



Management Discussion and Analysis November 10, 2010

For the third quarter and nine-month period ended September 30, 2010

This Management Discussion and Analysis ("MD&A") should be read in conjunction with the Unaudited Interim Consolidated Financial Statements of ProSep Inc. ("ProSep" or the "Company") for the three- and nine-month periods ended September 30, 2010 and 2009, as well as the Company's Annual Audited Consolidated Financial Statements and MD&A for the year ended December 31, 2009.

Regulatory Filings

The Company's continuous disclosure material, including interim filings, annual MD&A and Audited Consolidated Financial Statements, Annual Information Form and Notice of Annual Shareholder Meeting and Proxy Circular, are available at www.sedar.com and on the Company's website at www.prosepinc.com.

Caution Regarding Forward-Looking Statements

This MD&A may contain forward-looking statements, including statements regarding ProSep's business and anticipated financial performance. Such statements are based on, among other things, management's current assumptions, expectations, estimates, objectives, plans and intentions regarding projected revenues and expenses, the economic and industry conditions in which the Company operates or which could affect its activities, and the Company's ability to attract new clients and consumers, as well as its operating costs, raw materials and energy supply. Forward-looking statements can generally be identified by the use of the conditional tense, the words "may", "should", "would", "believe", "plan", "expect", "intend", "anticipate", "estimate", "foresee", "objective" or "continue" or the negative of these terms or variations of them or words and expressions of similar nature. Actual results could differ materially from the conclusion, forecast or projection stated in such forward-looking information. These statements are subject to a number of risks and uncertainties that may cause actual results to differ materially from those contemplated by the forward-looking statements. Some of the factors that could cause such differences include, but are not limited to, the Company's ability to develop, manufacture, and successfully commercialize value-added equipment and services, the availability of funds and resources to continue its operations and pursue its projects, legislative or regulatory developments, competition, technological change, changes in government and economic policy, inflation and general economic conditions in geographic areas where ProSep operates. These and other factors should be considered carefully, and undue reliance should not be placed on the forward-looking statements.

Use of Estimates

In the preparation of financial statements in accordance with Canadian generally accepted accounting principles ("GAAP"), management must make estimates and assumptions that affect the figures reported as assets and liabilities and contingent assets and liabilities at the date of the financial statements, as well as figures reported as revenues and expenses for the period. Actual results could differ from these estimates.

All amounts are in Canadian Dollars unless otherwise specified.

Non-GAAP Measures

This MD&A contains the terms "Earnings Before Interest, Taxes, Depreciation and Amortization" ("EBITDA") and "Net Invested Working Capital" ("NIWC"), which should not be considered as an alternative to, or more meaningful than, net earnings or cash flow from operating activities as determined in accordance with GAAP, as an indicator of the Company's performance. These terms do not have standardized meanings prescribed by GAAP. ProSep's determination of EBITDA and NIWC may not be comparable to that reported by other companies.

Management uses EBITDA, among other measures, to assess the operating performance of the ongoing businesses without the effects of depreciation expenses. The Company excludes depreciation expenses because they largely depend on the accounting methods and assumptions a company uses, as well as on non-operating factors such as the historical cost of capital assets. The following table reconciles EBITDA with net income.

	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
	\$	\$	\$	\$
Net loss	(1,544,990)	(3,440,258)	(3,154,374)	(12,572,626)
Plus				
Future tax provision (recovery)	(201,396)	128,383	(712,156)	100,011
Current tax provision	15,486	(74,047)	(351,756)	111,038
Amortization	361,961	410,637	1,106,661	1,180,816
(Gain) Loss on sale of assets	(800)		25,468	
Net Financial charges	528,360	2,742,592	1,695,188	4,773,825
Increase in fair value of long-term investments	-	(400,000)	(375,000)	(400,000)
Impairment of Goodwill	-	-	-	6,500,000
EBITDA (loss)	(841,379)	(632,693)	(1,765,969)	(306,936)

NIWC is also used by management to analyze the total amount invested to support outstanding contracts, and is defined as the sum of restricted cash related to letters of guarantee, receivables, inventories and prepaid expenses, less the sum of accounts payable, accrued liabilities and deferred revenue.

The following table shows the calculation of this non-GAAP measure.

	September 30, 2010 \$	December 31, 2009 \$
Restricted cash	-	2,022,940
Receivables	14,087,022	12,807,205
Inventories	318,418	392,709
Prepaid expenses	707,225	665,162
Total (a)	15,112,665	15,888,016
Less		
Accounts payable and accrued liabilities	11,921,011	12,836,057
Deferred revenue	224,717	71,796
Total (b)	12,145,728	12,907,853
Net Invested Working Capital (a minus b)	2,966,937	2,980,163

Comparative Figures

Where applicable, comparative figures for the financial information related to the three- and nine-month periods ended September 30, 2009, have been reclassified to conform with the September 30, 2010, presentation.

TABLE OF CONTENTS

1.	OVERALL PERFORMANCE.....	4
1.1	Highlights of the Quarter Ended September 30, 2010, and Subsequent Events	4
1.2	Material Events and Important Subsequent Events	4
2.	COMPANY OVERVIEW.....	5
2.1	Business Overview	5
2.2	Corporate Model and Sales Network.....	6
2.3	Business Environment and Strategy	6
3.	PRODUCTS.....	8
3.1	Market Segments and Product Penetration	8
3.2	Product and Services Overview	9
4.	RESULTS OF OPERATIONS	10
4.1	Contracts	10
4.2	Revenues.....	11
4.3	Cost of Goods Sold and Gross Margin.....	12
4.4	Goodwill Impairment	15
4.5.	Increase in Fair Value of ABCP	15
4.6	Financial Charges.....	15
4.7	Income Tax.....	15
4.8	Net Loss	15
4.9	Foreign Currency Translation Adjustment (part of Comprehensive Loss).....	15
4.10	Legal Proceedings	16
5.	SUMMARY OF QUARTERLY RESULTS.....	16
6.	BALANCE SHEET ITEMS.....	16
6.1	Assets.....	16
6.2	Liabilities	17
6.3	Equity	17
7.	OFF-BALANCE-SHEET ARRANGEMENTS	17
8.	LIQUIDITY AND CAPITAL RESOURCES	18
8.1	Cash Flows.....	18
8.2	Liquidity and Working Capital.....	18
8.3	Bank Overdraft Facilities and Obligations under Financial Liabilities.....	19
8.3.1	Financial Covenants	19
8.3.2	Obligation under Financial Liabilities	19
9.	TRANSACTIONS WITH RELATED PARTIES	19
10.	DESCRIPTION OF CAPITAL STRUCTURE	19
11.	IFRS CHANGEOVER PLAN	20
12.	CRITICAL ACCOUNTING ESTIMATES	21
13.	INTERNAL CONTROLS	21
14.	SELECTED RISKS	23

1. OVERALL PERFORMANCE

1.1 Highlights of the Quarter Ended September 30, 2010, and Subsequent Events

Financial:

- Revenues were \$8.1 million, a decrease of 11% when compared to \$9.2 million for the corresponding period of 2009. Year-to-date, revenues amount to \$26.2 million, a 17% reduction from the \$31.7 million generated during the first nine months of 2009.
- Gross margin of \$2 million (24% of revenues) compared to \$2.7 million (29%) for the corresponding period of 2009. Year-to-date, gross margin stands at \$7.1 million (27%) compared to \$9.6 million (30%) for the same period last year.
- Net loss of \$1.5 million compared with a net loss of \$3.4 million for the corresponding period of 2009. Year-to-date, net loss amounts to \$3.2 million compared to \$12.6 million for the same period last year. Included in the 2009 year-to date net loss were \$6.5 million goodwill impairment and debt conversion and settlement costs amounting to \$2.1 million.

Operational and Corporate:

- Announced approximately \$11 million in new contracts during the quarter including its first significant sale for the Canadian Oil Sands market.
- Appointed two industry veterans to the Company's executive committee:
 - Douglas A. Campbell, P.Eng., M.B.A. was appointed Executive Vice President of Sales and Business Development. Mr. Campbell was previously Vice President Marketing and Business Development at NATCO Group where he was intimately involved in the group's international success until its acquisition by Cameron, a leading equipment supplier with over \$5 billion in sales.
 - Parag P. Jhonsa was promoted to Executive Vice President Operations. Mr. Jhonsa previously led the American business unit's engineering and operations teams.
- Ranked for a second consecutive year among the Deloitte Technology Fast 50™, received a third Green 15 award and ranked fourteenth fastest growing company in the North American Fast 500 edition based on percentage of revenue growth over the last 5 years.
- Sales backlog stood at \$12.9 million on October 1, 2010, an increase of 32% from the last quarter. Subsequent to quarter-end, ProSep announced an additional US\$1.5 million in new contracts (see Section 1.2).

1.2 Material Events and Important Subsequent Events

In this section, all material events and commitments for the three-month period are presented, followed by information on important subsequent events, up to the date of this MD&A.

On November 4, 2010, ProSep announced the nomination of two new executives. Douglas A. Campbell P. Eng., M.B.A., as Executive Vice President of Sales and Business Development and Parag P. Jhonsa, as Executive Vice President Operations.

On October 7, 2010, ProSep announced that it had been awarded a \$1.5 million supply contract to provide additional equipment associated with a CO₂ gas membrane treatment plant to be delivered to a South American customer. Additional equipment includes the supply of spare gas membranes.

On September 27, 2010, the Company announced that it would supply after-market services and spare parts valued at \$2 million to clients located in Kuwait and the United States for produced water and gas treatment systems.

On September 23, 2010, the Company announced that it ranked for a second consecutive year among the Deloitte Technology Fast 50™, a ranking of the 50 fastest growing technology companies in Canada, based on the percentage of revenue growth over the last five years. ProSep ranked seventh with a 10,203 percent revenue growth from 2005 to 2009. The Company also received for the third consecutive year, a Technology Green 15™ Award created in 2007 to showcase 15 Canadian companies that are leading the way to create major breakthroughs in the field of green technology. ProSep also ranked 14th fastest growing company according to revenue growth over the last 5 years in the North American Fast 500 edition.

On August 24, 2010, the Company received new contracts in the United States, South America and Asia Pacific for a total of US\$2.4 million. Under a contract valued at US\$1.5 million, ProSep will supply CO₂ gas separation membrane and hydrocarbon dew point packages for installation at an onshore gas plant in South America. The Company also announced that a second supply agreement had been concluded for the delivery of a nitrogen generator package valued at US\$0.5 million to be installed on a Floating Production Storage and Offloading (“FPSO”) facility expected to operate in the South China Sea. Under a contract valued at US\$0.4 million, ProSep will supply a pitless air drilling de-duster skid for a large international oil services company.

On August 9, 2010, the Company was awarded a US\$4.1 million contract to supply a gas dehydration system for a natural gas development project located in the South China Sea. On the same day, the Company announced that it had received a contract valued at US\$0.5 million to supply a chemical injection package for a leading engineering and construction services provider.

On July 8, 2010, ProSep announced that it had been awarded a US\$2.0 million contract to provide process engineering and specialized internals for a crude separation solution to be installed at a super major oil and gas producer’s steam-assisted gravity drainage (“SAGD”) facility located in Alberta’s oil sands.

2. COMPANY OVERVIEW

2.1 Business Overview

ProSep designs, develops, manufactures, and commercializes process solutions to treat, separate and purify oil, gas, and water for the oil & gas (O&G) upstream industry. ProSep has a wide range of conventional and proprietary process equipment sold in units or in packages to O&G producers and engineering procurement and construction firms (“EPC”), with process warranties.

Global Business Model:

ProSep is a solutions provider supplying high efficiency process equipment packages with process warranty.

ProSep provides:

- In-house engineering from process to details; and
- Direct and hands-on involvement with project management that includes fabrication, assembly, commissioning and services.

ProSep operates around the world in the most important O&G service hubs, with operations in Houston (USA), Bergen (Norway), Fusa (Norway), Kuala Lumpur (Malaysia), and Manama (Bahrain). Its head office is in Montreal (Canada).

ProSep has approximately 100 employees, mainly technical sales people, process engineers, product engineers and project managers as well as workers in its 55,000 square-foot assembly shop located in Houston.

2.2 Corporate Model and Sales Network

ProSep has three diversified business units that promote the Company's solutions across all regional markets. Each business unit has developed its own specific expertise and reputation by tailoring the Company's solutions to the markets it serves. Each business unit has its own team of engineers and experienced sales people, including a network of agents.



2.3 Business Environment and Strategy

In 2009, the global upstream O&G market contracted significantly with the global financial crisis, recession and depressed energy demand. The International Energy Agency (IEA) estimated that upstream CAPEX spending in 2009 fell by approximately \$90 billion, or by 22%¹ as many capital intensive projects were rendered uneconomical with the then prevailing price levels and recessionary environment. For 2010, the upstream oil and gas industry is back to growth after almost two years of decline. IHS, a leading source of industry information, forecasts an 8% growth in E&P investments at the world's leading publicly traded oil and gas producers² to \$353 billion, while Barclays Capital forecasts the increase to be closer to 9% and reach \$335 billion³ by the end of this year.

The IEA indicated in its monthly Oil Market Report (released mid-July 2010) that demand would reach an average of 86.5 million bpd this year, up from 84.93 million last year, although consumption in Europe still looks weak. Looking into 2011, the IEA predicts oil demand to grow exclusively on non-OECD demand, to 87.8 million bpd, with OECD demand continuing to decline (-0.5% or -0.2 mbpd)⁴. The organisation also forecasts an average price of \$79.40 per barrel of oil in 2011.

Increasing backlog

The Company's backlog has been growing steadily since the second half of this year. Standing at \$13 million at the end of the third quarter, the backlog is up 32% from \$9.8 million at the end of the previous quarter. As discussed above, after falling significantly in 2009, oil and gas producers started increasing their CAPEX budgets in 2010. This has translated into increased opportunities in the industry and invitations to tender on larger projects. Since oil and gas producers contract EPCs for the design and construction of these new projects, there is a significant time delay between the initiation of the tender process and signature of supply

¹ Aliza Fan Dutt, senior equity analyst at IHS Herold quoted in a June 15, 2010 article "E&P Capital Moving from Offshore to Onshore US - Report", in Rigzone.

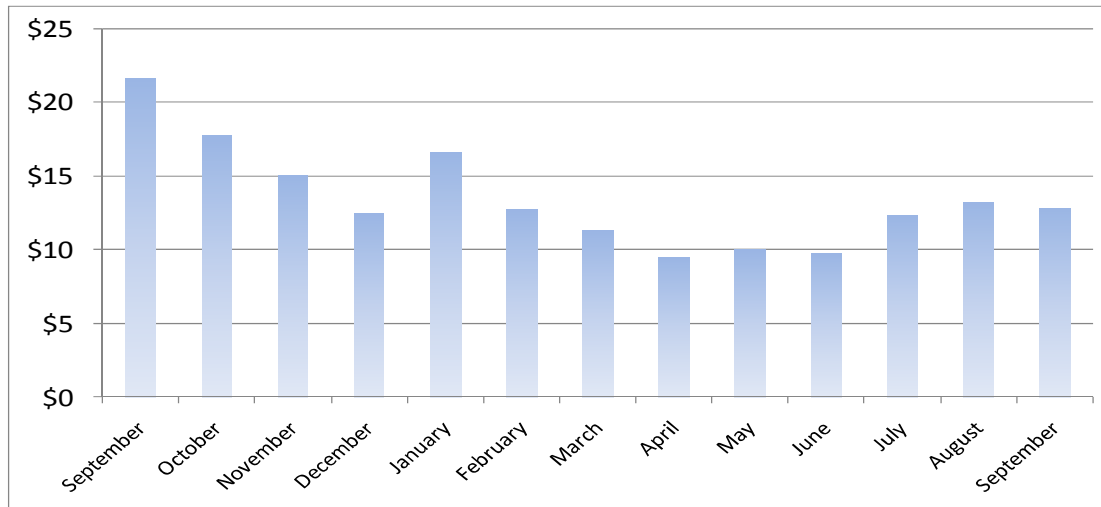
² IHS Herold 2010 Global Upstream Capital Spending Report

³ Barclays Capital Capital Original E&P Spending Survey mid-year update, June 2010

⁴ IEA's Oil Market Report published July 13, 2010. www.omrpublic.iea.org

agreements. During the first half of the year, ProSep's bidding activity with EPCs reached record levels. This has resulted in increased backlog levels during the second half of the year. Revenues should start improving before the end of the year and continue through 2011.

Recent backlog trend



Stricter regulatory environment and new technologies

The Deepwater Horizon accident that occurred on April 20, 2010 in the Gulf of Mexico led the USA Minerals Management Service (MMS) to institute a moratorium on deepwater drilling on the coast of the United States on May 27, 2010. The moratorium was lifted on October 12 with the provision that producers certify compliance with existing and new rules and requirements. It is still unclear how this accident and subsequent oil spill will affect the industry but it remains clear that the oil and gas industry will operate under tighter regulation and stronger oversight⁵. With new discoveries moving offshore and in deeper, more challenging environments, it can be reasonably speculated that the increased attention on the offshore oil and gas industry should accelerate producers' willingness to invest in more efficient and sustainable technologies to mitigate the environmental impact of their activities.

Because of its global operations and limited activity in the deepwaters of the Gulf of Mexico, ProSep has not been affected by the Deepwater Horizon accident. It is, however, too early to assess the future impact of this accident on the global offshore industry. ProSep remains cautiously optimistic about the industry's renewed growth and will continue to target areas of strong demand, such as South East Asia and Western Canada, and look at expanding its offering in new promising regions such as Latin America.

It remains clear that, in order to meet projected demand growth⁶ for fossil fuels, the industry will need to increase its investments to raise net capacity. The world's conventional proven reserves are depleting and new discoveries are mostly unconventional and offshore, and thus will require newer treatment technologies. As downhole improvements such as drilling, fracking and enhanced recovery have changed the profile of the industry, ProSep believes that innovative process solutions are needed to continue improving the economics of oil and gas production and face increased regulatory and environmental standards.

⁵ www.upstreamonline.com, October 15, 2010, "Some industry relief as Salazar lifts deep-water US Gulf drill ban"

⁶ www.upstreamonline.com, May 31, 2010 « IEA sees 2010 boost in energy spend »

ProSep's growth strategy

To achieve its growth objective, ProSep will continue to focus on its core business. In 2009, the Company expanded its produced water treatment offering and invested in a larger state-of-the-art manufacturing facility. As a result, ProSep is able to package its various solutions for and bid on larger projects. This strategy started delivering results with recent produced water treatment sales, the supply of an important technology component for a high profile carbon capture project, and a \$13 million CO₂ gas treatment system. ProSep will also continue to expand its offering in new markets such as Western Canada and support its growing South East Asian business operations. By accelerating the validation cycle of promising technologies, ProSep plans to substantially differentiate its offering from the competition. By working to position the Company as a market leader in technology oriented process solutions, this key differentiation factor should lead to improved gross margins in a highly competitive environment.

As the oil and gas equipment industry is entering a new economic cycle, ProSep must face and manage robust competition and increased pressure on gross margins. The challenge this year will be to position the Company on a solid profitability track to benefit from increasing market opportunities.

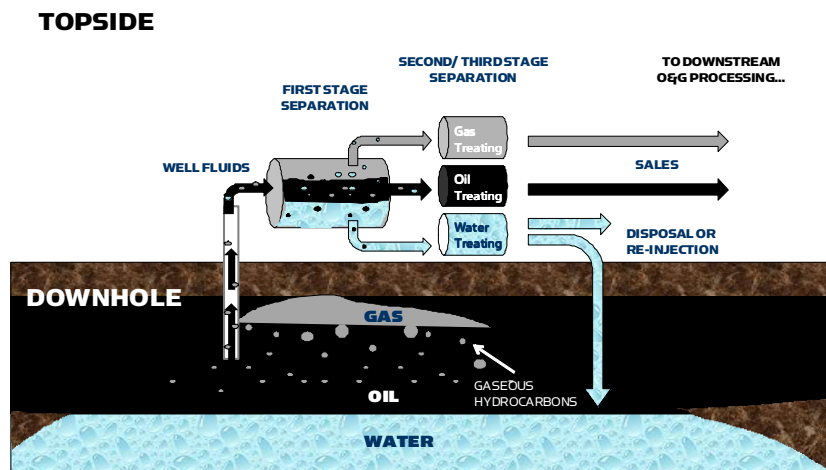
To maximize resources, promote best practices in engineering and operations and improve its sales process and customer reach, ProSep has added two new members to its executive committee. Parag Jhonsa was promoted to coordinate and improve engineering and operations at all the Company's business units. His impeccable record at managing the Company's 55,000 square feet Houston fabrication facility will help other business units achieve the same level of operational excellence and seamless execution. The arrival of Douglas A. Campbell, a former sales and marketing executive at NATCO Group, will help expand ProSep's global reach and unlock significant value residing in some of the Company's proprietary step-change technologies.

3. PRODUCTS

3.1 Market Segments and Product Penetration

ProSep's international team of engineers has developed extensive knowledge of process solutions for the upstream O&G treatment market. The Company's expertise lies in the development of technically advanced separation solutions to treat gas, oil and produced water for upstream production activities.

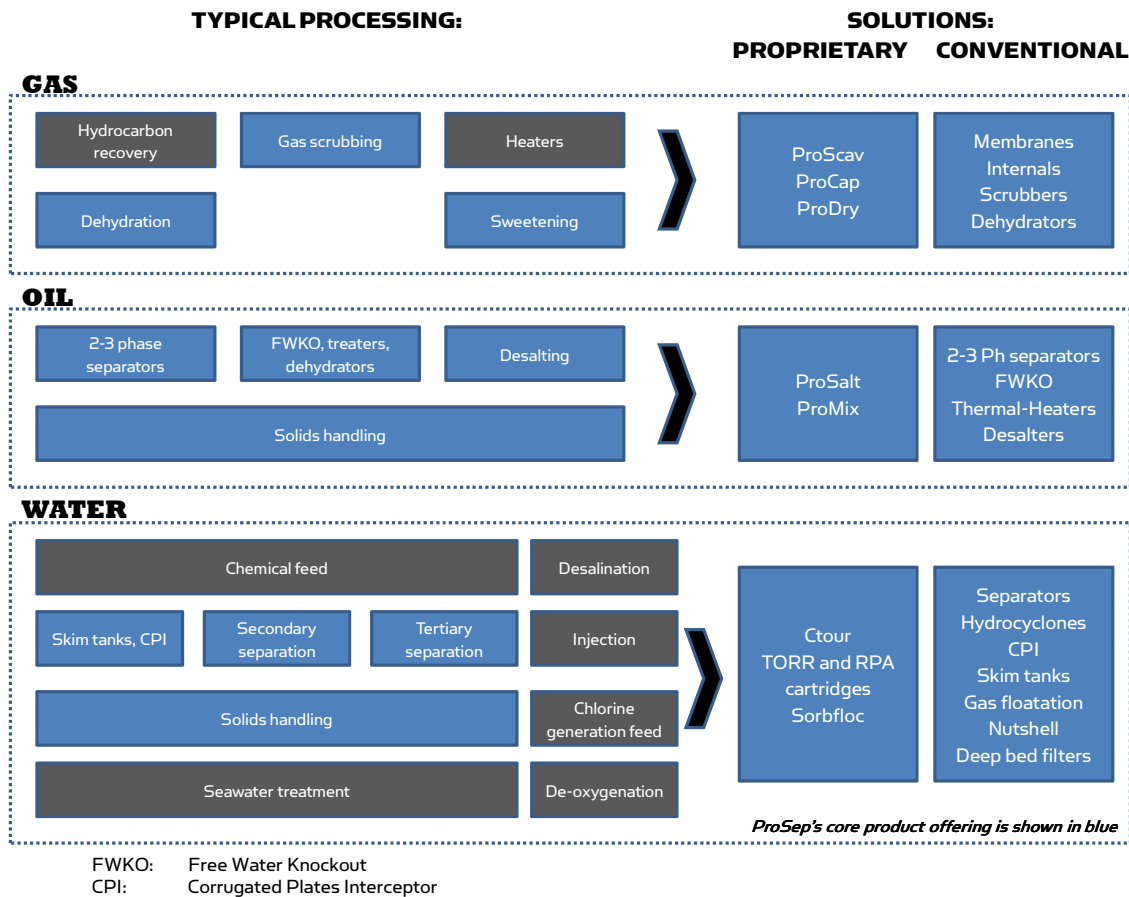
Topside Oil and Gas Separation



Whether recovered from onshore or offshore production facilities, the extracted hydrocarbon stream (oil, gas, water and solids) is brought to the surface (topside) to be processed and separated. Oil must be cleaned of salt and dissolved gas and other components; gas must be stabilized and cleaned of all liquids and unwanted components, such as hydrogen sulphide and carbon dioxide, before being commercialized. Produced water needs to be treated to remove all dissolved components, organic materials and solids before being disposed of or used for re-injection.

3.2 Product and Services Overview

ProSep designs customer specific solutions by utilizing its wide range of equipment to separate, treat and polish well fluids and gas before they can be sent downstream for further refining, disposed of, or used for re-injection. The following is a diagram of the Company's core product offering/penetration:



Process Design Experts:

ProSep's process engineers have developed a wide range of complementary branded proprietary and conventional technologies. Offered as individual equipment or complete custom-designed packages, ProSep's technically advanced process solutions are used by O&G producers around the world to optimize separation and treatment of produced water, oil and gas. ProSep's solutions offer environmental and economic efficiencies, allowing oil and gas producers to meet industry and regulatory requirements while optimizing profitability. The Company believes that this is an important, unique value-added proposition as the industry faces increasing production challenges, such as diminishing production at older wells, difficult production environments, unconventional resources, and increasing use and co-production of water.

For a complete list and description of the Company's conventional and proprietary offering, refer to the most recent Annual Information Form, available at www.sedar.com and www.prosepinc.com.

4. RESULTS OF OPERATIONS

4.1 Contracts

Sales originate from a number of contracts for the supply of conventional and proprietary gas, oil and water treatment systems to both large international oil and gas companies ("IOC") and national oil and gas companies ("NOC"). ProSep's systems have been delivered and installed on onshore and offshore oil and gas fields around the world.

Table of Contracts Announced Since January 2009

Date	Value	Product	Customer	End User
January 2009	US\$3.7 M	Fuel gas package	*: Major EPC firm	*: Asia Offshore IOC
February 2009	US\$1.2 M	Separator	Worley Parsons	BP Exploration
March 2009	US\$2.0 M	Fuel gas package	Powertium/MMHE	Petronas
March 2009	US\$2.1 M	Gas membrane units	Whiting Petroleum	Whiting Petroleum
May 2009	\$1.4 M	ProDry "JIP"	Total, Statoil, Con.Phil.	-
July 2009	\$1 M	ProSalt, ProDry	BP, Con.Phil, Maersk	BP, Con.Phil, Maersk
October 2009	US\$12.9 M	Gas separation	Ecopetrol	Ecopetrol
January 2010	\$1 M	Water treatment (TORR)	*	*: Asia Offshore NOC
January 2010	US\$3.5 M	Gas membrane	*	*: US Onshore producer
January 2010	\$3.6 M	Water treatment (CTour)	*	*: Offshore super major
March 2010	\$0.4 M	Proprietary mixer for CO ₂ capture project	Statoil, Norske Shell, Gassnova	Statoil, Norske Shell, Gassnova
May 2010	n/a	Water treatment	Dragados	Dragados-Pemex
May 2010	US\$2.2 M	Water treatment	*	*: Asia Offshore
July 2010	US\$2.0 M	Engineering and specialized internals for crude separation	*	*: Super major producer in Canadian Oil Sand market
August 2010	US\$0.5M	Chemical injection package	*	*: Asia Pacific
August 2010	US\$4.1M	Gas dehydration	*	*: Asia Pacific
August 2010	US\$1.5	CO ₂ gas separation membrane and hydrocarbon dew point packages	*	*: South America
August 2010	US\$0.5	Nitrogen generator package	*	*: South China Sea
August 2010	US\$0.4	Pitless air drilling de-duster skid	*	*: United States
September 2010	US\$2.0	After-market services and spare parts	*	*: Kuwait & United States
October 2010	US\$1.5	Additional equipment (including spare gas membranes)	*	*: South America

*: Information could not be revealed for competitive reasons.

4.2 Revenues

	US operations	European & Middle East operations	Asia Pacific operations	Consolidation & Inter segment eliminations	Consolidated operations
	\$'000	\$'000	\$'000	\$'000	\$'000
Three-month period ended September 30,					
2010 Revenues	5,491	751	1,951	(53)	8,140
2009 Revenues	5,828	1,155	2,204	-	9,186
Nine-month period ended September 30,					
2010 Revenues	16,516	4,979	4,810	(104)	26,201
2009 Revenues	21,058	3,815	7,231	(415)	31,689

Three-month period ended September 30

ProSep reported consolidated revenues of \$8.1 million during the third quarter of 2010, a decrease of 11% from \$9.2 million generated during the same quarter in 2009. Revenues for all three operations were affected by a weaker historical backlog, with the Europe and Middle East operations accounting for the largest share of revenue decline. Encouragingly, a significant increase in the total value of signed contracts, resulting in a 32% increase in the Company's backlog was noted in this quarter. This could lead to revenue growth in the upcoming quarters as these contracts are executed within a twelve-month period.

Segment comments

ProSep's *US operations* generated 67% of the consolidated revenues, with sales of \$5.5 million, down 6% from \$5.8 million reported in 2009. The decrease in sales is mostly attributable to the unfavourable US currency exchange rate that negatively affected revenues by \$0.3 million. During the third quarter of 2010, the average currency conversion rate for sales concluded at the US operations was 1.04 CAD/USD compared to 1.10 CAD/USD in 2009. Most quarterly revenues came from the advancement of the Ecopetrol and Whiting Petroleum gas skids contracts, as well as various orders for spare parts.

The *European and Middle East operations* reported revenues of \$0.8 million for the third quarter of 2010, representing a 35% decrease from \$1.2 million reported for the corresponding period of 2009. Since most of this operation's offering is based on a relatively new suite of proprietary solutions, revenues are still volatile. As this offering gains technical validation and builds market recognition, quarterly revenue variations should be less significant.

The *Asia Pacific operations* reported revenues of \$2.0 million for the third quarter of 2010, down 12% from \$2.2 million generated during the same period in 2009. Delays in the contractual completion of the glycol regeneration package, in part caused by change orders and requisitions, limited the operations' ability to recognize more revenues during the quarter. As of the date of this MD&A, the contract was delivered to the satisfaction of the customer.

Nine-month period ended September 30

Year-to-date, ProSep reported consolidated revenues of \$26.2 million, down 17% from \$31.7 million in the first nine-months of 2009. Growth at the European and Middle Eastern operations was offset by decreased revenue at the Asia Pacific and US operations. Overall, lower order intake following residual weakness in upstream capital expenditure programs, increased competition, delays in contract completion at the Asian operations and unfavourable USD/CAD exchange rates explain most of the variance.

Segment comments

ProSep's *US operations* reported year-to-date revenues of \$16.5 million, 22% lower than the \$21.1 million reported in 2009. Tighter market conditions resulting from the industry's downturn continued to affect ProSep's US operations and unfavourable exchange rates lowered revenues by approximately \$1.8 million.

The *European and Middle East operations* reported revenues of \$5 million, up 31% from \$3.8 million reported for the first nine months of 2009. The sale of a large produced water treatment system during the first quarter, valued at \$3.6 million for a super major operating in the North Sea, explains most of the revenue improvement year-to-date.

The *Asia Pacific operations* recorded revenues of \$4.8 million for the first three quarters of 2010, 33% lower than the \$7.2 million reported for the same period in 2009. Changes in orders delayed the completion of an important contract for the supply of a glycol regeneration package, reducing the amount of revenues recognized during the first nine months of the year. This situation has been remedied and the system was recently delivered to the customers' satisfaction. Year-to-date, the value of the Malaysian Ringgit improved significantly against the US dollar. On average, the MYR/USD currency exchange was 3.03 compared to 3.60 during 2009. The value of certain contracts signed in USD was negatively affected by the appreciating value of the Ringgit, and impacted revenues by approximately \$0.4 million in 2010. Management is currently developing a hedging strategy to protect revenues from such currency fluctuations.

4.3 Cost of Goods Sold and Gross Margin

Three-month period ended September 30

Three-month period ended September 30		US Operations	European & Middle East operations	Asia Pacific operations	Consolidation & Inter segment eliminations	Consolidated operations
		\$'000	\$'000	\$'000	\$'000	\$'000
2010	Cost of goods sold	4,066	344	1,817	(53)	6,174
	Gross margin	1,425	407	134	-	1,966
		26%	54%	7%	-	24%
2009	Cost of goods sold	4,308	471	1,746	-	6,524
	Gross margin	1,520	684	458	-	2,662
		26%	59%	21%	-	29%

The Company reported a consolidated gross margin of \$2 million or 24% of revenues, down 5% from \$2.7 million or 29% of revenues during the corresponding quarter of 2009. During the quarter, gross margins were in line with recent historical performance except at the Asia Pacific Operations. Rapid growth experienced by this operation led to difficulties in executing certain contracts. ProSep has taken the necessary steps to ensure that this business unit has access to additional resources, allowing it to reach the same level of seamless execution and cost controls that the other more established operations have achieved.

Segment comments

ProSep's *US Operations* reported a gross margin of \$1.4 million or 26% of revenues, in-line with \$1.5 million or 26% during the third quarter of 2009. Strict controls over engineering, procurement and operations at the Company's largest fabrication facility have been successful at maintaining sustainable gross margin levels in a highly competitive market.

The *European and Middle East operations* reported a gross margin of \$0.4 million or 54% of revenues, slightly lower on a percentage basis than the \$0.7 million or 59% of revenues that occurred in the same quarter of 2009. This business unit almost exclusively designs, engineers and fabricates proprietary solutions that command higher gross margins. Depending on the type of contract and contract mix during the period, margins can vary but not significantly.

The *Asia Pacific operations* reported a gross margin of \$0.1 million or 7% of revenues during the third quarter of 2010, compared to \$0.5 million or 21% for the corresponding period of 2009. Excluding extra costs related to challenges at the Company's newest operations and currency fluctuations, the third quarter normalized margin would have been in the 20% range, in line with historical performance.

Nine-month period ended September 30

Nine-month period ended September 30		US Operations	European & Middle East operations	Asia Pacific operations	Consolidation & Inter segment eliminations	Consolidated operations
		\$'000	\$'000	\$'000	\$'000	\$'000
2010	Cost of goods sold	12,536	2,210	4,444	(104)	19,085
	Gross margin	3,980	2,769	366	-	7,115
		24%	56%	8%	-	27%
2009	Cost of goods sold	15,093	1,845	5,571	(415)	22,094
	Gross margin	5,965	1,970	1,660	-	9,596
		28%	52%	23%	-	30%

Year-to-date, the *US* and *European and Middle East Operations* were the largest contributors to consolidated gross margins. Gross margins for the first nine-months of operations stood at \$7.1 million, or 27% of revenues, compared to \$9.6 million, or 30% of revenues generated during the same period last year. The contribution to gross margins from the *European and Middle East Operations*, where most of the Company's proprietary expertise resides, is significant relative to its contribution to total revenues. Expanding this knowhow and engineering expertise to other operations will improve their ability to efficiently promote the solutions across their respective markets. This will be key in achieving higher levels of consolidated gross margins in an increasingly competitive environment.

Segment comments

Gross margin achieved at the *US operations* were \$4.0 million or 24% of revenues for the first nine-months of the year, down from \$6.0 million, or 28% for the same period of 2009. The gross margin in 2009 reflected higher non-recurring cost savings in project commissioning.

Gross margins at the *European & Middle East operations* were close to \$2.8 million, or 56% of revenues compared with \$2 million, or 52% of revenues for the corresponding period in 2009. The improved gross margin reflects the contribution of the large produced water contract concluded in January, as well as the delivery of several TORR™ RPA cartridges.

Gross margins at the *Asia Pacific operations* stood at \$0.4 million or 8% of revenues on a year-to-date basis compared to \$1.7 million or 23% of revenues during the same period of last year. As previously mentioned, this year's unusually low gross margin was caused by extra costs on one contract and delays due to changes in orders as well as by currency fluctuations.

Expenses and EBITDA

Expenses and EBITDA* for the 3-month periods ended September 30

	2010 \$'000	2009 \$'000
Revenue	8,140	9,186
Sales and marketing	519	539
Research and development	35	95
General and administrative	2,253	2,661
	2,807	3,295
EBITDA (loss)	(841)	(633)

Expenses and EBITDA* for the 9-month periods ended September 30, 2010 and 2009

	2010 \$'000	2009 \$'000
Revenue	26,201	31,689
Sales and marketing	1,529	1,645
Research and development	187	396
General and administrative	7,165	7,862
	8,881	9,902
EBITDA (loss)	(1,766)	(307)

* EBITDA is a non-GAAP measure. Please refer to the section called non-GAAP measures for detailed calculations.

Earnings before interest, taxes, depreciation and amortization (“EBITDA”) were negative \$0.8 million for the third quarter of 2010 compared to negative \$0.6 million during the same period of 2009. Despite the Company’s ability to tightly control operating expenses, residual weakness in the industry, growing pains at the Asia Pacific operations and unfavourable currency exchange rates led to a negative year-to-date EBITDA of \$1.8 million compared with negative \$0.3 million for the same period in 2009.

Sales and Marketing Expenses

Sales and marketing expenses were stable at \$0.519 million or 6.3% of revenues for the third quarter of 2010 compared with \$0.539 million or 5.9% for the same quarter in 2009. Year-to-date, sales and marketing expenses were \$1.5 million or 5.8% of revenues compared to \$1.6 million or 5.2% in the same period of 2009. The majority of these expenses relate to salaries, marketing, promotions and travel activities.

Research and Development Expenses

Research and development expenses represented \$0.035 million during the third quarter of 2010 compared to \$0.095 for the same quarter of 2009. Year-to-date, such expenses represented \$0.187 million compared to \$0.396 million during the first three quarters of 2009. Since 2009, R&D expenses represent an increasingly smaller portion of total operating expenses as all the Company’s technology is developed with industry partners. They are usually industry super majors such as Total, Chevron and ConocoPhillips, who contribute to most of the cost of developing ProSep’s proprietary technologies under Joint Industry Partnerships.

General and Administrative Expenses

General and administrative expenses were \$2.3 million for the third quarter of 2010 also in-line with the \$2.7 million spent on G&A during the same period in 2009. Year-to-date, these expenses represented \$7.2 million compared to \$7.9 million for the corresponding period of 2009. Tight cost controls at all operations helped these expenses remain in-line with lower levels of revenues experienced during the first three quarters of the year.

4.4 Goodwill Impairment

No goodwill impairment charges were taken during the first three quarters of 2010. However, in the second quarter of last year, the Company performed a goodwill valuation test in light of the anticipated impact of the balance sheet restructuring initiative. As such, the Company determined that the anticipated value of ProSep was below its carrying value. Accordingly, an impairment charge of \$6.5 million was recorded in June of 2009.

4.5. Increase in Fair Value of ABCP

In the second quarter, the Company recognized a \$375,000 increase in the value (no adjustment was recorded in the current quarter) of its investment in Notes held since January 2009 following the restructuring of the asset-backed commercial paper. The current value reflects the effect of market indicators as of September 30, 2010, on the valuation technique used by the Company.

4.6 Financial Charges

The total variation in financial charges for the quarter and the nine-month period ended September 30, 2010, reflects the positive impact of the balance sheet restructuring initiative whereby close to \$8 million in indebtedness was converted to equity in July 2009. The reconsideration of the functional currency of each of the Company's domestic and foreign operations (see 4.9 below) also had a positive impact on the financial charges, as the underlying changes in measurement currencies of the foreign subsidiaries are now accounted for as part of the currency translation adjustment.

Total financial charges were \$0.5 million for the quarter compared to \$2.7 million for the same period of 2009. On a year-to-date basis, total financial charges stood at \$1.7 million compared to \$4.8 million.

4.7 Income Tax

Current year tax recovery for both the quarter and the year-to-date arose from the net loss reported at our *US operations*. This compares to the net profit from these operations in 2009. The Company's operating revenues and expenses are reported by various operations located around the world and are subject to various fiscal jurisdictions. Some of the subsidiaries are profitable, while others have yet to generate net income and some have accumulated tax losses.

4.8 Net Loss

During the third quarter of 2010, the Company reported a net loss of \$1.5 million (\$0.01 per share), compared to \$3.4 million (\$0.03 per share) in 2009. On a year-to-date basis, the net loss stands at \$3.2 million (\$0.02 per share) compared to \$12.6 million (\$0.14 per share) last year. In 2009, the net loss was affected by a \$6.5 million goodwill impairment charge resulting from the balance sheet restructuring initiative concluded in the third quarter of 2009.

4.9 Foreign Currency Translation Adjustment (part of Comprehensive Loss)

During the third quarter of 2010, the Company recorded a foreign currency translation adjustment of \$0.9 million resulting from the conversion of the balance sheet of the foreign subsidiaries into Canadian currency.

The conversion of bank debts denominated in the Norwegian Kroner, which appreciated in the quarter in relation to the Canadian dollar, predominantly accounted for this amount.

On a year-to-date basis, the Company recorded a positive foreign currency translation adjustment of \$0.4 million, reflecting the net depreciation of the Norwegian Kroner since January 2010. In addition, the conversion of the US operations' goodwill denominated in US dollars, which appreciated in relation to the Canadian dollar, also contributed to the positive year-to-date currency translation. In the fourth quarter of 2009, following several significant changes, the Company reconsidered the functional currency of each of its domestic and foreign operations and concluded that all of the foreign subsidiaries were self-sustaining. The underlying changes in measurement currencies of the foreign subsidiaries were accounted for prospectively, effective October 2009, with no change to previously-reported results or balances. As such, no amount was accounted for in relation to the foreign currency translation adjustment for the first three quarters of 2009.

4.10 Legal Proceedings

The Company was the defendant in a claim made by Westend Enviro Consultants in the Supreme Court of British Columbia on March 31, 2006, for damages relating to breach of contract and fraudulent misrepresentation in an amount totalling \$280,000. This claim was settled in the first quarter of 2010 for a total amount of \$102,000 (plus interest). As a provision covering substantially all this amount had been recorded in the previous year, this settlement had no significant impact on the Company's 2010 results.

5. SUMMARY OF QUARTERLY RESULTS

Selected Quarterly Financial Performance

	2010			Year Ending December 31, 2009				Year Ending December 31, 2008			
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Revenue (000 \$)	8,140	8,653	9,408	9,730	9,186	9,316	13,187	14,799	12,548	15,141	9,117
Net income (loss) (000 \$)	(1,545)	(304)	(1,305)	(1,306)	(3,440)	(7,148)	(1,985)	27 ²	1,848 ¹	(162)	(3,338)
Basic EPS* (loss) (\$)	(0.01)	(0.00)	(0.01)	(0.01)	(0.03)	(0.11)	(0.03)	0.00	0.03	(0.00)	(0.05)
Diluted EPS (\$)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	0.00	0.03	n/a	n/a

*EPS: Earnings per share

¹Net income includes a reversal of \$1.3 million of warranty provision.

²Net income includes a further reversal of \$1.3 million of warranty provision.

6. BALANCE SHEET ITEMS

6.1 Assets

Total short-term assets at September 30, 2010, were \$18.8 million, representing a decrease of \$5.5 million from the December 31, 2009 amount of \$24.3 million. Most of this decrease is related to reduced cash levels used to temporarily repay the bank credit facilities in relation to the clean down covenant. As part of the current bank covenant with DnB NOR, the Company is required to proceed with two annual cleandown periods during which the credit facility is fully repaid for a period of three weeks. At the end of September

2010, the Company had \$2.5 million in cash and cash equivalents and no amount drawn on the credit facilities, compared to \$7.7 million and \$5 million drawn on the credit facilities at December 31, 2009.

At September 30, 2010, the Company had no restricted cash compared to a restricted amount of \$2 million at December 31, 2009. The restricted cash was related to the issuance of letters of guarantee (“LGs”) required to receive advance payments on the Ecopetrol contract, which was delivered during the quarter. The Company’s receivables were \$14.1 million at September 30, 2010, up \$1.3 million from \$12.8 million at December 31, 2009. This increase is in line with the advancement of work on contracts in all operations. Other than the increase in income tax recoverable largely due to the lower profitability of the US operations (refer to Section 4.7 above), no major changes have occurred in other current assets accounts since the beginning of the year.

Total long-term investments were \$3.7 million at September 30, 2010, reflecting an increase of \$375,000 recorded in the second quarter in the estimated market value of the Notes issued by Master Asset Vehicle II (“MAV 2”), see note 7 to financial statements.

Goodwill totalled \$15.1 million at September 30, 2010, compared to \$15.2 million at December 31, 2009. The variation is due to changes in foreign exchange conversion rates as goodwill is recorded in the local currency of each operating unit. Total intangible assets were \$8.4 million at September 30, 2010, compared to \$8.9 million in December 2009. This decrease relates to amortization, with an offsetting impact due to current foreign exchange conversion rates.

6.2 Liabilities

Total liabilities were \$26.2 million at September 30, 2010, representing a difference of \$7.3 million from the December 31, 2009, amount of \$33.4 million. The net variance is predominantly caused by the temporary repayment of the credit facilities in relation to the clean down covenant and scheduled payments made on the DnB NOR term credit facility.

6.3 Equity

The Company’s net equity was \$21.1 million at September 30, 2010, compared to \$19.9 million at December 31, 2009. This increase results from the equity issuance during the second quarter, less the net loss and other comprehensive loss reported in the first three quarters of 2010.

7. OFF-BALANCE-SHEET ARRANGEMENTS

The Company did not enter into off-balance-sheet arrangements during the nine-month period ended September 30, 2010, other than the LGs issued in the normal course of business in relation to contracts with customers.

8. LIQUIDITY AND CAPITAL RESOURCES

8.1 Cash Flows

Operating Activities

Despite a lower net loss, the Company still generated a negative cash flow from operations of \$1.4 million during the quarter ended September 30, 2010 compared to a negative \$6.2 million the year before. For the nine-month period, ended September 30, 2010, cash flow from operations was negative \$4.9 million, a substantial improvement over the negative \$10.8 million reported in 2009. The improved cash flows for both the quarter and the nine-month periods are predominantly related to lower investment in the operating working capital items required to support ongoing contracts.

Investing Activities

Investing activities during the third quarter of 2010 mainly involved the release of the restricted cash required for the issuance of LGs on the Ecopetrol contract, which was delivered during the quarter.

Financing Activities

Third quarter financing activities consisted primarily of an outflow of \$5.9 million related to the repayment of the credit facilities (see comment on clean down covenant in Section 6.1 above). On a year-to-date basis, financing activities also include an inflow of \$3.6 million related to the net proceeds received from the private placement concluded in the second quarter of 2010. Year-to-date 2009 financing activities included the proceeds of the offering concluded in August 2009 and the release of restricted cash required under the credit facility with DnB NOR. On April 29, 2009, the Company agreed to a new covenant structure on this credit facility.

8.2 Liquidity and Working Capital

At September 30, 2010, the Company had net cash (defined for the purpose of this section as being Cash less Bank credit facilities) of \$2.5 million compared \$2.7 million at December 31, 2009.

At September 30, 2010, the Company had net invested working capital (NIWC – see definition on page 2) of \$3.0 million or 8.2% of 12 months rolling sales, which is more or less in line with the \$3.0 million it had at December 31, 2009 (7.2% of annual sales). NIWC represents the total net investment made by the Company to support outstanding contracts. Management actively monitors NIWC to ensure it is as low as possible.

As shown in previous MD&As, the level of NIWC can be volatile depending on the structure and progress of contracts (please refer to last quarter's MD&A, where NIWC was more than \$8 million or 23% of annual sales). NIWC is financed through cash on hand and a bank line of credit, and is reduced by customer advances or progress payments on contracts. In some cases, such advances or payments require the issuance of LGs using the DnB NOR 15 million NOK credit facility (approximately \$2.5 million at September 30, 2010), assistance provided by Export Development Canada ("EDC"), or simply the pledging of cash to secure the issuance of such LGs. At September 30, 2010, the total outstanding LGs (DnB, EDC and LGs secured by restricted cash) amounted to \$1.9 million (\$10.2 million at the end of the last quarter and \$5.6 million at December 31, 2009). As sales are migrating to countries where the Company does not have a physical presence, it is anticipated that increased levels of NIWC and LGs will be required. The Company intends to finance its future NIWC requirements using cash on hand, cash flow from operating activities, bank credit lines, assistance from EDC and funds from external sources.

8.3 Bank Overdraft Facilities and Obligations under Financial Liabilities

ProSep's Bank Credit Facility at September 30, 2010

Lender	Description	Currency	Capacity (CAD)	Drawn (CAD)	Available (CAD)
			\$'000	\$'000	\$'000
DnB NOR	Overdraft	NOK/USD	5,250	-	5,250
	Guarantee facility	NOK	2,625	1,548	1,077

8.3.1 Financial Covenants

With the successful completion of the clean down covenant (see Section 6.1 above), the Company is in full compliance with its financial covenants.

8.3.2 Obligation under Financial Liabilities

ProSep's Debt and Credit Facility Repayment Schedule at September 30, 2010

	Carrying Amount	One to nine months	Nine to twelve months	One to five years	More than five years
	\$'000	\$'000	\$'000	\$'000	\$'000
DnB bank credit facility	-	-	-	-	-
DNB NOR long-term credit facility	3,938	1,575	-	2,363	-
Convertible unsecured debenture	3,644	-	-	3,644	-
Revolving credits with National Bank	4,710	54	-	4,657	-
Other	68	37	13	17	-
Total	12,359	1,666	13	10,680	-

9. TRANSACTIONS WITH RELATED PARTIES

The Company did not enter into any transactions with related parties during the three- and nine-month periods ended September 30, 2010.

10. DESCRIPTION OF CAPITAL STRUCTURE

The Company's authorized share capital consists of an unlimited number of common shares, of which 191,798,008 were issued and outstanding at September 30, 2010. During the second quarter of 2010, the Company issued 28,465,385 new shares at a price of \$0.13 for total gross proceeds of approximately \$3.7 million. Following this transaction, Fondaction and Cycle Capital Fund I, L.P., own 21.8% and 18.9% of the total issued and outstanding shares, respectively.

At September 30, 2010, there were outstanding options to purchase 420,000 common shares of the Company issued pursuant to ProSep's stock option plan at a weighted average exercise price of \$0.31 per share.

The Company grants restricted share units to attract, retain and motivate key personnel and reward directors, officers and employees for significant performance and distributable cash flow growth. Each restricted share

unit is equal in value to one common share of the Company. The shares will be issued from the treasury of the Company. The number of shares reserved at any time must not exceed 10% of the aggregate number of outstanding shares.

At September 30, 2010, 7,080,000 restricted share units were issued and outstanding.

At September 30, 2010, warrants to purchase 4,460,242 common shares of the Company at a weighted average exercise price of \$0.44 per share were outstanding.

At September 30, 2010, convertible debentures with a nominal value of \$3,953,500 were outstanding. These debentures mature on July 16, 2014, and can be converted into 13,178,333 common shares, representing a conversion price of \$0.30 per share.

11. IFRS CHANGEOVER PLAN

As described in the last annual MD&A, the Company has established a changeover plan to adopt IFRS by 2011. Based on the work performed to date, the differences identified between IFRS and Canadian GAAP are not expected to have a material impact on our reported results and financial position. In addition, the effects on the Company's commercial activities in terms of financial covenants, contractual agreements, incentive plans, budgeting, and financial risk management strategies, for example, have been assessed as relatively minor to date. Accordingly, efforts with respect to the areas of training, and internal and external communications are expected to be minor. During the second quarter of 2010, the Company had already reviewed its existing accounting systems and procedures along with its internal control over financial reporting and disclosure control processes, concluding that they would not need significant modification because of the Company's conversion to IFRS. During the third quarter, further progress been made in the conversion analysis. The review to date indicates that it is likely that there will be no material differences to the majority of line items appearing in the Company's consolidated balance sheet and income statement from what has been reported under Canadian GAAP in terms of recognition and measurement. The key focus during the fourth quarter will be the completion of the IFRS January 1, 2010 opening balance sheet, the 2010 quarterly comparative financial statements and the model annual and interim IFRS financial statements.

Initial adoption of International Financial Reporting Standards

IFRS 1 *First-time Adoption of International Financial Reporting Standards* puts forth guidance for the initial adoption of IFRS. Under IFRS 1, the standards apply retrospectively at the transition date with all adjustments to assets and liabilities taken to retained earnings, unless certain exemptions are applied. The Company has to date decided to take the following optional exemptions provided by IFRS 1. All other available exemptions have been considered either not applicable or not significant to the Company.

Business Combinations

The Company will elect to not apply IFRS 3(R) *Business Combinations* retrospectively to business combinations that occurred prior to January 1, 2010. Accordingly, such business combinations will not be restated.

Employee benefits

The Company will elect to not apply IAS 19 *Employee Benefits* retrospectively to its defined benefit plan. It will therefore recognize to opening deficit all actuarial gains/losses at January 1, 2010 on its plan.

Cumulative translation adjustment (CTA)

The Company will elect to use the option to reset its cumulative foreign currency translation adjustment account to nil at January 1, 2010, with the balance being recognized to opening deficit.

Share-based payment transactions

The Company will elect to apply the requirements of IFRS 2 *Share-Based Payments* to all equity instruments granted since July 1, 2002 which was the date when similar requirements were adopted under Canadian GAAP.

Compound financial instruments

The Company will elect to use the exemption whereby it does not need to separate the two portions of a compound instrument in accordance with IAS 32 *Financial Instruments: Presentation* when the liability component is no longer outstanding at January 1, 2010.

Expected Areas of Significance

No areas of significance besides those previously described in the last Annual MD&A, namely impairment of assets, have been identified. It should be remembered that our analysis of possible changes is still in process, and that not all decisions have been made where choices of accounting policies are available. Until our analyses and choices are finalized, the Company is not able to reliably quantify the impacts expected on our consolidated financial statements for these differences.

We note also that the standard-setting bodies that promulgate IFRS and, to a lesser extent, Canadian GAAP, continue to have significant ongoing projects that could affect the ultimate differences between Canadian GAAP and IFRS and their impact on the Company's consolidated financial statements in future years. There are a significant number of ongoing projects at the International Accounting Standards Board that may become requirements after 2011, and that could be adopted earlier in order to reduce the number of accounting changes in the future. Such projects that may be relevant to the Company include Liabilities, Employee Future Benefits, Revenue Recognition, and Leases. Depending on the timing of the publication of the final standards that may arise from those projects and their impact on the Company, opportunities to early adopt any such new standard will be assessed during the remainder of 2010 and 2011. We have processes in place to ensure that these potential changes are monitored and evaluated. The future impact of IFRS will also depend on the particular prevailing circumstances in those years. The differences described are those existing based on Canadian GAAP and IFRS today.

The Company's IFRS project continues to be on target to meet the changeover date.

12. CRITICAL ACCOUNTING ESTIMATES

Please refer to the September 30, 2010 consolidated financial statements as well as the annual 2009 MD&A for an extended discussion on critical accounting estimates.

13. INTERNAL CONTROLS

In order to comply with the Canadian Securities Administrators' National Instrument 52-109 ("NI 52-109"), the Company has conducted an evaluation of the design of its disclosure controls and procedures and internal

control over financial reporting. The implementation of NI 52-109 involves a continuous improvement process, which has led the Company to ensure that all relevant processes and controls are documented.

Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP.

Internal control over financial reporting includes policies and procedures that pertain to the maintenance of records, which, in reasonable detail, accurately and fairly reflect the transactions, provide reasonable assurance that transactions are recorded as necessary and therefore permit the preparation of consolidated financial statements in accordance with determined authorizations. This provides reasonable assurance regarding prevention or timely detection of unauthorized use of assets that could have a material effect on our consolidated financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of the effectiveness of our internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate due to changes in conditions or the degree to which policies and procedures are adhered.

At December 31, 2009, management had evaluated the design of its internal controls over financial reporting as defined in NI 52-109, and based on that evaluation, had determined that certain aspects of its internal controls over financial reporting were not designed effectively, but were instead mitigated by compensating procedures. As part of the evaluation conducted, the Company has implemented entity-level controls that are in accordance with the COSO control framework. This results in a much greater level of confidence in the mitigating controls to compensate for the identified deficiencies. The control deficiencies identified by the Company did not result in adjustments to our consolidated financial statements for the quarter ended September 30, 2010. Management's assessment had identified the following significant deficiencies along with related remediation:

Entity-Level Controls

During the course of 2009, the Company had ensured its entity-level controls were maintained in accordance with the COSO control framework. The entity-level controls have continuously evolved during the last financial year as the Company finalized implementing the previously identified entity-level controls. The Company now regularly reviews and continues to update on a quarterly basis policies to ensure that they remain relevant and up to date. Amended policies are communicated to appropriate employees of the Company on a timely basis.

In order to mitigate the risks of entity-level controls inherent to the continuously changing business, management has maintained the following activities:

- Communication with employees and management about their roles and responsibilities in regards to internal control over financial reporting;
- Production of bi-weekly management reports;
- Bi-weekly management committee meetings;
- Bi-weekly disclosure committee meetings (included in management committee meetings);
- Full-time availability of all policies and procedures to employees, managers, and directors;
- Evaluation of the design of internal controls and continuous implementation of additional controls to ensure an increased level of confidence;

- Monthly financial statements are established by the corporate controller and reviewed and analyzed by all vice-presidents, the CFO and the President and CEO. An analytic review is provided with the financial statements in order to explain variances between actual and budget figures; and
- Quarterly financial statements along with all related documents are reviewed by members of the audit committee and approved by the Board of Directors.

In summary, the Company has implemented a number of controls during the year ended December 31, 2009, and those controls are continuing to be applied in the current financial year. The Company will be testing the implemented controls to validate their effectiveness and performance as part of the annual certification process in the fourth quarter of the year.

Segregation of Duties

As part of the effectiveness assessment as of December 31, 2009, the Company had determined that the controls within its accounting and finance department were deficient in the segregation of duties; such deficiencies are inherent to its small size. Due to the limited number of personnel in the accounting and finance department, certain financial personnel had incompatible duties that allowed for the creation, review, and processing of certain financial data without independent review and authorization.

To mitigate this risk, we continue to implement improved monitoring systems as well as other procedures to prevent potential fraud, properly assign roles and responsibilities to employees to maximize segregation of duties within the limited environment, and rely on procedures and controls as described in “Entity-Level Controls” above.

It should be noted that some of the deficiencies mentioned above are related to the size of the Company. Management is nevertheless committed to establishing effective internal controls over financial reporting and will continue to assess existing controls and implement additional controls as deemed necessary.

14. SELECTED RISKS

Risks, proposed remedies and risk management practices did not change materially during the quarter ended September 30, 2010. Please refer to the 2009 annual MD&A for a complete list of risks and proposed remedies.



Head Office:

2015 Peel Street, Suite 630
Montreal, Quebec
H3A 1T8 Canada
Tel: 514-522-5550
Fax: 514-522-2643
www.prosepinc.com

International Operations:

ProSep Technologies, Inc	ProPure AS	ProSep AP Sdn. Bhd.
5353 W. Sam Houston Pkwy N., Ste 150 Houston, TX 77041 USA Tel: (281) 504-2040 Fax: (281) 598-2688 Toll-free: (866) 377-8788	Kokstaddalen 4 P.O. Box 106 5863 Bergen, Norway Tel: +47 55 52 94 00 Fax: +47 55 52 94 01	Suite 4.12, 4th Floor Kompleks Antarabangsa Jalan Sultan Ismail 50250 Kuala Lumpur, Malaysia Tel: +603 2715 6680 Fax: +603 2715 6670
	ProPure ME SPC	
	ProPure ME P.O. Box: 11175 1st Floor, Suite 106 Bahrain Car Parks Bldg. Manama, Kingdom of Bahrain Tel: +973 16 500 188 Fax: +973 17 500199 Mobile+ 973 36 460 142	

ProSep Inc. common shares trade on the Toronto Stock Exchange under the symbol "PRP"

Transfer Agent and Registrar:

Computershare
1500 University Street
Montreal, Quebec
H3A 3S8 Canada
www.computershare.com