**INTERNATIONAL ROAD DYNAMICS INC.**
Notice of No Auditor Review of Interim Condensed Consolidated Financial Statements
Period Ended February 29, 2012

The accompanying unaudited interim condensed consolidated financial statements of the Company have been prepared by and are the responsibility of the Company's management.

The Company's independent auditor has not performed a review of these financial statements in accordance with the standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

May 14, 2012

| | |
|---|---|
| [Signed] | [Signed] |
| Terry Bergan | Connie Wong, CA |
| Chief Executive Officer | Interim Chief Financial Officer |

# INTERNATIONAL ROAD DYNAMICS INC.

Interim Condensed Consolidated Statements of Financial Position
Unaudited

| Canadian dollars | Note | February 29, 2012 | November 30, 2011 | December 1, 2010 |
|---|---|---|---|---|
| | | | (note 17) | (note 17) |
| **Assets** | | | | |
| Current assets: | | | | |
| Cash and cash equivalents | | $ 920,361 | $ 917,161 | $ 667,724 |
| Accounts receivable | | 11,162,492 | 9,672,204 | 11,079,295 |
| Unbilled revenue | | 3,035,083 | 3,868,862 | 4,025,218 |
| Income taxes receivable | | 296,744 | 312,727 | 347,442 |
| Inventories | 4 | 6,770,921 | 6,873,808 | 7,187,770 |
| Prepaid expenses and deposits | | 675,094 | 784,963 | 601,811 |
| | | 22,860,695 | 22,429,725 | 23,909,260 |
| Property, plant and equipment | | 1,946,833 | 2,033,583 | 9,308,836 |
| Investment in XPCT | 5 | 4,582,581 | 4,781,709 | 5,118,780 |
| Investment tax credits recoverable | | 2,886,322 | 2,856,573 | 3,267,486 |
| Deferred taxes | | 770,307 | 618,556 | – |
| | | $ 33,046,738 | $ 32,720,146 | $ 41,604,362 |
| **Liabilities and Shareholders' Equity** | | | | |
| Current liabilities: | | | | |
| Short-term loans | 6 | 6,883,845 | $ 6,558,389 | $ 5,732,459 |
| Accounts payable and accrued liabilities | | 5,230,084 | 5,205,917 | 5,360,417 |
| Current portion of deferred revenue | | 2,910,582 | 2,332,143 | 2,500,007 |
| Current portion of long-term debt | 7 | 860,781 | 903,000 | 6,328,234 |
| | | 15,885,292 | 14,999,449 | 19,921,117 |
| Deferred revenue | | 292,660 | 324,674 | 535,404 |
| Long-term debt | 7 | – | 178,867 | – |
| Deferred taxes | | – | – | 73,453 |
| Shareholders' equity: | | | | |
| Share capital | 8 | 12,071,009 | 12,071,009 | 12,071,009 |
| Contributed surplus | | 266,318 | 262,900 | 246,587 |
| Retained earnings | | 4,409,437 | 4,922,356 | 8,398,874 |
| Accumulated other comprehensive income (loss) | | 122,022 | (39,109) | 357,918 |
| | | 16,868,786 | 17,217,156 | 21,074,388 |
| | | $ 33,046,738 | $ 32,720,146 | $ 41,604,362 |
| Commitments | 5, 12 | | | |

See accompanying notes to interim condensed consolidated financial statements.

**INTERNATIONAL ROAD DYNAMICS INC.**
Interim Condensed Consolidated Statements of Loss
Unaudited

| Canadian dollars | Note | Three months ended February 29, 2012 | Three months ended February 28, 2011 |
|---|---|---|---|
| | | | (note 17) |
| Sales | | $ 8,916,244 | $ 8,916,323 |
| Cost of sales | 9 | 6,554,597 | 6,765,995 |
| | | 2,361,647 | 2,150,328 |
| Administrative and marketing expenses | 9 | 2,419,261 | 2,370,189 |
| Research and development | 9 | 241,284 | 260,787 |
| Financing costs, net | 10 | 247,457 | 216,898 |
| Other expense (income) | | (13,704) | (2,451) |
| XPCT loss (income) | 5 | 73,446 | 59,758 |
| Loss before income tax recovery | | (606,097) | (754,853) |
| Income tax recovery | | (93,178) | (62,724) |
| Net loss | | $ (512,919) | $ (692,129) |
| Loss per share | 11 | | |
| Basic | | $ (0.04) | $ (0.05) |
| Diluted | | $ (0.04) | $ (0.05) |

Interim Condensed Consolidated Statements of Comprehensive Loss
Unaudited

| Canadian dollars | Three months ended February 29, 2012 | Three months ended February 28, 2011 |
|---|---|---|
| | | (note 17) |
| Net loss | $ (512,919) | $ (692,129) |
| Other comprehensive income (loss) | | |
| Unrealized foreign currency translation gains (losses) | 161,131 | (312,949) |
| Total comprehensive loss | $ (351,788) | $ (1,005,078) |

See accompanying notes to interim condensed consolidated financial statements.

## INTERNATIONAL ROAD DYNAMICS INC.

Interim Condensed Consolidated Statements of Changes in Shareholders' Equity
Unaudited

| | | Attributable to equity holders of the Company | | | | |
|---|---|---|---|---|---|---|
| Canadian dollars | Note | Share capital | Contributed surplus | Retained earnings | Accumulated other comprehensive income (loss) | Total shareholders' equity |
| Balance at December 1, 2010 | 17 | $ 12,071,009 | $ 246,587 | $ 8,398,874 | $ 357,918 | $ 21,074,388 |
| Net loss | | - | - | (692,129) | - | (692,129) |
| Unrealized foreign currency translation losses | | - | - | - | (312,949) | (312,949) |
| Share-based compensation | 8 | - | 3,882 | - | - | 3,882 |
| Balance at February 28, 2011 | | $ 12,071,009 | $ 250,469 | $ 7,706,745 | $ 44,969 | $ 20,073,192 |
| | | | | | | |
| Balance at December 1, 2011 | 17 | $ 12,071,009 | $ 262,900 | $ 4,922,356 | $ (39,109) | $ 17,217,156 |
| Net loss | | - | - | (512,919) | - | (512,919) |
| Unrealized foreign currency translation gains | | - | - | - | 161,131 | 161,131 |
| Share-based compensation | 8 | - | 3,418 | - | - | 3,418 |
| Balance at February 29, 2012 | | $ 12,071,009 | $ 266,318 | $ 4,409,437 | $ 122,022 | $ 16,868,786 |

Accumulated other comprehensive income (loss) is comprised solely of unrealized foreign currency translation gains and losses.

See accompanying notes to interim condensed consolidated financial statements.

# INTERNATIONAL ROAD DYNAMICS INC.

Interim Condensed Consolidated Statements of Cash Flows
Unaudited

| | | Three months ended | |
|---|---|---|---|
| Canadian dollars | Note | February 29, 2012 | February 28, 2011 |
| | | | (note 17) |
| Cash flows from (used in): | | | |
| Operations: | | | |
| Net loss | | $ (512,919) | $ (692,129) |
| Adjustments for: | | | |
| Deferred revenue | | 546,425 | (750,834) |
| Depreciation | 9 | 158,157 | 214,236 |
| Share-based compensation | 8 | 3,418 | 3,882 |
| XPCT loss (income) | 5 | 73,446 | 59,758 |
| Interest expense | 10 | 108,255 | 167,368 |
| Income tax recovery | | (93,178) | (62,724) |
| Investment tax credits recoverable | | (29,749) | (34,267) |
| Income taxes paid | | (42,590) | (120,607) |
| Other operating items | 14 | (149,831) | 377,357 |
| | | 61,434 | (837,960) |
| Investing: | | | |
| Additions to property, plant and equipment | | (102,056) | (42,383) |
| | | (102,056) | (42,383) |
| Financing: | | | |
| Interest paid | | (108,255) | (167,368) |
| Short-term loans | | 325,456 | 1,567,809 |
| Repayment of long-term debt | | (221,086) | (921,490) |
| | | (3,885) | 478,951 |
| Decrease in cash and cash equivalents | | (44,507) | (401,392) |
| Exchange rate changes on foreign currency cash balances | | 47,707 | (8,847) |
| Cash and cash equivalents, beginning of period | | 917,161 | 667,724 |
| Cash and cash equivalents, end of period | | $ 920,361 | $ 257,485 |

See accompanying notes to interim condensed consolidated financial statements.

## 1. Reporting entity

International Road Dynamics Inc. is incorporated under the *Canada Business Corporations Act*. The address of its registered office is 702 43rd Street East, Saskatoon, Saskatchewan, Canada, S7K 3T9. The interim condensed consolidated financial statements as at and for the period ended February 29, 2012 comprise International Road Dynamics Inc. and its subsidiaries (together the "Company") and the Company's interest in its associate. The Company is a highway traffic management technology company specializing in supplying products and integrated systems to the global Intelligent Transportation Systems (ITS) industry.

## 2. Basis of preparation

(a) Statement of compliance

These interim condensed consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and, in particular, IAS 34, *Interim Financial Reporting*. These are the Company's first interim condensed consolidated financial statements prepared in accordance with IFRS and IFRS 1, *First-time Adoption of International Financial Reporting Standards* has been applied. The interim condensed consolidated financial statements do not include all of the information required for full annual financial statements.

These interim condensed consolidated financial statements have been prepared in accordance with accounting policies the Company expects to adopt in its November 30, 2012 financial statements. An explanation of how the transition to IFRS has affected the interim condensed consolidated financial statements of the Company is provided in note 17.

The interim condensed consolidated financial statements were authorized for issue by the Board of Directors on May 14, 2012.

(b) Basis of presentation

These interim condensed consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency.

These interim condensed consolidated financial statements have been prepared on the historical cost basis except for derivative instruments at fair value through profit and loss.

The preparation of the interim condensed consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, revenue and expenses and disclosures of contingent assets and liabilities at the dates of the condensed consolidated financial statements. Actual results may vary from these estimates.

Estimates, judgments and underlying assumptions are reviewed on an ongoing basis and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the interim condensed consolidated financial statements are as follows:

---

**2. Basis of preparation – continued:**

(i) Stage of completion of contracted projects

In recording contracted project revenue, the Company makes estimates of the stage of completion of each project by comparing the actual costs incurred to the total estimated costs of the project. These estimates are subject to change which would impact the timing of revenue recognition.

(ii) Impairments

Significant judgment is required in assessing the carrying values of the Company's assets relative to recoverable amounts. The primary assets subject to impairment assessments include accounts receivable and unbilled revenue, inventory, property, plant and equipment and equity investments. Assessments of recoverability are typically dependent upon cash flow assumptions such as future prices, future costs, sustaining capital requirements and discount rates.

(iii) Deferred taxes and investment tax credits

The Company operates in a number of tax jurisdictions and is, therefore, required to estimate its income taxes in each of these tax jurisdictions in preparing its financial statements. The Company is also engaged in scientific research and development giving rise to investment tax credits that may be refundable or available to reduce future taxes payable in certain jurisdictions. In calculating income taxes and investment tax credits consideration is given to factors such as current and future tax rates in the different jurisdictions, non-deductible expenses, qualifying expenditures and changes in tax law. In addition the Company must assess the ability of the Company to realize deferred taxes and investment tax credits reported as assets based on management's expectations of future taxable income in the related jurisdiction.

**3. Significant accounting policies:**

The accounting policies set out below have been applied consistently by all reporting entities of the Company and to all periods presented in these interim condensed consolidated financial statements and in preparing the opening IFRS statement of financial position at December 1, 2010 for the purposes of the transition to IFRS, unless otherwise indicated.

(a) Basis of consolidation

(i) Subsidiaries

Subsidiaries are entities controlled by the Company and include the following wholly-owned entities: PAT Traffic Limitada, International Road Dynamics Corporation and International Road Dynamics South Asia Pvt. Ltd.

The financial statements of subsidiaries are included in the interim condensed consolidated financial statements from the date that control commences until the date that control ceases. The accounting policies of subsidiaries are consistent with the policies adopted by the Company.

**3. Significant accounting policies - continued:**

(ii) Equity accounted investments

Investments over which the Company is able to exercise significant influence are accounted for using the equity method whereby the investments are initially recorded at cost. The investments are increased or decreased to reflect the Company's proportionate share of the earnings or losses and equity movements of the investees, after adjustments to align the accounting policies with those of the Company, from the date that significant influence or joint control commences until the date that significant influence or joint control ceases. When the Company's share of losses exceeds its interest in an equity accounted investee, the carrying amount of that interest, including any long-term investments, is reduced to nil, and the recognition of further losses is discontinued except to the extent that the Company has an obligation or has made payments on behalf of the investee.

The Company has one equity accounted investment in Xuzhou-PAT Control Technologies Limited (XPCT).

(iii) Business combinations

As part of its transition to IFRS, the Company elected, under IFRS 1, not to restate those business combinations that occurred prior to December 1, 2010.

(iv) Transactions eliminated on consolidation

Intra-company balances and transactions, and any unrealized income and expenses arising from intra-company transactions, are eliminated in preparing the interim condensed consolidated financial statements. Unrealized gains arising from transactions with equity accounted investees are eliminated against the investment to the extent of the Company's interest in the investee. Unrealized losses are eliminated in the same way as unrealized gains, but only to the extent that there is no evidence of impairment.

(b) Foreign currency

(i) Foreign currency transactions

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at exchange rates prevailing at the financial reporting date and non-monetary items are translated at rates of exchange in effect when assets were acquired or obligations incurred. Revenue and expenses are translated into Canadian dollars using the approximate rate of exchange on the date of the transactions. The resulting gains or losses are included in the statement of loss.

Non-monetary items measured at historic cost in a foreign currency are translated using the exchange rate at the date of the transaction.

(ii) Foreign operations

The functional currency of the Company's subsidiary in Chile - PAT Traffic Limitada is the Chilean Peso and the functional currency of its subsidiary in India - International Road Dynamics South Asia Pvt. Ltd. is the Indian Rupee. All assets and liabilities are translated to Canadian dollars at exchange rates in effect at the financial reporting date

### 3. Significant accounting policies - continued:

and all revenue and expenses are translated into Canadian dollars using the approximate rate of exchange on the date of the transactions. Exchange gains and losses arising from this translation, representing the net unrealized foreign currency translation gain (loss) on the Company's investment, are recorded in accumulated other comprehensive income (loss).

The functional currency of the Company's equity investment in XPCT is the Chinese Yuan. Goodwill and purchase adjustments to reflect the fair values of assets acquired and liabilities assumed at date of acquisition are treated as though they were included in the XPCT financial statements. The financial statements of XPCT, including the adjustments to reflect the fair values of assets acquired and liabilities assumed, are translated to Canadian dollars at exchange rates in effect at the financial reporting date and all revenue and expenses are translated into Canadian dollars using the approximate rate of exchange on the date of the transactions. Exchange gains and losses arising from this translation, representing the net unrealized foreign currency translation gain (loss) on the Company's investment, are recorded in accumulated other comprehensive income.

When a foreign operation is disposed of, the relevant amount in accumulated other comprehensive income is transferred to the statement of loss as part of the gain or loss on disposal. On the partial disposal of a subsidiary that includes a foreign operation, the relevant proportion of such cumulative amount is reattributed to non-controlling interest. In any other partial disposal of a foreign operation, the relevant proportion is reclassified to the statement of loss.

Foreign exchange gains or losses arising from a monetary item receivable from or payable to a foreign operation, the settlement of which is neither planned nor likely to occur in the foreseeable future and which in substance is considered to form part of the net investment in the foreign operation, are recognized in other comprehensive income.

(c) Revenue recognition

(i) Contracted projects

The majority of sales of integrated systems are delivered as contracted projects. Contract revenue includes the initial amount agreed in the contract plus any amendments in contract work to the extent that it is probable they will result in revenue and can be reliably measured. Revenue from contracted projects is recorded in accordance with the stage of completion of the contract by comparing the actual costs incurred to the total estimated costs for the project. An expected loss on a contract is recognized immediately in the statement of loss.

Unbilled revenue represents the excess of contract costs incurred and estimated gross profits recognized over billings to date. If progress billings exceed costs incurred plus recognized gross profits, then the difference is presented as deferred revenue in the statement of financial position.

**3. Significant accounting policies - continued:**

(ii) Product sales

Revenue from the sale of goods in the course of ordinary activities is measured at the fair value of the consideration received or receivable. Revenue is recognized when persuasive evidence exists, that the significant risks and rewards of ownership have been transferred to the buyer, recovery of the consideration is probable, the associated costs and possible return of goods can be estimated reliably, there is no continuing management involvement with the goods, and the amount of revenue can be measured reliably.

The timing of the transfers of risks and rewards varies depending on the individual terms of the contract of sale. For sales of products, usually transfer occurs when the product is received at the customer’s warehouse; however, for some international shipments transfer occurs upon loading the goods onto the relevant carrier at the port of the seller. Generally for such products the buyer has no right of return.

(iii) Services

Revenue which relates to service obligations is recognized in proportion to the stage of completion of the service arrangement at the financial reporting date.

Service arrangements may be included in a project contract. When projects and services are sold under a single arrangement, each component is accounted for separately. The allocation of consideration from a revenue arrangement to its separate units of account is based on the relative fair values of each component.

(d) Inventories

Inventories are measured at the lower of average cost and net realizable value. The cost of inventories is determined on the weighted average basis. Cost includes the costs of acquired material plus, in the case of manufactured inventories, direct labour applied to the product and the applicable share of manufacturing overhead, including depreciation based on normal operating capacity.

Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

(e) Property, plant and equipment

(i) Recognition and measurement

Items of property, plant and equipment are measured at cost less accumulated depreciation and accumulated impairment losses.

Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, borrowing costs (for self-constructed assets capitalized subsequent to December 1, 2010) and any other costs directly attributable to bringing the assets to the location and condition necessary for them to be capable of operating in a manner intended by management.

**3. Significant accounting policies - continued:**

When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

(ii) Depreciation

Depreciation is computed over the expected useful lives of the assets at 5% on buildings, 20% and 25% on office equipment and manufacturing equipment respectively, 30% on automotive and computer equipment and 100% on computer software based on the declining balance method. Depreciation methods and useful lives are reviewed annually and adjusted if appropriate.

(f) Leased assets

Leases in which the Company assumes substantially all the risks and rewards of ownership of the leased assets are classified as finance leases. Upon initial recognition the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

All existing leases are accounted for as operating leases. Operating lease payments are expensed in earnings (loss) and the leased assets are not recognized in the Company's statement of financial position.

(g) Impairment

(i) Financial assets

Financial assets not carried at fair value through profit or loss, including accounts receivable and unbilled revenue, are assessed at each financial reporting date to determine whether there is objective evidence of impairment. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably. Objective evidence can include default or delinquency by a debtor, restructuring of an amount due to the Company on terms that the Company would not consider otherwise, indications that a debtor or issuer will enter bankruptcy, or the disappearance of an active market for a security.

In addition, for an investment in an equity security, a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

An impairment loss is determined based on estimated future cash flows and is recognized in the statement of loss. An impairment loss is reversed when a subsequent event causes an increase to the fair value of a financial asset.

(ii) Non-financial assets

The carrying amounts of the Company's non-financial assets, other than inventories and deferred tax assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated.

**3. Significant accounting policies - continued:**

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit, or CGU").

Certain corporate assets do not generate separate cash inflows. If there is an indication that a corporate asset may be impaired, then the recoverable amount is determined for the CGU to which the corporate asset belongs.

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses are recognized in the statement of loss. Impairment losses recognized in prior periods, excluding losses related to goodwill, are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

Goodwill that forms part of the carrying amount of an equity investment is not tested for impairment separately. Instead the entire amount of the equity investment is tested for impairments as a single asset when there is objective evidence that the investment is impaired.

(h) Financial instruments

(i) Financial assets

All financial assets are initially recorded at fair value. Subsequent measurement is dependent upon classification as one of the following: financial assets at fair value through profit and loss, held-to-maturity financial assets, loans and receivables or available-for-sale financial assets.

Financial assets at fair value through profit and loss are measured at fair value with gains and losses recognized in the statement of loss.

Held-to-maturity financial assets and loans and receivables are measured at amortized cost, including transaction costs using the effective interest method.

Available-for-sale instruments are measured at fair value with gains and losses, net of tax, recognized in other comprehensive income (loss).

**3. Significant accounting policies - continued:**

The Company derecognizes a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Company is recognized as a separate asset or liability.

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Company has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

Financial assets of the Company consist of cash, accounts receivable and unbilled revenue.

Cash and cash equivalents comprise cash balances and deposits with original maturities of three months or less. Bank overdrafts that are repayable on demand and form an integral part of the Company's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

Accounts receivable and unbilled revenue are classified as "loans and receivables".

(ii) Financial liabilities

Financial liabilities are recognized initially at fair value net of any directly attributable transaction costs. Subsequent to initial recognition the Company's financial liabilities are measured at amortized cost using the effective interest method. The Company has not designated any financial liabilities through profit and loss.

The Company derecognizes a financial liability when its contractual obligations are discharged or cancelled or expire.

The Company has the following non-derivative financial liabilities: accounts payable and accrued liabilities, short-term loans and long-term debt.

(iii) Share capital

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares and share options are recognized as a deduction from equity, net of any tax effects.

(iv) Derivative financial instruments

Derivative financial instruments are utilized by the Company to reduce exposure to fluctuations in foreign currency exchange rates. The Company may enter into foreign exchange contracts to hedge anticipated cash flows denominated in a foreign currency.

The Company has elected not to follow hedge accounting and all derivative contracts are marked to market with resulting net gains or losses recognized in the statement of loss.

**3. Significant accounting policies - continued:**

Derivatives are carried at fair value and are reported as other receivables when they have a positive fair value and as accrued liabilities when they have a negative fair value. Derivatives may also be embedded in other financial instruments. Derivatives embedded in other financial instruments are valued as separate derivatives when their economic characteristics and risks are not clearly and closely related to those of the host contract; the terms of the embedded derivative would meet the definition of a derivative if it was a free standing instrument; and the combined contract is not held for trading or designated at fair value.

(i) Research and development costs:

The Company expenses research and development costs during the year in which they are incurred. Research and development related investment tax credits are recognized as a reduction of related expenditures when the Company has reasonable assurance that they will be utilized.

(j) Employee benefits

(i) Share-based compensation

The grant date fair value of share-based compensation awards granted to employees is recognized as an expense, with a corresponding increase in contributed surplus, over the period that the employees unconditionally become entitled to the awards. For awards with multiple vesting dates, each tranche of an award is considered a separate grant with a different vesting date and fair value. The fair value of each tranche is measured at the date of grant, using the Black-Scholes option pricing model.

The amount recognized as an expense is adjusted to reflect the number of awards for which the related service and non-market vesting conditions are expected to be met, such that the amount ultimately recognized as an expense is based on the number of awards that do meet the related service and non-market performance conditions at the vesting date.

(ii) Short-term employee benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided.

A liability is recognized for the amount expected to be paid under short-term cash bonus or profit-sharing plans if the Company has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee, and the obligation can be estimated reliably.

## 3. Significant accounting policies - continued:

(k) Provisions

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. The unwinding of the discount is recognized as financing cost.

A provision for onerous contracts is recognized when the expected benefits to be derived by the Company from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract. Before a provision is established, the Company recognizes any impairment loss on the assets associated with that contract.

(l) Financing costs

Financing costs comprise interest expense on short-term loans and long-term debt, unwinding of the discount on provisions, changes in the fair value of financial assets and financial liabilities at fair value through profit or loss, gains and losses on hedging instruments recognized through profit and loss and impairment losses recognized on financial assets. Borrowing costs that are not directly attributable to the acquisition, construction or production of a qualifying asset are recognized in the statement of loss using the effective interest method.

Foreign currency gains and losses are reported on a net basis.

(m) Income tax

Income tax expense (recovery) comprises current and deferred tax. Current tax and deferred tax are recognized in the statement of loss except to the extent that it relates to a business combination, or items recognized directly in equity or in other comprehensive income.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized in respect of losses available for carryforward and temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized for differences relating to investments in subsidiaries to the extent that it is probable that they will not reverse in the foreseeable future. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

**3. Significant accounting policies - continued:**

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

(n) Earnings per share

The Company presents basic and diluted earnings per share (EPS) data for its common shares. Basic EPS is calculated by dividing the profit or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period, adjusted for own shares held. Diluted EPS is determined by adjusting the profit or loss attributable to common shareholders and the weighted average number of common shares outstanding, adjusted for own shares held, for the effects of all dilutive potential common shares, which comprise share options granted to employees.

(o) New standards and interpretations not yet adopted

A number of new standards, and amendments to standards and interpretations, are not yet effective for the interim period ended February 29, 2012 and have not been applied in preparing these interim condensed consolidated financial statements. None of these is expected to have a significant effect on the consolidated financial statements of the Company, except for IFRS 9 *Financial Instruments*, which becomes mandatory for the Company's 2014 consolidated financial statements and is expected to impact the classification and measurement of financial assets. The extent of the impact has not been determined.

**4. Inventories:**

| | February 29, 2012 | November 30, 2011 | December 1, 2010 |
|---|---|---|---|
| Raw materials | $ 865,195 | $ 802,122 | $ 673,285 |
| Original equipment manufacturer materials | 3,365,724 | 3,506,499 | 4,146,991 |
| Work in process | 1,646,731 | 1,713,575 | 1,651,166 |
| Finished goods | 1,891,692 | 1,897,837 | 1,312,493 |
| Provision for excess and obsolete inventory | (998,421) | (1,046,225) | (596,165) |
| | $ 6,770,921 | $ 6,873,808 | $ 7,187,770 |

During the quarter, inventories expensed within cost of sales was $3,931,956 (2011 - $4,310,106). The Company also recorded an incremental provision for excess and obsolete inventories within cost of sales of $50,000 (2011 - $nil).

## 5. Investment in XPCT:

| | February 29, 2012 | November 30, 2011 | February 28, 2011 (note 17) |
|---|---|---|---|
| **Xuzhou-PAT Control Technologies Limited (XPCT)** | | | |
| Balance – beginning of period | $ 4,781,709 | $ 5,118,780 | $ 5,118,780 |
| Currency gain (loss) on financial statement translation | (125,682) | 295,226 | (88,829) |
| Equity loss | (73,446) | (482,312) | (579,758) |
| Dividend received | - | (149,985) | - |
| Balance – end of period | $ 4,582,581 | $ 4,781,709 | $ 4,450,193 |

The Company had sales to XPCT of $352,450 during the quarter (2011 - $704,800). At February 29, 2012 accounts receivable from XPCT were $381,601 (November 30, 2011 - $785,598; December 1, 2010 - $431,816).

| | Three Months Ended February 29, 2012 | Three Months Ended February 28, 2011 |
|---|---|---|
| **XPCT loss (income)** | | |
| Gain on settlement of vendor loan (note 7) | $ - | $ (520,000) |
| Equity loss | 73,446 | 579,758 |
| | $ 73,446 | $ 59,758 |

The equity loss for the period ended February 28, 2011 includes charges of $507,650 for values assigned on acquisition related to receivables and inventory subject to the dispute with the vendor. In conjunction with the settlement of claims against the vendor as described in note 7, the Company recorded a gain on settlement of the vendor loan in the amount of $520,000.

The net book value of the Company's investment exceeds its proportionate share of the assets and liabilities reported by XPCT by approximately $2 million primarily due to goodwill on acquisition.

The Company has provided a guarantee in the amount of 7.5 million Yuan (approximately $1,185,500) for 50% of a bank loan to XPCT. The guarantee provided by the Company is proportionate to its shareholding in XPCT.

**6. Short-term loans:**

| | February 29, 2012 | November 30, 2011 | December 1, 2010 |
|---|---|---|---|
| Royal Bank of Canada credit facility. Authorized to a maximum of $8.5 million with interest at bank prime plus 1.55% and secured by a general security agreement (note 7). | $ 5,935,112 | $ 5,624,605 | $ 4,784,117 |
| HDFC Bank Limited credit facility. Authorized to a maximum of 50.0 million Indian Rupees (approximately $1,009,500), of which 47.0 million Indian Rupees was drawn at February 29, 2012, with interest at 12.5% and secured by a standby letter of credit issued by Royal Bank of Canada and guaranteed by Export Development Canada | 948,733 | 933,784 | 948,342 |
| | $ 6,883,845 | $ 6,558,389 | $ 5,732,459 |

The Company has no issued letters of credit against the Royal Bank of Canada credit facility as of February 29, 2012 (November 30, 2011 - $103,220; December 1, 2010 - $173,316) as bid and performance guarantees on certain contracts.

The Company has an additional credit facility of $1.0 million US with Royal Bank of Canada that is guaranteed by Export Development Canada for the support of performance guarantees provided by the Company's subsidiaries. At February 29, 2012 performance guarantees totaling $758,956 US were outstanding (November 30, 2011 - $663,887; December 1, 2010 - $734,566). Export Development Canada has informed the Company that they will continue to provide guarantees for the performance of existing projects but will not provide guarantees for any new projects. The Company is in discussions with Export Development Canada to have them continue their guarantee under this credit facility.

## 7. Long-term debt:

| | February 29, 2012 | November 30, 2011 | December 1, 2010 |
|---|---|---|---|
| Royal Bank of Canada term loan, repayable in monthly instalments of $78,430 including interest at a fixed rate of 5.65%. Due February 28, 2013 | $ 860,781 | $ 1,081,867 | $ 2,656,302 |
| Royal Bank of Canada mortgage repayable in monthly instalments of $20,906 including interest at a fixed rate of 6.144%. | - | - | 2,671,932 |
| Vendor loan to finance the acquisition of XPCT, with interest payable at 7% per annum. | - | - | 1,000,000 |
| | 860,781 | 1,081,867 | 6,328,234 |
| Less current portion | (860,781) | (903,000) | (6,328,234) |
| | $ - | $ 178,867 | $ - |

The Company's short-term loans and term loan with the Royal Bank of Canada are secured by a general security agreement on the assets of the Company held in Canada and the United States. Under the terms and conditions of its credit facilities with Royal Bank of Canada the Company is subject to certain covenants. These covenants require that the Company maintain a certain minimum level of fixed charge coverage as measured on an annual basis, and that it not exceed a certain maximum ratio of total liabilities to tangible net worth on a quarterly basis.

At December 1, 2010, the Company was not in compliance with the annual fixed charge coverage covenant; this constituted an event of default under the terms of the credit facilities, and therefore, amounts owing under the credit facilities with Royal Bank of Canada were included in the current portion of long-term debt.

In July 2011 the Company's credit facilities agreement with Royal Bank of Canada was amended. The amended agreement provided that the annual fixed charge coverage covenant will be effective commencing with the fiscal year ending November 30, 2012. The Company is in compliance with the liabilities to tangible net worth quarterly covenant at February 29, 2012 and does not expect to be in compliance with the fixed charge coverage covenant at November 30, 2012. See note 16 for a discussion of liquidity risk.

## 7. Long-term debt - continued:

In February 2011, the Company agreed to a settlement of the vendor loan associated with the XPCT acquisition in December, 2007. Under the settlement arrangement, the Company paid $700,000 of the outstanding vendor loan of $1,000,000 and accrued interest of $220,000 as final settlement of the XPCT purchase price. In addition, the Company has agreed to discontinue various claims against the vendor relating to the acquisition of XPCT.

Under the current debt arrangements the Company has scheduled principal payments totaling $860,781 over the next twelve months.

## 8. Share capital:

(a) Authorized:

An unlimited number of common voting shares, without par value.

(b) Share transactions:

| | Number of shares | Amount |
|---|---|---|
| Balance, December 1, 2010 and November 30, 2011 | 13,998,337 | $ 12,071,009 |
| Balance, December 1, 2011 and February 29, 2012 | 13,998,337 | $ 12,071,009 |

(c) Options:

Under the terms of the Company's stock option plan, the Company is authorized to grant officers, employees and others options to purchase common shares at prices based on the market price of shares as determined on the date of the grant. At February 29, 2012, 215,665 (November 30, 2011 – 238,165, December 1, 2010 – 1,110,665) options remain available to be granted. Stock options become exercisable at dates determined by the Compensation Committee of the Board of Directors.

**8. Share capital - continued:**

At February 29, 2012, the following stock options to officers, employees and others were outstanding:

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| Exercise Prices | Number Outstanding at February 29, 2012 | Weighted-Average Remaining Contractual Life (years) | Weighted-Average Exercise Price | Number Exercisable at February 29, 2012 | Weighted-Average Exercise Price |
| $ 0.31 | 1,005,000 | 4.66 | $ 0.31 | - | $ - |
| 0.34 | 200,000 | 4.76 | 0.34 | - | - |
| 1.20 | 600,000 | 6.37 | 1.20 | 600,000 | 1.20 |
| 1.29 | 110,000 | 1.17 | 1.29 | 110,000 | 1.29 |
| | 1,915,000 | 5.01 | $ 0.65 | 710,000 | $ 1.21 |

The Company has granted stock options to officers, employees and others as follows:

| | Number of Common Shares Issuable | Weighted Average Exercise Price |
|---|---|---|
| Outstanding, December 1, 2010 | 1,020,000 | $ 1.24 |
| Options forfeited | (20,000) | 1.31 |
| Outstanding, February 28, 2011 | 1,000,000 | $ 1.24 |
| Outstanding, December 1, 2011 | 1,892,500 | $ 0.74 |
| Options granted | 200,000 | 0.34 |
| Options expired | (167,500) | 1.32 |
| Options forfeited | (10,000) | 0.82 |
| Outstanding, February 29, 2012 | 1,915,000 | $ 0.65 |

Outstanding options expire between May 1, 2013 and February 28, 2019.

During the period the Company recorded share-based compensation expense of $3,418 (2011 – $3,882) along with a corresponding increase in contributed surplus in shareholders' equity for options vesting during the period.

## 9. Expense classification:

### (a) Personnel expenses:

| | Three Months Ended | |
|---|---|---|
| | February 29, 2012 | February 28, 2011 |
| Wages and salaries | $ 2,693,936 | $ 2,981,389 |
| Other employment benefits | 390,907 | 406,927 |
| | $ 3,084,843 | $ 3,388,316 |

Personnel expenses are allocated to cost of sales, administrative and marketing expenses and research and development on the basis of the functions performed by employees.

### (b) Depreciation expense:

| | Three Months Ended | |
|---|---|---|
| | February 29, 2012 | February 28, 2011 |
| Depreciation included in cost of sales | $ 106,500 | $ 134,387 |
| Depreciation included in administrative and marketing expenses | 51,657 | 79,849 |
| | $ 158,157 | $ 214,236 |

## 10. Financing costs, net

| | Three Months Ended | |
|---|---|---|
| | February 29, 2012 | February 28, 2011 |
| Interest on short-term debt | $ 91,893 | $ 73,667 |
| Interest on long-term debt | 16,362 | 93,701 |
| Interest expense | 108,255 | 167,368 |
| Foreign exchange losses | 206,202 | 75,830 |
| Gains on derivatives | (67,000) | (26,300) |
| | $ 247,457 | $ 216,898 |

## 11. Loss per share:

The computations for basic and diluted loss per share are as follows:

| | Three Months Ended | |
|---|---|---|
| | February 29, 2012 | February 28, 2011 |
| Net loss | $ (512,919) | $ (692,129) |
| Weighted average number of common shares outstanding: | | |
| Basic | 13,998,337 | 13,998,337 |
| Effect of stock options | – | – |
| Diluted | 13,998,337 | 13,998,337 |
| Earnings (loss) per share: | | |
| Basic | $ (0.04) | $ (0.05) |
| Diluted | $ (0.04) | $ (0.05) |

The Company has stock options outstanding to purchase 1,915,000 common shares at February 29, 2012 (2011 – 1,000,000). None of the options available to purchase common shares were included in the computation of diluted earnings (loss) per share as amounts were anti-dilutive.

## 12. Operating leases:

The Company leases land and building under an operating lease expiring on April 14, 2023. Contractual lease obligations comprised of base rent and operating costs for the next five years are as follows:

| | |
|---|---|
| Due within 1 year | $ 579,000 |
| Due between 1 and 2 years | 579,000 |
| Due between 2 and 3 years | 579,000 |
| Due between 3 and 4 years | 579,000 |
| Due between 4 and 5 years | 579,000 |
| Thereafter | 3,543,510 |
| | $ 6,438,510 |

During the quarter ended February 29, 2012 an amount of $145,000 was recognized as an expense in respect of the operating lease for land and building (2011 – $nil).

## 13. Segmented information:

The Company operates in one industry segment, the ITS industry, which involves the engineering, software development, manufacturing and integration of products and systems to highway departments and industry to improve the efficiency of traffic flows.

The Company had sales in the following geographic areas:

| | Three Months Ended | |
|---|---|---|
| | February 29, 2012 | February 28, 2011 |
| Canada | $ 444,553 | $ 551,496 |
| United States | 5,235,408 | 3,867,612 |
| Offshore | 3,236,283 | 4,497,215 |
| | $ 8,916,244 | $ 8,916,323 |

## 14. Interim condensed consolidated statements of cash flows:

Other operating items

| | Three Months Ended | |
|---|---|---|
| | February 29, 2012 | February 28, 2011 |
| Accounts receivable | $ (1,386,164) | $ 1,060,103 |
| Unbilled revenue | 833,779 | (18,239) |
| Inventories | 202,065 | (21,713) |
| Prepaid expenses and deposits | 131,766 | (202,231) |
| Accounts payable and accrued liabilities | 68,723 | (440,563) |
| | $ (149,831) | $ 377,357 |

## 15. Key management personnel compensation:

In addition to salaries and benefits, executive officers participate in the share option program (note 8). The Company also provides cash and non-cash benefits to external directors of the Company.

Certain executive officers are subject to a mutual term of notice of four months. Upon resignation at the Company's request certain executive officers are entitled to termination benefits ranging from 12 to 18 months' gross salary.

Key management compensation includes:

| | Three Months Ended | |
|---|---|---|
| | February 29, 2012 | February 28, 2011 |
| Salaries and short-term employee benefits | $ 267,179 | $ 259,745 |
| Share–based compensation | 2,241 | 2,921 |
| | $ 269,420 | $ 262,666 |

## 16. Financial risk:

The Board of Directors is responsible to ensure that management identifies the principal risks of the Company's business and for the implementation of appropriate measures for dealing with and managing these risks. The principal risks and the measures for managing these risks are as discussed in the audited annual consolidated financial statements as of November 30, 2011 and there have been no changes in these risks and the methods of managing these risks.

The sensitivity analyses discussed and illustrated below for currency, interest rate and liquidity risk should be used with caution as the changes are hypothetical and are not predictive of true performance. The below sensitivities are calculated with reference to period-end balances and will change due to fluctuation in the balances throughout the year. In addition, for the purpose of the sensitivity analyses, the effect of a variation in a particular assumption on the fair value of the financial instrument was calculated independently of any change in another assumption. Actual changes in one factor may contribute to changes in another factor, which may magnify or counteract the effect on the fair value of the financial instrument.

The Company is exposed to various financial instrument related risks. The following are the types of risk exposures and methods of managing these risks:

**16. Financial risk - continued:**

**Credit risk:**

Credit risk arises from the potential that a customer or counterparty will fail to meet its contractual obligations. The Company is exposed to credit risk from its customers on its trade receivables and unbilled revenue. The Company is also exposed to credit risk relating to forward currency exchange contracts which it manages by dealing with Royal Bank of Canada. The maximum exposure to credit risk is represented by the carrying amount of its receivables and the balance of foreign exchange contracts.

The cash balances and other foreign currency forward contracts are held and transacted with bank and financial counterparties that are credit worthy with high credit ratings.

Accounts receivable is comprised of both trade and non-trade accounts. An allowance for doubtful accounts is established when there is a reasonable expectation that the Company will not be able to collect all amounts due according to the original terms of the receivables. Accounts ultimately determined to be uncollectible are written off against the allowance.

Accounts receivable include amounts due from customers in both the government and private industry sectors which exposes the Company to risk of nonpayment. Government accounts are considered secure and are normally not subjected to extensive credit reviews. Industry accounts are subjected to internal credit review in order to minimize risk of non-payment. Canadian export sales to non-government customers, not otherwise secured by Letters of Credit, are generally insured by Export Development Canada ("EDC") to the extent of 90% of the invoiced amount. At February 29, 2012 EDC continued to insure sales to non-government customers. As outlined in note 6, EDC informed the Company that subsequent to February 29, 2012 they will not provide performance guarantees for certain of its new projects. The Company is in discussions with EDC to have them continue their guarantees under this program.

**Currency fluctuation risk:**

Foreign currency risk arises as a result of fluctuations in exchange rates. During the first quarter approximately 70% of the Company's sales are denominated in U.S. dollars while the majority of its costs are denominated in Canadian dollars. Fluctuations in the value of the U.S. dollar compared to the Canadian dollar can affect earnings and cash flow.

During the quarter the Canadian dollar weakened against the U.S. dollar by approximately 1.5% compared to first quarter 2011. This resulted in an increase in the Canadian dollar value of the Company's U.S. dollar denominated sales of approximately $95,000 during the first quarter of 2012. This impact is partially offset by the corresponding higher value of U.S. dollar denominated expenses.

From time to time the Company enters into forward foreign exchange contracts to sell U.S. dollars to hedge its net accounts receivable denominated in that currency. The term of these forward contracts is of a short term nature with the objective of matching the expected payments from customers.

## 16. Financial risk - continued:

At February 29, 2012 the Company has foreign currency exchange contracts to sell $2.5 million U.S. dollars at an average exchange rate of 1.0164. These contracts mature within the next 71 days and have a gain of $49,000 based on the actual exchange rate at February 29, 2012. In addition, the Company had in place $200,000 USD in forward currency contracts at an average exchange rate of 520.3 CLP (Chilean pesos) per U.S. dollar with a gain of approximately $18,000 based on the actual exchange rate at February 29, 2012. Gains and losses on all foreign exchange contracts are recognized in earnings (loss).

The Company also has exposure to other currencies including the Indian Rupee, Chilean Peso and Chinese Yuan primarily as a result of its operations in those countries. The Company's investments in these operations are not hedged as those currency positions are considered to be long-term in nature.

The following table illustrates the Company’s exposure to exchange risk and the pre-tax effects on earnings and other comprehensive income (OCI) of a 5% increase in the Canadian dollar in comparison to the relevant foreign currency. This analysis assumes all other variables remain constant.

| | Carrying Amount of Asset (Liability) at February 29, 2012 | Foreign Exchange Risk 5% increase in Canadian $ | |
|---|---|---|---|
| | | Income | OCI |
| Net US dollar foreign currency exposure | $ 5,783,000 | $ (289,150) | $ - |
| US dollar foreign currency forward contracts | $ 67,000 | $ 135,000 | $ - |
| Net Indian Rupee foreign currency exposure | $ 365,000 | $ - | $ (18,250) |
| Net Chilean Peso foreign currency exposure | $ 1,372,000 | $ - | $ (68,600) |
| Net Chinese Yuan foreign currency exposure | $ 4,582,581 | $ - | $ (229,129) |

A 5% decrease in the Canadian dollar would have the opposite impact to those noted above.

### Interest rate risk:

Interest rate risk arises because of the fluctuation in interest rates. Fluctuations in interest rates impact the future cash flows and fair values of various financial instruments. The Company’s future cash flows are exposed to fluctuations in interest rates since the majority of its borrowings are at variable rates. As at February 29, 2012, a 1% increase or decrease in interest rates, with all other variables held constant, would have resulted in a corresponding increase or decrease of $17,000 to the Company’s net loss for the period. The Company does not use derivative financial instruments to mitigate interest rate risk.

**16. Financial risk - continued:**

**Liquidity risk:**

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities as they become due. The Company facilitates this in part by maintaining a line of credit in the amount of $8.5 million with the Royal Bank of Canada (“RBC”) and a 50.0 million Indian Rupees (approximately $1,009,500) line of credit with HDFC Bank Limited. The line of credit with HDFC Bank Limited is guaranteed by Export Development Canada (“EDC”). The guarantee provided by EDC is renewable on an annual basis. The current guarantee was to expire on March 15, 2012 but was extended to June 15, 2012. EDC no longer offers the program under which this guarantee is provided but does have a similar program to provide the guarantee. The Company is in negotiations with EDC to establish the guarantee under this new program. At February 29, 2012 the remaining amount available to be drawn under these credit facilities are approximately $0.8 million and $0.1 million, respectively.

Under the terms of its short and long-term credit facilities with RBC, as referred to in Note 7, the Company is required to meet certain covenants. In addition, the terms of the credit facility with RBC provide that borrowings are repayable on demand and that RBC may cancel or restrict the availability of any unutilized portion at any time. As outlined in note 7 the Company does not expect to meet its fixed charge coverage covenant at November 30, 2012. Management is confident that it will be able to negotiate a favorable solution to this covenant violation with the Royal Bank of Canada.

The table below presents a maturity analysis of the Company’s financial liabilities based on the expected cash flows from the date of the balance sheet to the contractual maturity date. The amounts represent the contractual undiscounted cash flows (thousands of dollars).

| | Carrying Amount of Liability at February 29, 2012 | Contractual Cash Flows Including Interest | < 1 year | 1 to 5 years |
|---|---|---|---|---|
| Short-term loans * | $ 6,884 | $ 7,272 | $ 7,272 | $ - |
| Accounts payable and accrued liabilities | $ 5,230 | $ 5,230 | $ 5,230 | $ - |
| Long-term debt | $ 861 | $ 886 | $ 886 | $ - |

* Assumes balance is outstanding for 365 days.

## 16. Financial risk - continued:

### Management of capital

The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern, so that it can provide returns for shareholders and benefits for other stakeholders, and to provide an adequate return to shareholders.

The Company manages the capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, the Company may issue new shares, purchase and cancel shares previously issued, return capital to shareholders or sell assets to reduce debt.

The capital structure of the Company is as follows:

| | February 29, 2012 | November 30, 2011 | December 1, 2010 |
|---|---|---|---|
| Short-term debt | $ 6,883,845 | $ 6,558,389 | $ 5,732,459 |
| Long-term debt | 860,781 | 1,081,867 | 6,328,234 |
| Total debt | 7,744,626 | 7,640,256 | 12,060,693 |
| Shareholders' equity | 16,868,786 | 17,217,156 | 21,074,388 |
| Total capital | $ 24,613,412 | $ 24,857,412 | $ 33,135,081 |

### Fair value:

The carrying amounts of the Company's financial assets and liabilities including cash, accounts receivable, unbilled revenue and accounts payable and accrued liabilities approximate fair value due to the short-term maturity of these items. The fair value of the short-term loans approximates the carrying amounts since the debt bears interest at current market rates. The fair value of long-term debt approximates its carrying value as at February 29, 2012. The fair value of the Company's fixed long-term debt was estimated based on discounted future cash flows using current rates for similar debt subject to similar rates and maturities.

## 17. Explanation of transition to IFRS

As stated in note 2, these are the Company's first interim condensed consolidated financial statements prepared in accordance with IFRS. The accounting policies set out in note 3 have been applied in preparing the financial statements for the period ended February 29, 2012, the comparative information presented in these financial statements for the period ended February 28, 2011 and in the opening IFRS statement of financial position at December 1, 2010 (the Company's date of transition).

**17. Explanation of transition to IFRS – continued:**

In preparing its opening IFRS statement of financial position, the Company has determined whether adjustments were required to amounts reported previously in financial statements prepared in accordance with previous Canadian GAAP. An explanation of how the transition has affected the Company's financial position, financial performance and cash flows is set out in the following tables and the notes that accompany the tables.

**Reconciliation of equity at December 1, 2010 (date of transition to IFRS):**

| | | Canadian GAAP | Adjustments | IFRS |
|---|---|---|---|---|
| Assets | | | | |
| Current assets: | | | | |
| Cash and cash equivalents | | $ 667,724 | $ - | $ 667,724 |
| Accounts receivable | | 11,079,295 | - | 11,079,295 |
| Unbilled revenue | | 4,025,218 | - | 4,025,218 |
| Income taxes receivable | | 347,442 | - | 347,442 |
| Inventories | | 7,187,770 | - | 7,187,770 |
| Prepaid expenses and deposits | | 601,811 | - | 601,811 |
| | | 23,909,260 | - | 23,909,260 |
| Property, plant and equipment | (a) | 6,151,430 | 3,157,406 | 9,308,836 |
| Equity investment | | 5,118,780 | - | 5,118,780 |
| Investment tax credits recoverable | | 3,267,486 | - | 3,267,486 |
| Deferred taxes | (b) | 738,000 | (738,000) | - |
| | | $ 39,184,956 | $ 2,419,406 | $ 41,604,362 |
| Liabilities and Shareholders' Equity | | | | |
| Current liabilities: | | | | |
| Short-term loans | | $ 5,732,459 | $ - | $ 5,732,459 |
| Accounts payable and accrued liabilities | | 5,360,417 | - | 5,360,417 |
| Current portion of deferred revenue | | 2,500,007 | - | 2,500,007 |
| Current portion of long-term debt | | 6,328,234 | - | 6,328,234 |
| | | 19,921,117 | - | 19,921,117 |
| Deferred revenue | | 535,404 | - | 535,404 |
| Deferred taxes | (b) | - | 73,453 | 73,453 |
| Shareholders' equity: | | | | |
| Share capital | | 12,071,009 | - | 12,071,009 |
| Contributed surplus | | 246,587 | - | 246,587 |
| Retained earnings | (a)(b)(f) | 6,099,579 | 2,299,295 | 8,398,874 |
| Accumulated other comprehensive income | (f) | 311,260 | 46,658 | 357,918 |
| | | 18,728,435 | 2,345,953 | 21,074,388 |
| | | $ 39,184,956 | $ 2,419,406 | $ 41,604,362 |

### 17. Explanation of transition to IFRS – continued:

**Reconciliation of equity at November 30, 2011:**

| | | Canadian GAAP | Adjustments | IFRS |
|---|---|---|---|---|
| Assets | | | | |
| Current assets: | | | | |
| Cash and cash equivalents | | $ 917,161 | $ - | $ 917,161 |
| Accounts receivable | | 9,672,204 | - | 9,672,204 |
| Unbilled revenue | | 3,868,862 | - | 3,868,862 |
| Income taxes receivable | | 312,727 | - | 312,727 |
| Inventories | | 6,873,808 | - | 6,873,808 |
| Prepaid expenses and deposits | | 784,963 | - | 784,963 |
| | | 22,429,725 | - | 22,429,725 |
| Property, plant and equipment | | 2,033,583 | - | 2,033,583 |
| Equity investment | | 4,781,709 | - | 4,781,709 |
| Investment tax credits recoverable | | 2,856,573 | - | 2,856,573 |
| Deferred taxes | (d) | 1,358,000 | (739,444) | 618,556 |
| | | $ 33,459,590 | $ (739,444) | $ 32,720,146 |
| Liabilities and Shareholders' Equity | | | | |
| Current liabilities: | | | | |
| Short-term loans | | $ 6,558,389 | $ - | $ 6,558,389 |
| Accounts payable and accrued liabilities | | 5,205,917 | - | 5,205,917 |
| Current portion of deferred revenue | (c) | 2,585,079 | (252,936) | 2,332,143 |
| Current portion of long-term debt | | 903,000 | - | 903,000 |
| | | 15,252,385 | (252,936) | 14,999,449 |
| Deferred revenue | (c) | 2,948,951 | (2,624,277) | 324,674 |
| Long-term debt | | 178,867 | - | 178,867 |
| Shareholders' equity: | | | | |
| Share capital | | 12,071,009 | - | 12,071,009 |
| Contributed surplus | | 262,900 | - | 262,900 |
| Retained earnings | (c)(d)(f) | 2,831,245 | 2,091,111 | 4,922,356 |
| Accumulated other comprehensive income (loss) | (f) | (85,767) | 46,658 | (39,109) |
| | | 15,079,387 | 2,137,769 | 17,217,156 |
| | | $ 33,459,590 | $ (739,444) | $ 32,720,146 |

## 17. Explanation of transition to IFRS – continued:

### Reconciliation of equity at February 28, 2011:

| | | Canadian GAAP | Adjustments | IFRS |
|---|---|---|---|---|
| Assets | | | | |
| Current assets: | | | | |
| Cash and cash equivalents | | $ 257,485 | $ - | $ 257,485 |
| Accounts receivable | | 9,880,152 | - | 9,880,152 |
| Unbilled revenue | | 4,043,457 | - | 4,043,457 |
| Income taxes receivable | | 315,996 | - | 315,996 |
| Inventories | | 7,227,577 | - | 7,227,577 |
| Prepaid expenses and deposits | | 790,229 | - | 790,229 |
| | | 22,514,896 | - | 22,514,896 |
| Property, plant and equipment | (a) | 5,977,887 | 3,122,930 | 9,100,817 |
| Equity investment | | 4,450,193 | - | 4,450,193 |
| Investment tax credits recoverable | | 3,301,753 | - | 3,301,753 |
| Deferred taxes | (b) | 974,151 | (802,593) | 171,558 |
| | | $ 37,218,880 | $ 2,320,337 | $ 39,539,217 |
| Liabilities and Shareholders' Equity | | | | |
| Current liabilities: | | | | |
| Short-term loans | | $ 7,300,268 | $ - | $ 7,300,268 |
| Accounts payable and accrued liabilities | | 4,774,436 | - | 4,774,436 |
| Current portion of deferred revenue | | 1,808,922 | - | 1,808,922 |
| Current portion of long-term debt | | 5,106,744 | - | 5,106,744 |
| | | 18,990,370 | - | 18,990,370 |
| Deferred revenue | | 475,655 | - | 475,655 |
| Long-term debt | | - | - | - |
| Shareholders' equity: | | | | |
| Share capital | | 12,071,009 | - | 12,071,009 |
| Contributed surplus | | 250,469 | - | 250,469 |
| Retained earnings | (a)(b)(f) | 5,433,066 | 2,273,679 | 7,706,745 |
| Accumulated other comprehensive Income (loss) | (f) | (1,689) | 46,658 | 44,969 |
| | | 17,752,855 | 2,320,337 | 20,073,192 |
| | | $ 37,218,880 | $ 2,320,337 | $ 39,539,217 |

## 17. Explanation of transition to IFRS – continued:

### Reconciliation of comprehensive loss for the three month period ended February 28, 2011:

| | | Canadian GAAP | Adjustments | IFRS |
|---|---|---|---|---|
| Sales | | $ 8,916,323 | $ - | $ 8,916,323 |
| Cost of sales | (a)(e) | 6,631,608 | 134,387 | 6,765,995 |
| | | 2,284,715 | (134,387) | 2,150,328 |
| Administrative and marketing expenses | (e) | 2,290,340 | 79,849 | 2,370,189 |
| Research and development | | 260,787 | - | 260,787 |
| Financing costs, net | | 216,898 | - | 216,898 |
| Depreciation | (e) | 179,760 | (179,760) | - |
| Other expense (income) | | (2,451) | - | (2,451) |
| XPCT loss (income) | | 59,758 | - | 59,758 |
| Loss before income tax recovery | | (720,377) | (34,476) | (754,853) |
| Income tax recovery | (b) | (53,864) | (8,860) | (62,724) |
| Net loss | | $ (666,513) | $ (25,616) | $ (692,129) |
| Other comprehensive loss | | | | |
| Unrealized foreign currency translation losses | | (312,949) | - | (312,949) |
| Total comprehensive loss | | $ (979,462) | $ (25,616) | $ (1,005,078) |

**17. Explanation of transition to IFRS – continued:**

**Reconciliation of comprehensive loss for the year ended November 30, 2011:**

| | | Canadian GAAP | Adjustments | IFRS |
|---|---|---|---|---|
| Sales | | $ 39,098,503 | - | $ 39,098,503 |
| Cost of sales | (a)(e) | 29,555,078 | 511,531 | 30,066,609 |
| | | 9,543,425 | (511,531) | 9,031,894 |
| Administrative and marketing expenses | (e) | 10,730,805 | 316,315 | 11,047,120 |
| Research and development | | 1,005,553 | - | 1,005,553 |
| Financing costs, net | | 528,004 | - | 528,004 |
| Depreciation | (e) | 776,132 | (776,132) | - |
| Other expense (income) | (c) | (278,023) | 228,479 | (49,544) |
| XPCT loss (income) | | (37,688) | - | (37,688) |
| Loss before income tax recovery | | (3,181,358) | (280,193) | (3,461,551) |
| Income tax expense (recovery) | (b)(d) | 86,976 | (72,009) | 14,967 |
| Net loss | | $ (3,268,334) | (208,184) | $ (3,476,518) |
| Other comprehensive loss | | | | |
| Unrealized foreign currency translation losses | | (397,027) | - | (397,027) |
| Total comprehensive loss | | $ (3,665,361) | (208,184) | $ (3,873,545) |

**Adjustments to the statement of cash flows:**

Interest paid and income taxes paid are now included in the body of the statement of cash flows rather than being disclosed as supplementary information. The Company has elected to reflect interest paid as a financing cash flow rather than an operating cash flow. There were no other material differences between the statements of cash flows presented under IFRS compared to Canadian GAAP.

**IFRS 1 *First-time adoption of International Financial Reporting Standards*:**

IFRS 1 *First-time adoption of International Financial Reporting Standards* sets out the reporting requirements when IFRS is adopted for the first time. The Company is required to establish its IFRS accounting policies for the period ended February 29, 2012 and apply those policies retrospectively to determine the Company's consolidated statement of financial position at the date of transition, December 1, 2010. IFRS 1 provides for a number of mandatory exceptions applicable to first time adopters of IFRS. None of these mandatory exceptions had a material impact on the Company's transition to IFRS. IFRS 1 also provides certain optional exemptions that may be elected by first time adopters of IFRS. As part of the transition, the Company elected the following optional exemptions:

**17. Explanation of transition to IFRS – continued:**

Business combinations

The Company elected to apply the business combinations exemption in IFRS 1 and did not apply IFRS 3 *Business Combinations* retrospectively to past business combinations. Accordingly, the Company has not restated business combinations that were effected prior to December 1, 2010 and the transition to IFRS has not impacted amounts previously reported for business combinations under Canadian GAAP.

Borrowing costs

The Company elected to apply IAS 23 *Borrowing Costs* to borrowing costs relating to qualifying assets for which the commencement date for capitalization is on or after the transition date to IFRS. There was no impact as a result of this election.

Fair value of property, plant and equipment as deemed cost:

Companies may elect to report items of property, plant and equipment in their opening statement of financial position on the transition date at either deemed or IFRS compliant historical cost. The option can be applied separately to each asset or class of assets. The Company has elected to report the land and building that houses its head office and manufacturing facility at fair value on transition to IFRS. Two independent fair value appraisals for the building were obtained to determine the fair value of the land and building as at December 1, 2010. Depreciation for the building began as at that date using a 5% depreciation rate. See note (a) for the impact of this election.

Share-based payments:

The Company has elected not to retrospectively apply IFRS 2 *Share-based Payments* to equity instruments that were granted and had vested before the transition date. As a result of applying this exemption, the Company will apply the provisions of IFRS 2 only to all outstanding equity instruments that are unvested as at the Transition Date to IFRS. The impact of applying this election to outstanding equity instruments unvested at the transition date was not material.

**Notes to reconciliations:**

a) Fair value of property, plant, and equipment as deemed cost

As noted above, the Company has elected to recognize land and building that houses its head office and manufacturing facility in Saskatoon, Saskatchewan, at fair value as deemed cost on transition date. As a result of applying this exemption, the net book value of the land and building increased by $3,157,406 at December 1, 2010 with a corresponding increase in retained earnings.

The increase in the net book value of the building resulted in an increase in depreciation of $34,476 for the period ended February 28, 2011 and $51,714 for the year ended November 30, 2011.

---

**17. Explanation of transition to IFRS – continued:**

b) Deferred tax adjustment related to fair value of property, plant, and equipment as deemed cost

The election to recognize land and building at fair value as deemed cost results in a taxable temporary difference of $811,453 with a corresponding decrease in retained earnings on transition.

This taxable temporary difference reverses as the building is depreciated and resulted in a tax recovery of $8,860 for the period ended February 28, 2011 and $13,290 for the year ended November 30, 2011.

c) Sale leaseback transaction

In April 2011, the Company sold its head office and manufacturing facility for net proceeds of $6,516,625 under a sale leaseback transaction. Under Canadian GAAP, the Company realized a gain of $3,035,298 on the sale. The gain on sale was deferred and was being amortized over the term of the building lease. For the year ended November 30, 2011, the Company recognized $158,085 of the deferred gain in other income resulting in a residual deferred gain at November 30, 2011 of $2,877,213.

As a result of the deemed cost election made by the Company on transition to IFRS, the corresponding loss realized on disposition under IFRS was $70,394. Under IFRS, the realized loss is recognized immediately in other expense.

Current and long-term deferred gain amounts under Canadian GAAP have been reversed as at November 30, 2011 with a corresponding increase in retained earnings. Other income for the year ended November 30, 2011 was reduced by $228,479 representing the reversal of deferred gains recognized in income under Canadian GAAP of $158,085 and the loss realized on disposition under IFRS of $70,394.

d) Deferred tax adjustment related to gains (losses) on sale leaseback transaction

On the disposition of land and buildings under the sale leaseback transaction, the remaining taxable temporary difference described in note (b) of $798,163 was reversed.

The deductible temporary difference arising from the recognition of the deferred gain on the sale leaseback transaction under Canadian GAAP described in note (c) reversed as the deferred gain was recognized in other income. The tax provision of $40,628 recognized under Canadian GAAP on income recognized for the year ended November 30, 2011 has been reversed.

Similarly a tax recovery of $18,091 has been recorded on the loss recognized on the sales leaseback transaction under IFRS for the year ended November 30, 2011.

---

**17. Explanation of transition to IFRS – continued:**

e) Reclassification of depreciation expense

Depreciation expense has been allocated to cost of sales or administrative and marketing expenses on the basis of the function of the class of assets.

f) Foreign currency translation

Under Canadian GAAP, the Company recognized a portion of the net unrealized foreign currency translation gain (loss) in earnings (loss) on the receipt of dividends from XPCT. Under IFRS such amounts are not recognized.