172,520)	\$ 153,359
Adjustments for:				
Amortization of property, plant and equipment and intangible assets other than value of acquired order backlog	434,746	48,910	726,176	72,224
Amortization of intangible assets related to acquired order backlog	1,309,064	-	1,309,064	-
Future income taxes	(485,596)	-	(552,579)	-
Minority interest	7,049	-	10,701	-
Arrangement fee capitalized to principal	200,000	-	200,000	-
Stock compensation expense	141,177	37,428	282,354	317,243
	<u>1,028,391</u>	<u>266,022</u>	<u>1,803,196</u>	<u>542,826</u>
Changes in working capital balances other than cash and equivalents (Note 13)	765,767	(556,210)	(1,625,043)	54,126
<b>Total cash flows from operating activities</b>	<u>1,794,158</u>	<u>(290,188)</u>	<u>178,153</u>	<u>596,952</u>
<b>Cash flows from financing activities</b>				
Advances from (payments to) shareholders	-	(20,000)	-	30,000
Proceeds from (repayment of) long-term borrowings - net	3,715,467	(155,217)	5,157,968	2,874,783
Borrowings from (repayment of) operating bank line - net	(780,000)	(60,000)	1,790,000	1,160,000
Payment of amounts due to vendors for working capital	(30,051)	-	(1,153,552)	-
Issue of capital stock – net of issuance cost	4,056,378	5,000	4,056,378	5,000
	<u>6,961,794</u>	<u>(230,217)</u>	<u>9,850,794</u>	<u>4,069,783</u>
<b>Cash flows from investing activities</b>				
Purchase of property and equipment	(326,489)	(15,123)	(2,281,264)	(23,878)
Business acquisitions, net of cash	(4,410,710)	(74,295)	(7,414,736)	(5,703,878)
Loan receivable	-	20,238	-	22,234
	<u>(4,737,199)</u>	<u>(69,180)</u>	<u>(9,696,000)</u>	<u>(5,705,522)</u>
<b>Increase (decrease) in cash and equivalents</b>	<b>4,018,753</b>	<b>(589,585)</b>	<b>332,947</b>	<b>(1,038,787)</b>
Decrease due to changes in foreign exchange	(12,465)	-	(12,219)	-
Cash and equivalents, beginning of period	<u>214,663</u>	<u>1,008,613</u>	<u>3,900,223</u>	<u>1,457,815</u>
<b>Cash and equivalents, end of period</b>	<u>\$4,220,951</u>	<u>\$ 419,028</u>	<u>\$4,220,951</u>	<u>\$ 419,028</u>
<b>Supplemental Cash Flow Information:</b>				
Interest paid	\$ 257,651	\$ 101,950	\$ 605,367	\$ 129,047
Taxes paid	187,500	-	187,500	-

During the six months ended June 30, 2008, the Company completed an acquisition where a promissory note was issued as consideration in addition to the cash paid on closing. In total, a promissory note of \$272,728 (2007 - \$nil) was issued to vendors (Note 3).

**As at June 30, 2008 and 2007**

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## **1. Nature of Operations**

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Semcan Inc. (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.

Semcan operates two core businesses: Engineering & Design, and Distribution & Product Development. The businesses are owned by subsidiaries: Semco Systems Limited ("Semco") and Naston Limited ("Naston") operate the Engineering & Design businesses in North America and the United Kingdom, respectively, while Nucleus Distribution Inc. (formerly Nucleus Financial Network Inc.) ("Nucleus") operates the Distribution & Product Development business. Semco has a wholly-owned US subsidiary, Transfer Bulk Systems, Inc., which in turn owns a Florida corporation called Enviro-Pro-Tech, Inc.

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## **2. Significant Accounting Policies**

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The consolidated interim financial statements of the Company should be read in conjunction with the annual audited consolidated financial statements as these interim financial statements do not conform in all respects to the requirements of Canadian generally accepted accounting principles for annual financial statements. These consolidated interim financial statements follow the same accounting policies and methods of application as the annual consolidated financial statements for the year ended December 31, 2007, except that the Company has adopted the following Canadian Institute of Chartered Accountants ("CICA") guidelines effective January 1, 2008:

- (a) Section 1535 - Capital Disclosures. 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.
  - (b) Section 3862 - Financial Instruments Disclosure and Section 3863 - Financial Instruments 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.
  - (c) Section 3031 – Inventories. Section 3031 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 writedowns to net realizable value when there is a subsequent increase in the value of the inventories is now required. The cost of the inventories should be based on a first-in, first-out or a weighted average cost formula. 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.
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**As at June 30, 2008 and 2007**

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## **2. Significant Accounting Policies - continued**

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The standard is effective for fiscal years beginning on or after January 1, 2008. The adoption of these standards did not have a material impact on the Company's results.

The following accounting policies are applicable to the current period and were not applicable to previous periods:

- (d) The Company recognizes intangible assets related to customer order backlogs acquired as part of business acquisitions. These intangible assets are amortized over the period of the underlying customer contracts rather than the 10 year period the Company uses to amortize other intangible assets.
- (e) The Company has two self-sustaining foreign subsidiaries, Naston Limited and Enviro-Pro-Tech, Inc. Foreign currency balances for these subsidiaries are translated on the following bases:
  - (i.) assets and liabilities are translated at the rate of exchange prevailing at the consolidated balance sheet date; and
  - (ii.) revenue and expenses are translated at the average rate of exchange for the period.

Gains or losses arising on translation are credited or charged to Accumulated Other Comprehensive Earnings, which is a component of Shareholders' Equity. Any balances in this account are charged to income upon the disposition of the investment in the self-sustaining foreign subsidiary.

- (f) The Company's new subsidiary, Naston Limited, owns a 50% interest in a joint venture. The accounts of the joint venture have been proportionately consolidated in these financial statements.

The following future accounting standards are not applicable to the current period:

- (g) In February 2008, the CICA issued Handbook Section 3064, Goodwill and Intangible Assets effective for interim and annual periods relating to fiscal years beginning on or after October 1, 2008. Section 3064, which replaces Section 3062, Goodwill and Other Intangible Assets, and Section 3450, Research and Development Costs, establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets. This new standard is effective for the Company's interim and annual financial statements for the period commencing January 1, 2009. The Company is assessing the impact of the new standard on its financial statements.
- (h) In February 2008, the Canadian Accounting Standards Board confirmed that the use of International Financial Reporting Standards ("IFRS") will be required for Canadian publicly accountable enterprises for years beginning on or after January 1, 2011. The Company is currently evaluating the impact of adopting IFRS.

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**Semcan Inc.**  
**Notes to Consolidated Financial Statements**  
**(Unaudited)**

As at June 30, 2008 and 2007

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### 3. Acquisitions

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(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 effective January 31, 2008.

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

*Net assets acquired:*

Non-cash working capital	\$ 690,039
Property and equipment	161,771
Intangible asset – acquired order backlog <sup>(1)</sup>	302,144
Other intangible assets <sup>(1)</sup>	1,008,819
Goodwill <sup>(1)</sup>	1,515,889
Future tax liability <sup>(1)</sup>	<u>( 412,166)</u>
Net assets acquired	<u>\$ 3,266,496</u>

<sup>(1)</sup> The intangible asset of \$302,144 consisting of acquired order backlog will be amortized for accounting purposes over the life of the underlying orders. The intangible asset of \$1,008,819 consisting of customer lists will be amortized for accounting purposes over 10 years, which is its estimated useful life. Since the acquisition of EPT was a share purchase, the intangible asset is not deductible for tax purposes. This non-deductibility gives rise to a future income tax liability of \$412,166, with a corresponding increase in goodwill of \$412,166. 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 vendors are 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.

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**Semcan Inc.**  
**Notes to Consolidated Financial Statements**  
**(Unaudited)**

As at June 30, 2008 and 2007

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**3. Acquisitions - continued**

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- (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.

**(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 thirty years and enjoys 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 preliminary purchase price allocation is as follows:

*Net assets acquired:*

Non-cash working capital	\$ ( 3,550,896)
Property and equipment	94,486
Intangible asset – acquired order backlog <sup>(1)</sup>	1,467,786
Other intangible assets <sup>(1)</sup>	6,369,334
Goodwill <sup>(1)</sup>	2,194,394
Future tax liability <sup>(1)</sup>	<u>( 2,194,394)</u>
Net assets acquired	<u>\$ 4,380,710</u>

<sup>(1)</sup> The intangible asset of \$1,467,786 consisting of acquired order backlog will be amortized for accounting purposes over the life of the underlying orders. The intangible asset of \$6,369,334 consisting of customer lists will be amortized for accounting purposes over 10 years, which is its estimated useful life. Since the acquisition of Naston was a share purchase, the intangible asset is not deductible for tax purposes. This non-deductibility gives rise to a future income tax liability of \$2,194,394, with a corresponding increase in goodwill of \$2,194,394. 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>\$ 4,380,710</u>

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**Semcan Inc.**  
**Notes to Consolidated Financial Statements**  
**(Unaudited)**

**As at June 30, 2008 and 2007**

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**3. Acquisitions - continued**

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- (i) The vendors are entitled to up to £300,000 (approximately \$608,280) 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 ninety days after the first and second anniversary of the effective date.
- (c) **Acquisition of Stanco Projects Ltd.**

During the current period, the Company finalized the purchase price allocation for the purchase of Stanco Projects Ltd., 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. As a result of this change in estimate, an adjustment to amortization amounting to \$585,578 was recorded in the current period (see Note 2(d)).

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**4. Cash and Cash Equivalents**

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Cash and cash equivalents include a term deposit of \$275,553 which is pledged by the Company to one of its banks to support a letter of credit (see Note 9).

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**5. Work in Progress**

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Work in progress of \$6,090,272 (December 31, 2007 - \$1,374,996) represents the value of work performed on engineering contracts for which the Company has not yet billed customers.

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**6. Inventory**

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Inventory is comprised of the following:

	<b>June 30, 2008</b>	December 31, 2007
Raw materials	\$ 209,948	\$ 270,213
Work in progress	31,019	37,598
Finished goods	3,587,319	2,035,375
Parts and supplies	132,599	121,680
	<b>\$ 3,960,885</b>	<b>\$ 2,464,866</b>

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**Semcan Inc.**  
**Notes to Consolidated Financial Statements**  
**(Unaudited)**

As at June 30, 2008 and 2007

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**6. Inventory - continued**

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The inventory value shown above is net of a provision for obsolescence of \$467,771. The amount of inventories included in cost of sales during the quarter ended June 30, 2008 is \$4,845,943.

Inventory does not include work in progress related to engineering and design contracts.

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**7. Goodwill and Other Intangible Assets**

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

	<u>(Unaudited)</u> <u>June 30, 2008</u>	<u>December 31,</u> <u>2007</u>
<b>Goodwill</b>	\$ <u>7,826,476</u>	\$ <u>3,652,935</u>
<b>Backlog acquired:</b>		
Acquired order backlog	\$ <u>3,012,930</u>	\$ -
Accumulated amortization	<u>(1,309,064)</u>	-
	\$ <u>1,703,866</u>	\$ -
<b>Other intangible assets</b>		
Customer relationships	\$ <u>14,657,153</u>	\$ 8,522,000
Accumulated amortization	<u>(962,592)</u>	(451,320)
	\$ <u>13,694,561</u>	\$ <u>8,070,680</u>

**Semcan Inc.**  
**Notes to Consolidated Financial Statements**  
**(Unaudited)**

As at June 30, 2008 and 2007

**8. Property and Equipment**

	Cost	Accumulated Amortization	(Unaudited) June 30, 2008 Net Book Value
Land	\$ 1,780,410	\$ -	\$ 1,780,410
Building	2,910,408	103,391	2,807,017
Machinery and equipment	767,600	452,595	315,005
Furniture and fixtures	646,638	328,676	317,962
Automotive equipment	263,795	91,476	172,319
Computer equipment	936,658	439,423	497,235
Test lab equipment	105,076	97,400	7,676
	<u>\$ 7,410,585</u>	<u>\$ 1,512,961</u>	<u>\$ 5,897,624</u>

	Cost	Accumulated Amortization	December 31, 2007 Net Book Value
Land	\$ 1,012,500	\$ -	\$ 1,012,500
Building	1,907,500	50,620	1,856,880
Machinery and equipment	662,820	413,777	249,043
Furniture and fixtures	458,206	293,551	164,655
Automotive equipment	181,956	57,779	124,177
Computer equipment	524,376	371,513	152,863
Test lab equipment	105,076	96,548	8,528
	<u>\$ 4,852,434</u>	<u>\$ 1,283,788</u>	<u>\$ 3,568,646</u>

Subsequent to June 30, 2008, the Company entered into a conditional agreement of purchase and sale with respect to one of its properties (see Note 20(c)).

**Semcan Inc.**  
**Notes to Consolidated Financial Statements**  
**(Unaudited)**

**As at June 30, 2008 and 2007**

**9. Bank Indebtedness**

The Company has access to various revolving lines of credit to a maximum of \$3,274,302 at June 30, 2008 (December 31, 2007 - \$2,981,497), on which the drawn amount is \$1,980,000 at June 30, 2008 (December 31, 2007 - \$190,000). Amounts drawn are repayable on demand and bear interest at prime plus 0.5%. The lines are secured by general security agreements provided by certain subsidiaries of the Company, and are based on certain margin limits.

The Company has US\$221,338 of outstanding letters of credit issued to customers as performance guarantees as at June 30, 2008 (December 31, 2007 - US\$272,760). A term deposit of \$275,553 (December 31, 2007 - \$500,000) included within cash and cash equivalents is pledged to one of the Company's banks to support these letters of credit. In addition, the Company has US\$421,614 (December 31, 2007 - US\$421,614) of other letters of credit outstanding, which are guaranteed by the Export Development Corporation.

**10. Income Taxes**

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

	<b>June 30, 2008</b>	June 30, 2007
Income before income taxes	\$ <u>124,537</u>	\$ 402,502
Income tax provision at statutory rates	\$ 41,720	\$ 145,384
<u>Increase (decrease) related to:</u>		
Non-deductible amortization of stock options	94,589	114,588
Provincial and foreign rate differentials	(15,010)	-
Other permanent differences:		
Losses not recognized for tax purposes	101,283	-
Non-deductible meals and entertainment expenses	15,075	-
Other	<u>15,970</u>	<u>(10,829)</u>
Net reconciling items	<u>211,907</u>	103,759
Provision for income taxes	\$ <u><u>253,627</u></u>	\$ <u><u>249,143</u></u>

The Company and certain of its subsidiaries have non-capital tax loss carry-forwards of \$2,967,721, which expire between 2008 and 2027. The benefit of these income tax losses has not been recorded in these financial statements.

**Semcan Inc.**  
**Notes to Consolidated Financial Statements**  
**(Unaudited)**

As at June 30, 2008 and 2007

**11. Long-term Debt and Notes Payable**

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

<b>Term Bank Debt</b>	<b>(Unaudited)</b> <b>June 30,</b> <b>2008</b>	December 31, 2007
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, ON, 1150 Heritage Road, Burlington, ON and 96 Queen Street, Langton, ON.	<b>\$ 2,050,000</b>	\$ 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, ON.	<b>1,166,665</b>	-
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.	<b>2,083,333</b>	2,583,333
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.	<b>416,667</b>	541,667
Loan payable, due August 2010, bearing interest at 2.9%. Repayable in monthly payments of principal and interest of \$1,056.	<b>26,096</b>	32,430
Loan payable, due September 2008, non-interest bearing. Repayable in monthly instalments of \$837.	<b>2,840</b>	7,535
Total	<b>5,745,601</b>	5,289,965
Less: Portion due within one year	<b>1,497,202</b>	1,422,055
	<b>\$ 4,248,399</b>	\$ 3,867,910

**Semcan Inc.**  
**Notes to Consolidated Financial Statements**  
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As at June 30, 2008 and 2007

**11. Long-term Debt and Notes Payable - continued**

The Company also has the following promissory notes outstanding:

<b>Notes Payable</b>	<b>(Unaudited)</b> <b>June 30,</b> <b>2008</b>	December 31, 2007
	<u>          </u>	<u>          </u>
Debenture owing to Philip Jamieson, 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 3(b) and 16(c).	<b>4,200,000</b>	-
Promissory notes owing to the previous owners of 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.	<b>2,000,000</b>	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.	<b>696,462</b>	-
Promissory note owing to the previous owners of Stanco, due July 24, 2008, unsecured and bearing interest at 6%; issued as a result of contingent consideration being earned with respect to the Stanco acquisition. The recording of this note resulted in an increase of \$423,000 in goodwill. This note was repaid on July 24, 2008.	<b>423,000</b>	-
Promissory note with face value of US\$300,000 owing to the previous owners of Enviro-Pro-Tech, Inc., 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 3(a)).	<b>278,598</b>	-
Total	<b>7,598,060</b>	2,000,000
Less: Portion due within one year	<b>3,258,761</b>	-
	<b>\$ 4,339,299</b>	<b>\$ 2,000,000</b>

**As at June 30, 2008 and 2007**

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## **11. Long-term Debt and Notes Payable - continued**

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Under the terms of the Stanco acquisition, the Company will be required to pay \$477,000 on July 24, 2009 upon Stanco meeting certain earnings targets. This contingent consideration will be recorded in the financial statements as additional goodwill when the contingent element is resolved.

Under the terms of the EPT acquisition, the Company will be required to pay US\$200,000 (approximately \$203,940) 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 financial statements as additional goodwill when the contingent element is resolved.

Under the terms of the Naston acquisition, the Company will be required to pay £300,000 (approximately \$608,280) 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 financial statements as additional goodwill when the contingent element is resolved.

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 June 30, 2008 the Company was not in compliance with two of the covenants of its bank borrowing agreements due to i) the intangible assets recorded as part of the acquisitions (see Note 3), and ii) funding of Semcan Inc's operating expenses by one of its subsidiaries.

The Company received a waiver with respect to its non-compliance with both covenants at June 30, 2008. One of the covenants was amended for the September 30, 2008, December 31, 2008, March 31, 2009 and June 30, 2009 reporting periods, while the terms of the other covenant were not amended. As a result of the Company's expectation of compliance with both the amended and non-amended covenants, the term loans of \$5,716,665 continue to be classified as noncurrent. Should the Company fail to comply with any one of these or other covenants, the lenders would have the option to accelerate repayment of these outstanding balances or enforce their security rights against the Company and accordingly, these amounts would be reclassified to current liabilities.

The terms of the Debenture owing to Philip Jamieson, Tricaster Holdings Inc. and Combined Telecom Inc. provide that non-compliance with the covenants under the bank borrowing agreements constitutes an event of default with respect to the Debenture. This event of default has been waived by the lenders.

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## **12. Share Capital**

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- (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 June 30, 2008.

**Semcan Inc.**  
**Notes to Consolidated Financial Statements**  
**(Unaudited)**

**As at June 30, 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	3,618,775	3,734,974
Issuance of broker warrants (ii)	338,320	321,404	-	-	321,404
<b>Balance, June 30, 2008</b>	<b>9,150,265</b>	<b>2,324,667</b>	<b>31,048,267</b>	<b>11,901,469</b>	<b>14,226,136</b>

- 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 eighteen months.

Total gross proceeds of the issuance were \$4,591,493, and net proceeds after deducting agent's 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 (4) months plus one (1) 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.

- 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 eighteen months.

**As at June 30, 2008 and 2007**

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## **12. Share Capital - continued**

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The fair value assigned to the Warrants issued as part of the private placement was \$116,199 (net of issue costs) using the following assumptions under the Black-Scholes valuation model:

Risk free interest rate	4.00%
Expected life of warrants	18 months
Annualized volatility	38.18%
Exercise price	\$1.35

The fair value assigned to the Broker Warrants was \$0.95 per warrant. This amount is considered to be fair market value on the date of issue since the Broker Warrants have the same rights associated with the Units taken up by investors on the closing date. The Broker Warrants are subject to a lockup agreement expiring four (4) months plus one (1) day after the closing date.

### **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 \$93,564 during the six months ended June 30, 2008 (2007 - \$317,243) 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%
Expected life of options	5 years
Annualized volatility	115.54%
Dividends	0.00%

The fair value of the unamortized March 2007 Options at June 30, 2008 is \$124,762. 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.

The Company recorded stock compensation expense of \$188,790 during the six months ended June 30, 2008 (2007 - nil) 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%
Expected life of options	5 years
Annualized volatility	104.00%
Dividends	0.00%

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**Semcan Inc.**  
**Notes to Consolidated Financial Statements**  
**(Unaudited)**

As at June 30, 2008 and 2007

**12. Share Capital - continued**

The fair value of the unamortized November 2007 Options at June 30, 2008 is \$692,230. 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 of June 30, 2008 and December 31, 2007 is as follows:

	(Unaudited) June 30, 2008		December 31, 2007	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	2,285,000	\$0.87	nil	n/a
Granted	nil	n/a	2,285,000	\$0.87
Exercised	nil	n/a	nil	n/a
Cancelled	50,000	n/a	nil	n/a
Expired	nil	n/a	nil	n/a
<b>Balance at end of period</b>	<b>2,235,000</b>	<b>\$0.86</b>	2,285,000	\$0.87
<b>Options exercisable at end of period</b>	<b>500,000</b>	<b>\$0.65</b>	500,000	\$0.65
<b>Weighted average fair value of options granted during the year</b>	<b>n/a</b>		<b>\$0.69</b>	

The following table summarizes information about stock options outstanding at June 30, 2008:

Exercise Price	Options Outstanding		Options Exercisable	
	Number Outstanding	Weighted Average Remaining Contractual Life	Number Exercisable	Weighted Average Remaining Contractual Life
\$0.65	1,200,000	4-5 years	500,000	4 years
\$1.11	1,035,000	5 years	nil	5 years

**Semcan Inc.**  
**Notes to Consolidated Financial Statements**  
**(Unaudited)**

As at June 30, 2008 and 2007

**12. Share Capital - continued**

**Warrants**

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

	<b>Number Outstanding</b>	<b>Price per Common Share</b>	<b>Expiry Date</b>
<b>Warrants</b>			
Issued on December 21, 2006	1,645,370	\$0.40	December 21, 2008
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>8,228,612</u>		

	<b>Number Outstanding</b>	<b>Price per Unit (Common Share + ½ Warrant)</b>	<b>Expiry Date</b>
<b>Broker Warrants</b>			
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><u>9,150,265</u></u>		

**Semcan Inc.**  
**Notes to Consolidated Financial Statements**  
**(Unaudited)**

As at June 30, 2008 and 2007

**13. Changes in Working Capital Balances Other Than Cash and Equivalents**

	<b>For the three month period ended June 30, 2008</b>	For the three month period ended June 30, 2007	<b>For the six month period ended June 30, 2008</b>	For the six month period ended June 30, 2007
Changes in working capital balances other than cash and equivalents:				
Accounts receivable	<b>(825,208)</b>	(243,731)	<b>(4,049,952)</b>	(46,321)
Inventory	<b>(291,620)</b>	134,266	<b>(1,496,019)</b>	(215,912)
Prepaid expenses	<b>(188,514)</b>	51,880	<b>(536,708)</b>	89,978
Work in progress	<b>(934,524)</b>	-	<b>(714,113)</b>	-
Accounts payable	<b>2,533,526</b>	(512,226)	<b>3,066,946</b>	22,982
Deferred revenue	<b>6,537</b>	(123,519)	<b>1,329,564</b>	65,947
Income taxes	<b>465,570</b>	137,120	<b>775,239</b>	137,452
	<b><u>765,767</u></b>	<u>(556,210)</u>	<b><u>(1,625,043)</u></b>	<u>54,126</u>

**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 Systems Limited, Transfer Bulk Systems, Inc. and Enviro-Pro-Tech, Inc. Engineering & Design United Kingdom includes the operations of Naston Limited.

The Distribution & Product Development segment derives the majority of its revenue from the sale of precision machinery and equipment and after-market components through its extensive North American distribution network through the company's subsidiary, Nucleus Distribution Inc.

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, income taxes, minority interest and stock compensation expense.

**Semcan Inc.**  
**Notes to Consolidated Financial Statements**  
**(Unaudited)**

As at June 30, 2008 and 2007

**14. Segmented Information** - continued

6 months ended June 30, 2008 ( All amounts in Cdn \$ )	Engineering & Design			Distribution & Product Development	Corporate	Consolidated
	North America	United Kingdom	Total			
Revenue from external customers	15,364,804	11,489,087	26,853,891	7,763,644	-	34,617,535
Segment profit (loss) before amortization, interest, taxes and stock compensation expense	1,821,652	1,292,382	3,114,034	883,388	(968,252)	3,029,170
<b>Amortization:</b>						
Amortization of intangible asset relating to acquired order backlog	897,497	411,567	1,309,064	-	-	1,309,064
Other amortization	336,019	193,026	529,045	188,605	8,526	726,176
Interest expense	-	-	-	-	619,768	619,768
Stock compensation expense and minority interest	-	-	-	-	293,055	293,055
Segment profit (loss) before income taxes	588,136	687,789	1,275,925	694,783	(1,889,601)	81,107
Income tax provision	-	-	-	-	253,627	253,627
Net income for the period	-	-	-	-	-	(172,520)
Property and equipment additions	144,438	253,883	398,321	1,869,086	13,857	2,281,264
Goodwill and intangible assets	10,394,449	9,460,714	19,855,163	3,369,740	-	23,224,903
Total assets	20,354,233	25,194,521	45,548,754	14,327,503	198,687	60,074,944
6 months ended June 30, 2007 ( All amounts in Cdn \$ )	Engineering & Design			Distribution & Product Development	Corporate	Consolidated
	North America	United Kingdom	Total			
Revenue from external customers	4,235,389	-	4,235,389	4,610,680	5,427	8,851,496
Segment profit (loss) before amortization, interest, taxes and stock compensation expense	469,444	-	469,444	793,638	(302,066)	961,016
Amortization	21,939	-	21,939	50,285	-	72,224
Interest expense	5,871	-	5,871	105,411	57,765	169,047
Stock compensation expense and minority interest	-	-	-	-	317,243	317,243
Segment profit (loss) before income taxes	441,634	-	441,634	637,942	(677,074)	402,502
Income tax provision	-	-	-	-	249,143	249,143
Net income for the period	-	-	-	-	-	153,359
Property and equipment additions	20,103	-	20,103	3,775	-	23,878
Goodwill and intangible assets	-	-	-	2,424,002	-	2,424,002
Total assets	1,877,210	-	1,877,210	9,498,480	417,438	11,793,128

**Semcan Inc.**  
**Notes to Consolidated Financial Statements**  
**(Unaudited)**

**As at June 30, 2008 and 2007**

**14. Segmented Information - continued**

The sales revenue of the Engineering & Design North America segment includes sales of \$3,551,788 (2007 - \$729,277) in the United States by the Company's subsidiaries, Transfer Bulk Systems, Inc. and Enviro-Pro-Tech, Inc. All other sales are Canadian-based.

The total assets of the Engineering & Design North America segment includes assets of \$4,995,162 (2007 - \$372,050) in the United States owned by the Company's subsidiaries Transfer Bulk Systems, Inc. and Enviro-Pro-Tech, Inc. All other assets are Canadian-based.

At June 30, 2008, the Company had an amount receivable from one customer (2007 – none) which represents greater than 10% of its total accounts receivable.

<b>3 months ended June 30, 2008</b> ( All amounts in Cdn \$ )	<b>Engineering &amp; Design</b>			<b>Distribution &amp; Product Development</b>	<b>Corporate</b>	<b>Consolidated</b>
	<b>North America</b>	<b>United Kingdom</b>	<b>Total</b>			
Revenue from external customers	8,713,135	11,489,087	20,202,222	4,223,824	-	24,426,046
Segment profit (loss) before amortization, interest, taxes and stock compensation expense	872,702	1,292,382	2,165,084	285,751	(688,771)	1,762,064
<b>Amortization:</b>						
Amortization of intangible asset relating to acquired order backlog	897,497	411,567	1,309,064	-	-	1,309,064
Other Amortization	136,264	193,026	329,290	100,874	4,582	434,746
Interest expense	-	-	-	-	437,467	437,467
Stock compensation expense and minority interest	-	-	-	-	148,226	148,226
Segment profit (loss) before income taxes	(161,059)	687,789	526,730	184,877	(1,279,046)	(567,439)
Income tax provision	-	-	-	-	10,610	10,610
Net income for the period	-	-	-	-	-	(578,049)
Property and equipment additions	90,907	253,883	344,790	(31,196)	12,895	326,489
Goodwill and intangible assets	10,394,449	9,460,714	19,855,163	3,369,740	-	23,224,903
Total assets	20,354,233	25,194,521	45,548,754	14,327,503	198,687	60,074,944

**Semcan Inc.**  
**Notes to Consolidated Financial Statements**  
**(Unaudited)**

As at June 30, 2008 and 2007

**14. Segmented Information** - continued

3 months ended June 30, 2007 ( All amounts in Cdn \$ )	Engineering & Design			Distribution & Product Development	Corporate	Consolidated
	North America	United Kingdom	Total			
Revenue from external customers	2,120,600	-	2,120,600	3,509,000	-	5,629,600
Segment profit (loss) before amortization, interest, taxes and stock compensation expense	257,915	-	257,915	558,003	(158,803)	657,115
Amortization	11,241	-	11,241	37,669	-	48,910
Interest expense	3,181	-	3,181	81,004	57,765	141,950
Stock compensation expense and minority interest					37,428	37,428
Segment profit (loss) before income taxes	243,493	-	243,493	439,330	(253,996)	428,827
Income tax provision	-	-	-	-	249,143	249,143
Net income for the period	-	-	-	-	-	179,684
Property and equipment additions	11,348	-	11,348	3,775	-	15,123
Goodwill and intangible assets	-	-	-	2,424,002	-	2,424,002
Total assets	1,877,210	-	1,877,210	9,498,480	417,438	11,793,128

The sales revenue of the Engineering and Design segment includes sales of \$2,658,789 (2007 - \$566,770) in the United States by the Company's subsidiary, Transfer Bulk Systems, Inc. All other sales are Canadian-based.

**15. Commitments**

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

2009	\$	713,010
2010		644,027
2011		396,557
2012		378,501
2013		155,984
Thereafter		-
Total	\$	<u>2,288,079</u>

**As at June 30, 2008 and 2007**

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## **15. Commitments - continued**

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The Company has the following commitments noted in Note 11:

- (i) The vendors of Stanco Projects Ltd. are 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 vendors of Enviro-Pro-Tech, Inc. are 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.
- (iii) The vendors of Naston Limited are 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.

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:

- i. £67,780 (approximately \$137,431), expiring February 28, 2010; and
- ii. €14,922 (approximately \$184,346), expiring upon the customer's operational acceptance of the facility.

These bonds are guaranteed by the former principal of Naston.

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## **16. Related Party Transactions**

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Related party transactions during the period were:

- (a) During the quarter, the Company paid or accrued a total of \$233,000 owing to a shareholder for services provided, comprised of \$25,000 (2007 - \$25,000) as a retainer for advisory services (including strategic and legal advice) and \$208,000 of fees earned with respect to representation and completion of the Company's acquisition of Naston Limited.
  - (b) During the quarter, the Company paid rent of \$24,600 (2007 - \$nil) for its corporate office at 365 Adelaide Street East, Toronto. The landlord is a company controlled by the Company's chairman. The terms of this lease reflect market rates, which were confirmed by an independent real estate consultant at the inception of the lease.
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**Semcan Inc.**  
**Notes to Consolidated Financial Statements**  
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As at June 30, 2008 and 2007

**16. Related Party Transactions - continued**

- (c) During the quarter, 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 loan bears interest at 7.75% per annum, payable monthly. Upon conversion, the interest rate becomes prime + 3% per annum, payable monthly. The loan is secured by a General Security Agreement granted by Semcan Inc. and Naston Limited. The Company has accrued and expensed interest of \$60,857 on the loan for the period up to June 30, 2008.

**17. Earnings (Loss) Per Share**

The calculation of basic earnings (loss) 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:

	<b>3 months ended June 30, 2008</b>	3 months ended June 30, 2007	<b>6 months ended June 30, 2008</b>	6 months ended June 30, 2007
Weighted average number of shares used in basic earnings per share	<b>26,356,659</b>	16,447,501	<b>26,356,659</b>	16,447,501
Dilutive potential of Warrants	<b>973,790</b>	1,645,370	<b>973,790</b>	1,645,370
Dilutive potential of Broker Warrants	<b>168,367</b>	-	<b>168,367</b>	-
Dilutive potential of options	<b>47,619</b>	-	<b>47,619</b>	-
Weighted average number of shares used in dilutive earnings per share	<b>27,546,435</b>	18,092,871	<b>27,546,435</b>	18,092,871
Net income (loss) for the period	\$ <b>(578,049)</b>	\$ 179,684	\$ <b>(172,520)</b>	\$ 153,359
Earnings (loss) per share:				
Basic	\$ <b>(0.022)</b>	\$ 0.011	\$ <b>(0.007)</b>	\$ 0.009
Diluted	\$ <b>(0.022)</b>	\$ 0.010	\$ <b>(0.007)</b>	\$ 0.008

Stock options and warrants to purchase common shares are not included in the computation of diluted net loss per share in periods when net losses are recorded, given that they are anti-dilutive.

**As at June 30, 2008 and 2007**

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

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 work in progress to accounts receivable as quickly as possible.

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.

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 June 30, 2008, the Company's accounts receivable was as follows:

Gross accounts receivable, including holdbacks of \$506,055	\$ 15,344,775
Allowance for doubtful accounts	617,973
Net accounts receivable	\$ <u>14,726,802</u>
Portion aged over 90 days	\$ 2,688,135
Portion of over 90 days accounts for which the vendor of Stanco remains responsible. If uncollectible, this amount reduces the amount due to the vendor for working capital.	253,000
Net exposure to over 90 days accounts	\$ <u>2,435,135</u>

**Semcan Inc.**  
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**As at June 30, 2008 and 2007**

**18. Financial Risk Management - continued**

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 always have sufficient liquidity to meet its liabilities when due without incurring unacceptable losses or risking damage to the Company's reputation.

A summary of the maturities of the Company's obligations is as follows:

<b>All in \$000s</b>	<b>During 2008</b>	<b>During 2009</b>	<b>During 2010</b>	<b>During 2011</b>	<b>During 2012</b>	<b>During 2013</b>	<b>Total</b>
Bank indebtedness	<b>\$1,980</b>	-	-	-	-	-	<b>\$1,980</b>
Accounts payable and accrued liabilities	<b>12,446</b>	-	-	-	-	-	<b>12,446</b>
Income taxes payable	<b>1,005</b>	-	-	-	-	-	<b>1,005</b>
Due to vendor for working capital	<b>623</b>	-	-	-	-	-	<b>623</b>
Notes payable	<b>423</b>	<b>2,835</b>	<b>140</b>	<b>4,200</b>	-	-	<b>7,598</b>
Long- term debt	<b>751</b>	<b>1,740</b>	<b>613</b>	<b>230</b>	<b>1,605</b>	<b>806</b>	<b>5,745</b>
<b>Total</b>	<b>\$17,228</b>	<b>\$4,575</b>	<b>\$753</b>	<b>\$4,430</b>	<b>\$1,605</b>	<b>\$806</b>	<b>\$29,397</b>

The Company currently has a working capital position of \$610,091, including \$1,703,866 of value assigned to acquired order backlogs. The Company intends to take steps to strengthen its working capital position over the balance of the year.

The Company's strategy includes the use of long-term debt and vendor take-back promissory notes in its capital structure, assuming an appropriate cost of capital. As existing debt approaches maturity, the Company will either refinance it with new debt or equity, depending on the state of the capital markets at the time.

The Company manages its liquidity risk by continuously monitoring forecast and actual gross profit and cash flows from operations.

**As at June 30, 2008 and 2007**

**18. Financial Risk Management - continued**

(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 in 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 has 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 June 30, 2008 the Company's financial statements included the Canadian equivalent of the following US dollar denominated balances:

Cash and cash equivalents	\$ 810,307
Accounts receivable	<u>3,818,614</u>
Total assets	<u>4,628,921</u>
Accounts payable	<u>1,669,109</u>
Notes payable	<u>278,598</u>
Total liabilities	<u>1,947,707</u>
Net exposure to US dollars	<u>\$ 2,681,214</u>

If these balances had remained consistent throughout the period, a 10% strengthening (weakening) of the Canadian dollar against the US dollar would have decreased (increased) earnings from operations for the period by \$268,100.

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**Semcan Inc.**  
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**As at June 30, 2008 and 2007**

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**18. Financial Risk Management - continued**

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At June 30, 2008 the Company's financial statements included the Canadian equivalent of the following pounds Sterling denominated balances:

Cash and cash equivalents	\$ 3,311,284
Accounts receivable	<u>6,400,695</u>
Total assets	<u>9,711,979</u>
Accounts payable	6,548,397
Income taxes payable	<u>784,375</u>
Total liabilities	<u>7,332,772</u>
Net exposure to pounds Sterling	\$ <u><u>2,379,207</u></u>

If these balances had remained consistent throughout the period, a 10% strengthening (weakening) of the Canadian dollar against the pound would have decreased (increased) earnings from operations for the period by \$237,921.

(ii) Interest rate risk

The Company's revolving bank debt and term debt includes floating rate loans and fixed rate notes payable which arose from business acquisitions. The Company's position at June 30, 2008 is as follows:

Floating rate term loans	\$ 5,716,665
Floating rate operating loans	<u>1,980,000</u>
Total floating rate debt	<u>7,696,665</u>
Fixed rate loans and notes payable	<u>6,649,096</u>
Interest-free loans and notes payable	<u>977,900</u>
Total term debt and operating loans	\$ <u><u>15,323,661</u></u>

If these balances had remained consistent throughout the period, an increase (decrease) of one percentage point in the interest rate (for example, a change in the prime lending rate from 5.25% to 6.25%) would have resulted in \$19,242 decrease (increase) in the earnings from operations of the Company for this period. 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, accounts receivable, accounts payable and accrued liabilities carrying amounts approximate fair value due to their short-term maturity;
- (ii) The fair value of notes payable approximate their carrying value as their effective interest rates approximate current market rates. In the case of interest-free notes payable, the Company has discounted the notes at approximate current market rates.

**As at June 30, 2008 and 2007**

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## **19. Capital Management**

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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 maintains 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 facility, 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 is working toward a centralized cash management structure. At present, cash management is performed at the subsidiary level, with cash balances of operating divisions consolidated daily.

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.

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 June 30, 2008, the Company was not in compliance with its obligations under the credit facilities (Note 11).

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## **20. Subsequent Events**

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### **(a) Acquisition of TEC Automotive Industries Inc.**

On July 2, 2008, the Company completed the purchase of TEC Automotive Industries Inc. ("TEC"), a distributor of automotive filters based in Concord, Ontario. The purchase price was \$685,141, subject to a working capital adjustment.

### **(b) Conversion of Loan from Related Parties**

On July 20, 2008, the Company exercised its right to convert the \$4,000,000 loan discussed in Note 16(c) to a three year term loan. A fee of \$110,000 was payable by the Company upon conversion.

### **(c) Conditional Sale of Property**

On September 12, 2008, the Company entered into an agreement of purchase and sale with respect to its property at 1150 Heritage Road, Burlington, ON. The agreement is conditional until September 26, 2008 on financing, a property inspection, and due diligence by the buyer. The carrying value of this property at June 30, 2008 amounted to \$1,169,700, with the conditional sale price amounting to \$975,000 resulting in an expected loss of \$194,700 if sold.

As at June 30, 2008 and 2007

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**20. Subsequent Events** - continued

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**(d) Funding Commitment**

Subsequent to June 30, 2008, certain shareholders committed funding of up to \$1,000,000 to assist the Company with its working capital requirements. This funding is available in the form of either subordinated debt or equity issuance, at the Company's discretion.

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**21. Comparatives**

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Certain comparatives have been reclassified to conform to the current period presentation.