



Together creating pure
oil, gas and water.

Management Discussion and Analysis

May 10, 2011

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 month periods ended March 31, 2011 and 2010 and the Annual Audited Consolidated Financial Statements for the year ended December 31, 2010. For additional information on the business, products and services or industry, please refer to the 2010 Annual Information Form.

Regulatory Filings

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

Caution Regarding Forward-Looking Statements

This Management Discussion and Analysis may contain forward-looking statements, including statements regarding the business and anticipated financial performance of ProSep Inc. These 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 environments 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 and cost of raw materials and energy supply, which are subject to a number of risks and uncertainties. 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 conclusions, forecasts or projections 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 political and economic conditions in geographic areas where ProSep Inc. 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 course of preparing financial statements in accordance with International Financial Reporting Standards, management must make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses for the period. Actual results could differ from these estimates.

All amounts are in Canadian dollars (CAD) unless otherwise specified.

Adoption of International Financial Reporting Standards (IFRS)

As of January 1, 2011, the Company adopted International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board. Other than as specifically stated, the following disclosures, and the associated Unaudited Interim Consolidated Financial Statements, are presented in accordance with IFRS. The comparative periods for fiscal 2010 have been restated in accordance with IFRS.

Non-IFRS Financial Measures

This MD&A contains the terms "Earnings Before Interest, Taxes, Depreciation and Amortization" ("EBITDA"), "Net Invested Working Capital" ("NIWC") and "Gross Margin", 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 IFRS, as an indicator of the Company's performance. These terms do not have standardized meanings prescribed by IFRS. ProSep's determination of EBITDA, NIWC and Gross Margin 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 and amortization expenses. The Company excludes depreciation and amortization 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 Company also excludes depreciation and amortization expenses from its definition of Gross Margin for similar reasons.

The following table reconciles EBITDA with net income.

In millions of CAD	Three-Month Period Ended	
	2011	2010
		March 31
Net loss	(3.0)	(1.3)
Plus (minus):		
Current tax recovery	-	(0.6)
Depreciation and amortization	0.3	0.4
Net financial charges	<u>0.4</u>	<u>0.8</u>
EBITDA	(2.3)	(0.7)

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, trade and other receivables, inventories and prepaid expenses, less the sum of trade and other liabilities and deferred revenue.

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

	March 31, 2011	December 31, 2010
	In millions of CAD	
Restricted cash	-	0.2
Trade and other receivables	16.3	12.9
Inventories	0.7	0.3
Prepaid expenses	<u>0.8</u>	<u>0.6</u>
Total (a)	17.8	14.0
Less		
Trade and other liabilities	10.8	7.8
Deferred revenue	<u>1.9</u>	<u>0.1</u>
Total (b)	12.7	7.9
Net Invested Working Capital (a minus b)	5.1	6.1

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1. OVERALL PERFORMANCE

1.1. Highlights of the Quarter and Important Subsequent Events

Financial:

- As of January 1, 2011, ProSep adopted International Financial Reporting Standards (“IFRS”), as issued by the International Accounting Standards Board.
- Revenues of \$9.9 million, an increase of 5% when compared to \$9.4 million for the corresponding period of 2010, representing the first quarterly year-over-year revenue increase over the last three years.
- Gross margin of \$2.2 million (22% of revenues) compared to \$2.6 million (27% of revenues) for the corresponding period of 2010.
- EBITDA was negative \$2.3 million compared to negative \$0.7 million for the corresponding period of 2010, reflecting investments in organic growth.
- Net loss of \$3.0 million compared with a net loss of \$1.3 million for the corresponding quarter of 2010.
- Backlog stands at \$19.4 million, up 149% from \$7.8 million at year-end and up 72% from March 31, 2010.
- Subsequent Event: The Company concluded a \$2.5 million revolving credit facility with its largest shareholder to provide for additional working capital.

Commercial:

- Announced approximately \$23 million in new contracts in the first quarter of the year, already surpassing last years’ total new bookings. Concluded the sale of the Company’s largest offshore gas dehydration system to a new customer operating in South-East Asia.
- Took advantage of a unique market opportunity and hired a team of seasoned industry experts to complete the business development and engineering teams.
- Started commercialization of the Company’s offering to the South Korean Floating Production Storage and Offloading (“FPSO”) market with the ProSep Kolon joint venture.
- Successfully concluded Phase IV development and testing of the ProDry, with positive results demonstrating robustness and scalability.
- Obtained ISO certification of the Asia Pacific and European Operations. Ongoing ISO certification of American Operations.
- Hired Carl Nilsson, a multiphase flow expert, as Manager, Process Engineering and Product Development to further the development of key proprietary technologies.

Corporate:

- Appointed Claude Samson, CA, MBA, and a seasoned executive with some 30 years of experience in finance, as the Company’s Chief Financial Officer and Corporate Secretary.

1.2. Material Events and Important Subsequent Events

All material events and commitments for the first quarter ended March 31, 2011, are presented in this section, including information on important subsequent events, up to the date of this MD&A.

On April 4, 2011, ProSep announced that it had concluded a \$2.5 million unsecured revolving loan agreement with Fondaction, ProSep's largest shareholder. This facility will provide the Company with additional liquidities to fund working capital requirements due to an increased level of activity and growing backlog, as well as serving to support investments in strategic initiatives.

At March 31, one of the Company's wholly-owned subsidiaries was in breach of one of the financial ratios stipulated in a banking facility. This situation stems from the Company's decision to accelerate its pace of growth in view of the opportunities offered in the marketplace as outlined in Section 4.1, and more specifically to the up-front investments in hiring and related operating expenses that were approved as part of this strategy, as noted in Section 4.2. The Company anticipates that its subsidiary will continue to remain in breach of this covenant at the quarter-end dates of June 30, 2011 and September 30, 2011. A covenant waiver whereby the Lender confirmed that the breached covenant is not deemed to constitute an event of default was obtained by the Company and its subsidiary for the March 31 breach, as well as the June 30, 2011 anticipated breach. A new waiver request will be presented later in the year with respect to the anticipated breach at the quarter-end date of September 30, 2011.

On March 31, 2011, ProSep announced that it had been awarded a \$4.1 million contract to provide a gas membrane system to a large independent North-American customer. This system will be used for enhanced oil recovery activities for a repeat customer's operation in Texas,

On March 16, 2011, ProSep announced the appointment of Claude Samson as Chief Financial Officer and Corporate Secretary. Mr. Samson is an accomplished senior executive with some 30 years of experience in finance, management, strategy, risk management and mergers and acquisitions.

On March 10, 2011, ProSep announced that it had elected to exercise the put option related to the portion of the Asset-Backed Commercial Paper Credit Facility pertaining to the ineligible assets, in payment of the principal amount of the \$2.5 million. This transaction did not involve any cash disbursement.

On February 21, 2011, ProSep announced that it had been awarded a contract worth \$2.6 million for the supply of spare parts (gas membranes) to an existing customer, a large independent North American oil and gas company.

On February 14, 2011, ProSep announced that it had been awarded a US \$5.5 million contract to provide a gas dehydration system to a super major international oil and gas producer operating in the South China Sea.

On February 3, 2011, ProSep announced that it had been awarded a US \$9 million contract to provide an additional gas membrane system to a large independent North-American customer.

2. COMPANY OVERVIEW

ProSep designs, develops, manufactures, and commercializes technology-based process solutions to treat, separate and purify oil, gas and water for the upstream oil and gas (“O&G”) industry. ProSep offers a wide range of process equipment sold in units or in packages to O&G producers and engineering procurement and construction firms (“EPC”), with or without process warranties. ProSep has over 60 patents and has developed one of the industry’s most comprehensive suite of produced-water treatment solutions, including best-in-class polishing equipment. ProSep provides in-house engineering from process to details and is actively involved in project management and execution, including fabrication, assembly, commissioning and value-added 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), Manama (Bahrain) and Seoul (South Korea). Its head office is located in Montreal (Canada).

The Company has approximately 115 employees, mainly process engineers, product engineers, technical sales people, project managers and workers.

2.1. Corporate Model and Sales Network

ProSep has three diversified business units and a commercial joint venture (ProSep Kolon Company Ltd.) that promote the Company’s solutions across their respective markets. Each operation 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 select network of agents. The joint venture with Kolon Group, ProSep Kolon, was recently concluded and will aim to reproduce the same business model, but tailored to the Korean upstream oil and gas market. During the first quarter of the year, the Company’s subsidiaries changed (or are in the process of changing) their legal names to better reflect the new integrated operations and business model. All fully-owned business units now operate under the same commercial denomination around the world. See next section for details.



(Head office located in Montreal, Canada)

America

(Houston, USA)
Engineering
Project management
Manufacturing
Assembly
Commissioning

Europe + Middle East

(Bergen, Norway) +
(Manama, Bahrain)
Engineering Sales office
Project management
Commissioning
(Fusa, Norway)
Product development

Asia Pacific

(Kuala Lumpur, Malaysia)
Engineering
Project management
Manufacturing
Assembly
Commissioning



Far East

(Seoul, Republic of Korea)
Engineering
Project management
Commissioning

2.1.1. American Operations

ProSep's Houston (Texas) based operation is the Company's center of excellence for gas membranes, primary separation, heavy crude oil treatment and conventional produced-water treatment systems and packages. To support an increase in the level of activity, plans were made in 2009 to double the production capacity of the Company's only fabrication and assembly facility by relocating it to a new 55,000 square foot shop. This is where manufacturing and assembly of internals, process vessels, skid-mounted packages and complete process systems is done for a significant portion of the Company's offering. Most of the systems or packages assembled in Houston are for shipment to the Americas and the Middle East.

As of February 2011, this subsidiary changed its name by Certificate of Amendment filed with the Office of the Secretary of State (Texas) and now operates under the same of ProSep (USA) Inc. It was formerly called ProSep Technologies Inc.

2.1.2. Europe and Middle East Operations

ProSep's Bergen (Norway) based operation is the center of excellence for the development and commercialization of the Company's proprietary products. It is here that the ProMix technology was developed and that various applications using the Company's patented in-line multiphase injection-mixer process continue to be developed and commercialized. This business unit is also ProSep's commercial gateway to Europe and the Middle East, where an office was opened in Manama (Bahrain) in 2008.

The European subsidiary will be submitting a request to the Norwegian Business Registry (Brunnoysundregisterene) to change its name from ProPure AS to ProSep (Norway) AS. The Middle Eastern subsidiary has not yet made any changes to its name.

2.1.3. South-East Asia Operations

ProSep's Kuala Lumpur (Malaysia) based operation offers the Company's entire line of process solutions to the East Asian market, with an emphasis on offshore gas and produced-water treatment systems. It has developed strategic partnerships with local suppliers to build and assemble its process solutions and has concluded a non-exclusive agreement with an engineering firm for detailed engineering work.

In March 2011, the Malaysian Companies Commission received and accepted a request to change the name of ProSep AP Sdn. Bhd. to ProSep (Asia Pacific) Sdn. Bhd. The formal change will take effect on June 1, 2011.

2.1.4. Far East Operations

ProSep concluded a joint venture agreement with one of South Korea's largest diversified groups to commercialize the Company's process solutions. By leveraging Kolon Group's reputation, this new venture intends to quickly become Korea's first technology-focused process solutions provider for the upstream O&G market. By early 2011, the joint venture already employed five full-time personnel, mostly engineers, and had started representing ProSep's offering to FPSO shipbuilders Hyundai Heavy Industries, Samsung Heavy Industries and Daewoo Shipbuilding & Marine Industries. Until Far-East Operations reach the revenue generation stage, their results of operations are being reflected under Corporate activities.

2.1.5. Global Network of Agents

ProSep also uses a global network of agents to access markets where the Company does not have an office or employees and/or when the end-users, mostly National Oil Companies, require local representation. Agents are individuals or organizations with a good knowledge of potential customers, business practices and market needs in a specific region. Typically, they are remunerated on a success fee basis. Currently, agents cover several regions such as South America, the Middle East and South-East Asia.

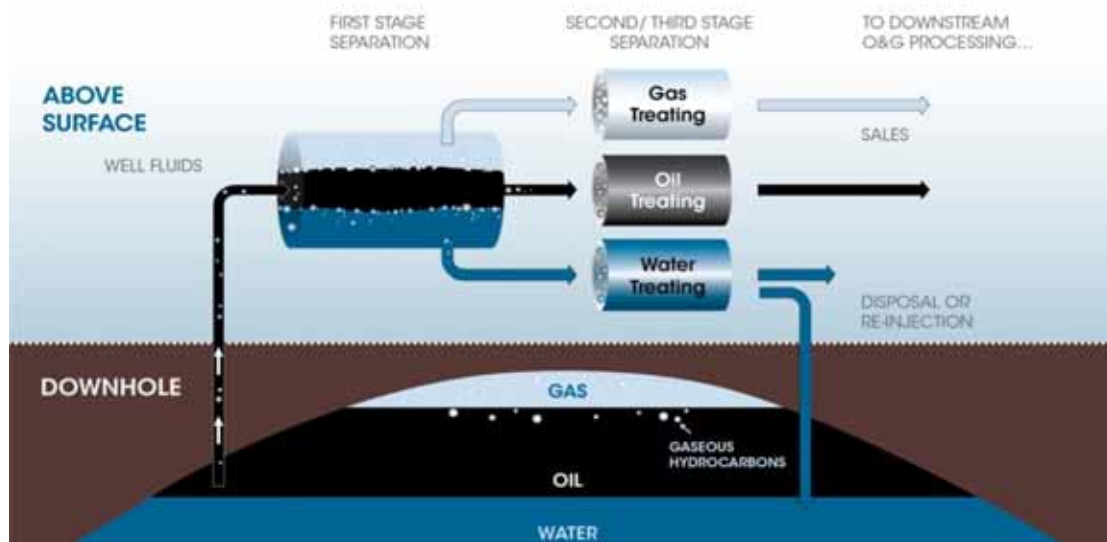
3. PRODUCTS

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 designed to treat gas, oil and produced-water for upstream production activities.

3.1. Upstream Oil and Gas Production Activities and Market

Upstream oil and gas activities consist of exploration, development and production of oil and gas assets, a market estimated by the International Energy Agency to total US\$470 billion in 2010 and US\$490 million in 2011. Hydrocarbons, natural gas, water and solids are recovered from geological formations (downhole) and treated at topside facilities before marketable commodities (hydrocarbons and natural gas) can be transported downstream for further refining.

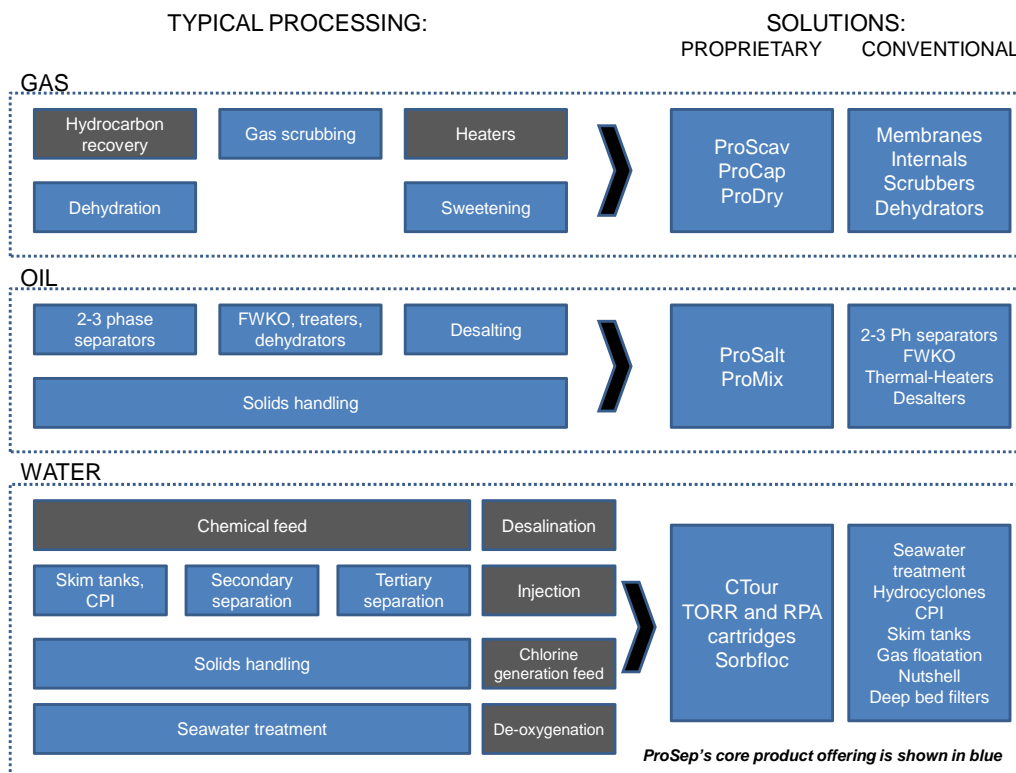
Representation of Upstream Oil and Gas Processing



Topside Oil and Gas Separation

When recovering oil and gas 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, dissolved gas and other components, and 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.

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:



3.2. Process Design Experts

Complete Portfolio of Solutions

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 this is an important and 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.

Technology-Focused Solutions

ProSep has also developed innovative proprietary offerings to address growing production challenges facing the onshore and offshore oil and gas industry. These solutions are designed to improve processing efficiencies, and are compact, lightweight and robust. They are often an environmentally-sound, cost-effective alternative to older, widely used processes. These systems are designed to use less energy and chemicals, reduce fresh water consumption and efficiently treat larger volumes of oil, gas and produced-water in challenging operating conditions.

Hybrid Fabrication Model

ProSep's systems are designed for optimal performance by highly experienced process engineers. These systems are custom designed to each client's specifications. By using a hybrid fabrication model, in-house fabrication capacity and a network of selected local suppliers, the Company can achieve the optimal balance between quality and cost control with local content requirement. Control over the design and fabrication process ensures timely delivery, better cost efficiencies and quality control, important differentiation factors in the oil and gas industry. These products are either offered as individual components or as "industrial packages", which are customized packages of equipment consisting of custom-built or assembled vessels, pumps, valves, instrumentation and other specialized equipment.

For a complete list and description of the Company's conventional and proprietary offering, please see the most recent Annual Information Form document, which can be found at www.sedar.com and www.prosep.com.

4. BUSINESS ENVIRONMENT AND STRATEGY

4.1. Business Environment

Supply and Demand:

The economic recovery continues to strengthen with robust demand from emerging countries and improving balance sheets in the "developed" world. Crude oil prices have continued to rise, with Brent futures reaching \$127/bbl and the West Texas Intermediate ("WTI") reaching \$112/bbl on April 8th, the highest oil prices seen in 2 1/2 years.

Unrest in the Middle East and spare capacity fluctuations have fuelled uncertainty about supply and contributed to the crude price increase of 25% since the beginning of the year. In its April 12, 2011 Oil Market Report, the International Energy Agency stated that global product demand would remain unchanged at 89.4 mbpd in 2011¹, but warned that "preliminary January and February data suggest that high prices are already starting to dent demand growth".

¹ <http://omrpublic.iea.org/>

E&P Capital Expenditure (“CAPEX”) Budgets:

Global upstream CAPEX budgets are expected to rise 11% according to Barclays Capital’s “Original E&P Spending Survey” published in December 2010. The survey forecasts that global E&P spending will amount to \$490 billion, up from \$442 billion last year, led by Latin America, the Middle East and South-East Asia. International Oil Companies (“IOC”) are likely to represent the largest share of this increase, a change from past years when National Oil Companies (“NOC”) represented the largest share of CAPEX.

According to the survey, Companies based their 2011 E&P budgets on an average WTI price of \$77/bbl. Most companies surveyed said that oil prices above \$90/bbl could justify further increases in CAPEX budgets. For natural gas, prices below \$4.00 - \$3.50/Mcf (Henry Hub) would justify lowering investments in 2011. Natural gas E&P were budgeted on average with \$4.27/Mcf (Henry Hub).

Key determinants of CAPEX budgets according to the same report are, in order of importance, available cash flows, oil prices, followed by gas prices. The availability of capital to fund E&P projects outlined as a major driver, explains the shift to IOC CAPEX dominance expected in 2011 from NOC-led E&P investments over the last few years. With improving capital markets and higher commodity prices, IOCs and super majors have a lower cost of capital.

Based on a sample of ProSep’s most significant repeat customers and potential clients with whom the Company is currently entertaining bidding discussions, the estimated CAPEX spending of this sub-group of producers comes in at an increase of 21% compared with an industry-wide expected spending growth of 11%.

Selected ProSep customer and targeted end-user’s 2010-2011 spending budgets² per region:

Company (Country) in millions of US\$	2011	2010	Variation
Apache Corp (international)	4,000	2,900	38%
BP (international)	9,500	7,000	36%
Chevron (international)	16,900	14,150	19%
ConocoPhillips (international)	6,000	4,800	25%
Ecopetrol (Columbia)	5,141	4,509	14%
ENI (international)	13,414	12,520	7%
ExxonMobil (international)	16,100	14,693	10%
Husky Energy (Canada)	4,224	2,117	100%
Kinder Morgan (USA)	395	415	-5%
Kuwait Oil Company (Kuwait)	4,900	2,600	88%

² Global upstream budgets to rise 11%, World Oil, February 2011. According to Barclays Capital estimates.

Occidental Petroleum (USA)	2,100	1,800	17%
Pemex (Mexico)	18,750	14,450	30%
Petrobras (Brazil)	28,000	24,000	17%
Petronas (Malaysia)	10,000	8,520	17%
Petroleum Development of Oman (Oman)	1,280	1,100	16%
Qatar Petroleum Company (Qatar)	1,850	1,850	0%
Sonatrach (Algeria)	6,335	5,000	27%
Saudi Aramco (Saudi Arabia)	8,450	7,900	7%
Total (international)	13,000	10,298	26%
Whiting Petroleum ³ (USA)	1,350	978	38%
Total:	171,689	141,600	21%

4.2. Growing Backlog and New Strategic Direction

With the global recovery and expected increase in energy demand from developing countries, the price of oil recovered and O&G companies revived their capital investment plans. To meet expected demand and replace declining production capacity, oil and gas producers around the world are working to increase output at existing fields and are exploring and developing new fields. To improve production and output quality, producers are looking for more efficient, technology-focussed production and process equipment. Consequently, ProSep's bidding activity has reached record levels. Since CAPEX expenditures lag the economic recovery and ProSep's sales cycle averages 6 to 18 months, the Company's backlog started showing signs of improvement in the latter part of 2010, leading to significant contract announcements in the first quarter of 2011. During the first three months of the year, ProSep concluded \$23 million in new contracts, already surpassing last year's total new bookings.

Strengthened Business Development and Engineering Teams

Consolidation in the process equipment industry has created a unique opportunity for ProSep, that has seen some leading business development and process engineer professionals join its ranks. These individuals are recognized as experts in their field and bring with them complimentary process knowledge and new customer relationships. This will allow the Company to further improve and expand its offering in all of its product lines (oil, gas and produced water) and strengthen its competitive position.

³ Whiting Petroleum April 2011 Corporate Presentation. <http://www.whiting.com/investor-relations/presentations-and-media-events/>

ProSep will need to invest approximately \$3 million in 2011, mostly related to the compensation and associated operating costs for these additional human resources. This investment program was initiated at the end of the previous year and is expected to continue, at a lesser pace, to the end of the second quarter of 2011.

To maximize this investment and leverage ProSep's existing global reach, the Company has implemented an integration plan where all its execution centers will share resources, improving geographical reach and ensuring the highest level of execution in this fast growing environment. By building a strong engineering backbone, improving business development and marketing activities, ProSep believes it can become the next leading independent technology-focused process solutions provider.

Key Strategic Initiatives:

- Integrate proprietary technologies in conventional processes:
 - Raise the competitiveness of ProSep's conventional offering: this would allow ProSep to offer a more efficient and compact conventional offering at competitive prices;
 - Reduce risk perception of proprietary technologies: conventional solutions are seen as less risky because of their wide acceptance and installation base. Even when performance of conventional technology is known to be inferior and overall costs are higher when considering initial capital investment and future operating expenses, the industry's path to adopting new technologies can still be long;
 - Build references: by integrating proprietary elements to conventional equipment, these solutions will no longer be seen as new technologies but rather as improved, widely used conventional equipment. This will make them easier to commercialize and help build additional references for proprietary technologies in an effort to accelerate their validation cycle;
- Create maintenance and service offerings:
 - Leverage customer base: By working closely with O&G companies, ProSep's engineers have an intimate understanding of each customer's production environments and technical challenges, an ideal repeat customer base for these services;
 - Create value added services: Offering services such as maintenance and process optimization will improve ProSep's competitive advantage and help attract and retain key relationships in a highly competitive environment;
 - Improve profitability: Value added services create a stronger relationship with customers and provide for additional, less volatile revenue streams;
- Develop local content;
 - Favourably position the Company in the eyes of National Oil Companies and other stakeholders by supporting local economic development strategies, help create employment and build the foundations of a more competitive national oil and gas supply industry. Some countries, such as Brazil, have official guidelines for minimum local content requirements;
 - Facilitate customers' procurement relationships. The joint-venture between ProSep and Kolon Group is the first concrete result of this strategy. Customers want to deal in their own language and time zone and be close to their suppliers. Establishing a presence near the FPSO builders in South Korea and employing local engineers improves project management and execution for the customers and reinforces relationships;
 - Reduce costs associated with transport when a capable local supply infrastructure is available;

- Move from a decentralized, divisional structure to a matrix organization:
 - ProSep's international presence is key to building and maintaining strong customer relationships. This requires a network of business units and agents around the world that are close to their respective markets. However, with multiple centers of execution, there is the risk of an uneven customer experience and operational redundancy. By implementing a matrix organization structure and grouping employees around their business functions such as sales, operations and marketing, the Company can leverage its best resources and ensure even execution across all business units;

4.3. Changes at the Norwegian Business Unit

Dr. Harald Linga, Senior Vice President of Technology and Kjell-Inge Arnevig, General Manager, who have acted as co-leads to the Norwegian business unit since January 2010, will be leaving the Company in the second quarter of 2011. In order to align this business unit's activities with the new strategic plan, ProSep hired and promoted key personnel.

Gustav Wee was appointed General Manager to manage the operation. He was formerly in charge of business development and sales for this business unit, and has been actively involved in ProSep's Middle Eastern activities. He has over 25 years of industry experience, from Field Engineer to Managing Director for various O&G service and equipment companies.

In support of the new strategic plan and to lead the development of ProSep's proprietary technology, the Company appointed Mr. Carl Nilsson as Manager, Process Engineering & Product Development. Mr. Nilsson holds a Master of Physics from the University of Bergen and is a recognized multiphase flow expert. He has held various research positions, most recently at Polytech R&D Institute and Petrotech in Norway, and is a published author and industry speaker.

In light of the new strategic plan, the new mandate of this business unit will be to:

- Continue developing proprietary technologies in collaboration with the industry;
- Become a training center for all engineers and promote understanding of the Company's proprietary technologies internally;
- Promote field trials in order to accelerate the commercialization of new and existing proprietary technologies.

The business unit will generate revenues from the following sources;

- Selling proprietary technologies to clients and other business units;
- Selling field trials and pilot tests;
- Funding from joint industry partners; and
- Charging business units for training.

5. RESULTS OF OPERATIONS

Adoption of IFRS:

As of January 1, 2011, ProSep adopted International Financial Reporting Standards (“IFRS”), as issued by the International Accounting Standards Board. Other than as specifically stated, the following disclosures, and associated Unaudited Interim Consolidated Financial Statements, are presented in accordance with IFRS. All comparative information presented in the Unaudited Interim Consolidated Financial Statements has been restated from previously reported amounts under Canadian GAAP, to comply with IFRS. As further discussed in Note 5.2 to the Unaudited Interim Consolidated Financial statements, the differences between IFRS and Canadian GAAP have not had a material impact on ProSep’s reported results, financial position and cash flows.

5.1. Contracts

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

Table of Contracts Announced over the last 15 months

Date	Value	Product	End User
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
May 2010	n/a	Water treatment	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 Sands market
August 2010	US\$0.5M	Chemical injection package	*: Asia Pacific
August 2010	US\$4.1 M	Gas dehydration	*: Asia Pacific
August 2010	US\$1.5 M	CO ₂ gas separation membrane and hydrocarbon dew point packages	*: South America
August 2010	US\$0.5 M	Nitrogen generator package	*: South China Sea
August 2010	US\$0.4 M	Pitless air drilling de-duster skid	*: United States
September 2010	\$2.0 M	After-market services and spare parts	*: Kuwait & United States
October 2010	\$1.5 M	Additional equipment (including spare gas membranes)	*: South America
February 2011	\$9.0M	Gas membrane units	*: US Onshore producer
February 2011	\$5.5M	Gas dehydration	*: South China Sea
February 2011	\$2.6 M	Gas membranes	North America
March 2011	\$4.1 M	Gas membranes	North America

* Information could not be revealed for competitive reasons.

5.2. Revenues

The Unaudited Interim Consolidated Financial Statements of ProSep for the three months ended March 31, 2011 and 2010 have been prepared in accordance with IFRS.

Quarter ended March 31 (\$ millions)

	US Operations	European & Middle East Operations	Asia Pacific Operations	Consolidated Operations
	\$ millions	\$ millions	\$ millions	\$ millions
Q1 2011 Revenues	7.4	0.2	2.3	9.9
Q1 2010 Revenues	5.6	2.2	1.6	9.4

ProSep reported consolidated revenues of \$9.9 million for the quarter ended March 31, 2011, an increase of 5% from \$9.4 million generated during the same period in 2010, and representing the first quarterly year-over-year revenue increase over the last three years. A significant revenue decline at the European and Middle East Operation was offset by strong growth in the Asia Pacific and US Operations, with respective revenue increases of 44% and 32%.

As noted earlier, ProSep's bidding activity has reached record levels in the last six months, and signings in the first quarter surpassed last year's total new bookings. This reflects the positive momentum observed in the O&G industry as described in Section 4.1, whereby oil and gas producers around the world are reviving their capital expenditure programs, and ProSep's new strategic direction starting to pay off, as evidenced by the revenue performance of the US and Asia Pacific Operations. The Company's European and Middle East Operations was affected by a lower order intake and is undergoing leadership changes that are further described in Section 4.3.

Backlog growth achieved over the last six months accelerated order intake and should continue to contribute to revenue growth. As a result of the signings activity in the first quarter of the year, the Company's backlog stood at \$19.4 million at March 31, 2011, as compared to \$7.8 million at December 31, 2010.

Segment Comments

ProSep's US Operations generated 75% of consolidated revenues, with revenues of \$7.4 million in the first quarter, up 32% from the \$5.6 million reported in 2010. During the first quarter of 2011, the average currency conversion rate for revenues recognized by the US Operations represented a 6.6% negative variance as compared to the same period in 2010. The revenue performance of the US Operations reflects contract advancement as well as the increase in order booking activity previously noted. Revenues in the quarter were mostly derived from a repeat customer order for a large CO₂ gas membrane plant expansion, engineering/internals supply for multiple crude oil desalter units for a major oil company operating in the Canadian oil sands, and CO₂ gas membrane spare parts for multiple existing customers.

The European and Middle East Operations reported revenues of \$0.2 million in the quarter, significantly down from the \$2.2 million recorded in 2010, reflecting major delays in contract awards. Revenue at the European operations continues to be volatile but the Company believes some of the new strategic initiatives put forward, and more specifically the integration of proprietary technologies in conventional processes as explained in Section 4.2, will unlock significant value residing in its proprietary offering and serve to improve the contribution of this business unit to ProSep's overall performance. Revenues in the first quarter of 2010 benefited from a substantial contract on the BP's Valhal project which accounted for a substantial share of the reported revenues.

The Asia Pacific Operations recorded revenues of \$2.3 million in the first quarter of 2011, a 44% increase over the corresponding period last year. Revenues expressed in Canadian dollars benefited from a favourable exchange rate of approximately 4% in the first quarter of 2011, as compared to the previous year. This performance also reflects contract advancement as the business unit started the year with a solid backlog of some \$4.7 million, as well as the increase in signings activity previously noted. Revenues for the quarter were mostly derived from the larger contracts in progress including two Gas Dehydration systems being supplied to regional clients.

5.3. Cost of Goods Sold and Gross Margin*

Three-month period ended March 31

		US Operations	European & Middle East Operations	Asia Pacific Operations	Consolidated Operations
		\$ millions	\$ millions	\$ millions	\$ millions
2011	Cost of goods sold	5.5	0.1	2.1	9.9
	Gross margin	1.9	0.1	0.2	2.2
		25%	56%	10%	22%
2010	Cost of goods sold	4.4	1.0	1.5	6.8
	Gross margin	1.2	1.3	0.1	2.6
		22%	57%	7%	27%

* Gross margin is a non-IFRS financial measure. Please refer to the section called non-IFRS financial measures for detailed calculations.

Gross margin for the first quarter of 2011 stood at \$2.2 million, or 22% of revenues, compared to \$2.6 million or 27% of revenues achieved during the same period last year. Overall margins as a percentage of revenues improved at the US and Asia Pacific Operations. However, the contribution of the European and Middle-East Operations, where the Company's more profitable proprietary offering resides, was lower during the first quarter of 2011.

Segment Comments

The US Operations were the largest contributors to consolidated gross margin in the first quarter of 2011. Gross margin reached \$1.9 million, or 25% of revenues, compared to \$1.2 million or 22% of revenues in the corresponding period of 2010. US operations' gross margin for the quarter benefited from the higher margin associated with crude desalter engineering/internals supply and CO² gas membrane equipment/parts. Overall, gross margin also benefited from the favourable outcome of negotiations with long-term, strategic suppliers.

The gross margin at the European & Middle East Operations benefited from the reversal of project provisions that were no longer necessary further to project completion. The substantial B P Valhal contract referred to previously accounted for the greater portion of the gross margin reported in the first quarter of 2010.

The gross margin at the Asia Pacific Operations stands at 10% of revenues in the first quarter of 2011 compared to 7% of revenues during the same period last year. The gross margin for the Asia Pacific Operations suffered from a one-time cost of some \$0.1 million due to changing transport conditions on an ongoing project, as well as an increase in fabrication costs due to a reduced time schedule and some more general unbudgeted cost impacts.

5.4. Expenses and EBITDA

Expenses and EBITDA* for the three-month period ended March 31

	2011	2010
	\$ millions	\$ millions
Revenue	9.9	9.4
Sales and marketing	0.9	0.5
Research and development	0.1	0.1
General and administrative	3.4	2.7
	4.4	3.3
EBITDA (loss)	(2.3)	(0.7)

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

First quarter EBITDA was negative \$2.3 million in 2011 compared to negative \$0.7 million during the same period of last year. ProSep devised an ambitious investment plan to benefit from a unique opportunity in the market, as explained in Sections 4.1 and 4.2, and engaged in the hiring of some of the industry's most seasoned business development professionals and process engineers. This investment in the Company's human resources foundation is expected to put ProSep in a unique position to capture its fast growing potential share of the business development opportunity provided by the current oil and gas marketplace as described earlier. This explains the greater portion of the unfavourable variance in sales and marketing expenses, as well as administrative expenses. Despite the slightly higher business volume realized, the current quarter's EBITDA was also negatively impacted by a lower overall gross margin.

EBITDA in the first quarter was also affected by certain changes in the European and Middle Eastern Operations which were made so as to better align this business units' activities with ProSep's overall growth objectives. Important non-recurring costs, of approximately \$0.4 million were incurred to adapt the structure and ensure a smooth transition towards the new model. It is expected that additional and residual non-recurring costs will be incurred through the second quarter as investments are being made to bring in new talent, ensure retention of key employees and support an intensive training program. Going forward, a reduced cost structure will result from the better alignment of this business unit with its new objectives.

Sales and Marketing Expenses

Sales and marketing expenses reached \$0.9 million or 9.3% of revenues for the quarter ended March 31, 2011 compared with \$0.5 million or 5.4% in 2010. The quarter-to-quarter increase reflects some of the impacts of the previously noted hiring strategy, including the promotion of a global business development approach, travel and marketing materials costs. Sales and marketing expenses are typically comprised of salaries, marketing, promotional and travel activities.

Research and Development Expenses

Research and development expenses were below \$0.1 million in the first quarter of both 2011 and 2010. Since 2009, R&D expenses have represented an increasingly smaller portion of total operating expenses as the Company's technology is developed with industry partners. These partners are usually industry super majors such as Total, Chevron and ConocoPhillips, who contribute most of the cost of developing ProSep's proprietary technologies under Joint Industry Partnerships.

General and Administrative Expenses

General and administrative expenses were \$3.4 million for the first quarter of this year compared with \$2.7 million for the same period in 2010. Additional costs were incurred in the quarter in connection with the implementation of the previously mentioned hiring strategy, travel and various office costs and professional fees, including legal and other charges in connection with the closing of the \$2.5 million revolving credit facility announced by the Company on April 4. Additional costs were also incurred in the Company's European and Middle East Operations in connection with the realignment of certain business activities as referred to previously. These have consisted mainly of recruitment fees and retention bonuses.

5.4.1. Impairment Test of Goodwill

At each year-end, or more frequently if any indication of impairment exists, the Company performs an impairment test to determine whether the carrying amounts of goodwill are recoverable. The Company's goodwill resides in multiple cash generating units. As part of the transition to IFRS, the Company tested goodwill for impairment as of January 1, 2010, and as of December 31, 2010. These tests indicated that the recoverable amounts of the cash generating units were in excess of their respective carrying amounts.

The impairment review process is subjective and requires significant judgment throughout the analysis. If the estimates or related assumptions change in the future, the Company may be required to record an impairment charge. Continued adverse conditions in the economy, among other factors, could impact the valuation of the Company's cash generating business units, which could trigger impairment of goodwill in future periods.

For the quarter ended March 31, 2011, the Company has determined that no indication of impairment has materialized that would require that an impairment test be performed.

5.4.2. Change in Fair Value of Long-term Investments

The Company has determined that no adjustment to the carrying value of its investment in notes held since January 2009 following the restructuring of the asset-backed commercial paper was required as at March 31, 2011, and that the current value reflects the effect of market indicators as of March 31, 2011, on the valuation technique used by the Company.

5.4.3. Financial Charges

Total financial charges were \$0.4 million for the quarter ended March 31, 2011, compared to \$0.8 million the same period of 2010. Most of this variance is explained by currency fluctuations between the Norwegian Kroner (NOK) and the Canadian dollar, whereby an exchange loss was recognized in the first quarter of the preceding year, while a currency gain was realized during the current quarter.

5.5. Amortization

The total amortization expense for the quarter was \$0.3 million, as opposed to \$0.4 million in the corresponding period of 2010.

5.6. Income Taxes

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 pre-tax income, and some have accumulated tax losses. The net provision for income taxes for the quarter ended March 31, 2011 is negligible while the comparative March 31, 2010 provision for income taxes pertained principally to the recognition of income taxes recoverable in connection with the Company's US Operations.

5.7. Net Loss

For the quarter ended March 31, 2011, the Company reported a net loss of \$3.0 million (\$0.02 per share), compared to a net loss of \$1.3 million (\$0.01 per share) in 2010, despite the higher business volume realized. The higher net loss for the first quarter of 2011 is mostly explained by a lower overall gross margin rate realized as well as the impact of the Company's investment in its human resources base, which is meant to favourably position ProSep in relationship to the significant business development opportunity offered by the current oil and gas marketplace, as noted earlier.

5.8. Other Comprehensive Loss

During the quarter ended March 31, 2011, the Company recorded a foreign currency translation adjustment of \$0.7 million resulting from the conversion of the balance sheet of the foreign subsidiaries into the Canadian currency. The conversion of the negative net assets of the Norwegian operations, which appreciated in relation to the Canadian dollar, predominantly accounted for this amount. In addition, the conversion of the US operations' net assets, which depreciated in relation to the Canadian dollar, also contributed to the negative year-to-date currency translation.

5.9. Legal Proceedings

As at March 31, 2011, there were no legal proceedings against the Company.

6. SUMMARY OF QUARTERLY RESULTS

Selected Quarterly Financial Performance

	2011	Year Ending December 31, 2010				Year Ending December 31, 2009			
	Q1	IFRS				Canadian GAAP			
	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Revenue (\$ millions)	9.9	8.5	8.1	8.7	9.4	9.7	9.2	9.3	13.2
Net loss (\$ millions)	(3.0)	(1.2)	(1.5)	(0.3)	(1.3)	(1.3)	(3.4)	(7.1)	(2.0)
Basic and diluted EPS' (loss) (\$)	(0.02)	(0.01)	(0.01)	(0.00)	(0.01)	(0.01)	(0.02)	(0.11)	(0.03)

*EPS: Earnings per share

At this stage of the Company's life, interim operating results continue to be volatile.

7. BALANCE SHEET ITEMS

7.1. Assets

The Company's total assets were \$47.2 million at March 31, 2011 as opposed to \$46.1 at December 31, 2010. Total short-term assets at March 31, 2011 were \$19.1 million, representing a \$1.1 million increase from the amount at December 31, 2010. Working capital asset components such as accounts receivable and inventories were up from the beginning of the year, reflecting the accelerated business activity, including ongoing projects. At the end of March 31, 2011, the Company had \$0.7 million in cash and cash equivalents compared to \$3.7 million at December 31, 2010.

The Company's receivables stood at \$16.3 million at March 31, 2011, up from \$12.9 million at December 31, 2010. Receivables consisted of billed and unbilled receivables. The latter category represents costs related to contracts that have not yet reached the milestones that allow the Company to invoice the customer. The Company did not experience major bad debts in the first quarter of 2011. No material changes have occurred in other operations-related current assets accounts since the beginning of 2011.

Total long-term investments stood at \$3.7 million at March 31, 2011, unchanged from the December 31, 2010 year-end figure. For more details on this matter, refer to Note 10 of the Unaudited Interim Consolidated Financial Statements for the quarter ended March 31, 2011.

The Company concluded a joint venture agreement that led to the formation of ProSep Kolon in South Korea in December 2010. The Company invested \$1.1 million in the joint venture during the first quarter of the current year. The carrying value of this investment is \$1.0 million as at March 31, 2011.

Property and equipment stand at \$2.4 million as at March 31, 2011, essentially unchanged from December 31, 2010, with current quarter depreciation being offset by currency exchange variations.

Goodwill totalled \$14.4 million at March 31, 2011, compared to \$14.6 million at December 31, 2010. The quarterly variance is attributable to changes in foreign exchange conversion rates, as goodwill is recorded in the local currency of each operating unit. Intangible assets stood at \$6.6 million at March 31, 2011, compared to \$6.9 million in December 2010. This reflects the amortization expense incurred in the quarter as well as the impact of foreign exchange conversion rates.

7.2. Liabilities

Total liabilities at March 31, 2011 were \$30.6 million, an increase of \$4.7 million from the December 31, 2010 figure of \$25.9 million. The variance since the beginning of the year stems mostly from the \$3.0 million increase in trade and other liabilities, which reflects the previously noted increased level of business activity during the quarter. Adjustments to long-term debt in relation to the foreign exchange rate used for the conversion to Canadian dollars also contributed to the increase in total liabilities.

Deferred revenue reflects the Company's work in progress that has not yet reached revenue recognition status. Deferred revenue stood at \$1.9 million at March 31, 2011, substantially higher than at December 31, reflecting business activity of the last quarter.

As noted in Section 9.3, as at the quarter-end date of March 31, 2011, one of the Company's wholly-owned subsidiaries was in breach of one of the financial ratios stipulated in the Senior Acquisition Term Loan Facility (the "Facility") dated October 23, 2007 between DnB NOR Bank ASA ("DnB NOR"), as Lender, and said subsidiary, as Borrower. A covenant waiver whereby the Lender confirmed that the breached covenant is not deemed to constitute an event of default has been obtained. However, in view of the breach condition as at the quarter-end date of March 31, 2011, all amounts outstanding under the credit facility at that date have been reclassified with current liabilities. The amount reclassified from non-current to current liabilities is \$1.6 million.

For more information on the Company's debt structure please see Section 9.3 below and Note 12 to the Unaudited Interim Consolidated Financial Statements.

7.3. Equity

The Company's net equity as at March 31, 2011, was \$16.6 million compared to \$20.1 million at December 31, 2010. The variation is almost entirely explained by the net loss incurred in the first quarter.

As of March 31, 2011, ProSep had 191,798,008 common shares issued and outstanding, unchanged from the previous year-end figure.

8. OFF-BALANCE-SHEET ARRANGEMENTS

The Company can from time to time enter into off-balance-sheet arrangements, essentially consisting of letters of guarantee or other similar forms of financial assistance, as well as commercial leases. The Company did not enter into any material off-balance-sheet arrangements during the quarter ended March 31, 2011

Most of the current lease obligations are related to the rental of office space and the Houston, TX fabrication facility. ProSep's annual commercial lease obligations as at March 31, 2011, were as follows:

\$ millions

12 months	Years 2 to 5	Total for the next 5 years
0.8	2.7	3.5

In the normal course of business, the Company also provides letters of guarantee in relation to contracts with customers. Please see Section 9.2 below.

9. LIQUIDITY AND CAPITAL RESOURCES

9.1. Cash Flows

Operating Activities

Net cash used in the Company's operations amounted to \$1.5 million during the quarter ended March 31, 2011, compared to \$0.5 million used in the first quarter of 2010. The difference between the two years is predominantly related to a higher net loss, as well as investments in the operating working capital items required to support ongoing contracts.

Investing Activities

Cash flow used in investing activities during the first quarter of 2011 was mainly in connection with the Company's \$1.1 million investment in the ProSep Kolon joint venture in South Korea, announced December 8, 2010. This Company announcement also made reference to a private placement subscription agreement with Kolon Glotech Inc. ("Kolon Glotech"), a wholly-owned subsidiary of Kolon Group Inc. The private placement consisted of a 5-year convertible unsecured subordinated debenture (the "Debenture") in the principal amount of CAD \$1,009,300 (the equivalent of US\$1 million) bearing interest at the rate of 5% per annum, the net proceeds of which were to be used to fund the Company's acquisition of a 51% interest in ProSep Kolon.

The release of the restricted cash required for the issuance of letters of guarantee on an Ecopetrol contract offset to a certain extent the amount invested in the ProSep Kolon Joint venture, and, as a result, total cash used in investing activities in the first quarter of the year amounted to \$0.9 million as against \$0.5 million in the corresponding quarter of the previous year. Last year's investing activities included the acquisition of certain property and equipment for some \$0.2 million, as well as an allocation to restricted cash of some \$0.3 million.

Financing Activities

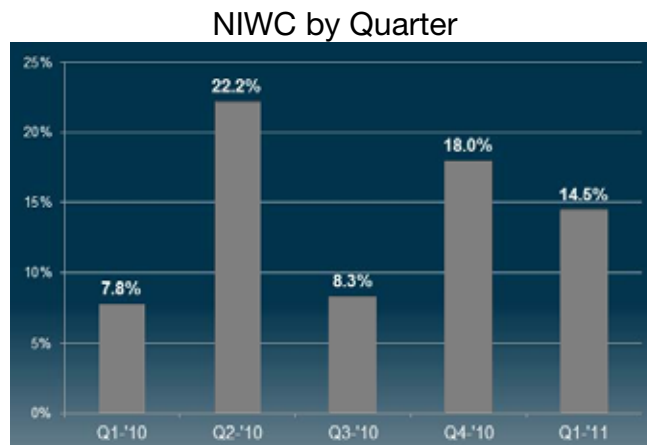
Cash used in financing activities amounted to \$0.7 million for the quarter and essentially represented net repayments on the Company's Senior Overdraft Facility since the December 31, 2010 year-end. Cash used in financing activities during the quarter ended March 31, 2010, amounted to \$0.1 million.

As noted in Section 1.2, on April 4, 2011, ProSep announced that it had concluded a \$2.5 million unsecured revolving loan agreement with Fondaction, ProSep's largest shareholder.

9.2. Liquidity, Working Capital and Credit Facility

At March 31, 2011, the Company had net cash (defined for the purpose of this section as being cash less senior overdraft facility and borrowings) of negative \$6.8 million compared to negative \$2.5 million at December 31, 2010. The increase in negative net cash stems from the Company's cash utilization during the quarter, which is essentially related to operating activities and the previously mentioned investment in the ProSep Kolon joint venture, as well as the reclassification to current liabilities of the non-current portion of the Senior Acquisition Term Loan with DnB NOR in the amount of \$1.6 million further to one of the Company's wholly-owned subsidiaries being in breach of its covenant to maintain one of the financial ratios set forth under the credit facility at March 31, 2011, as noted earlier and in Sub-Section 9.3.1.

At March 31, 2011, the Company had net invested working capital (NIWC – see definition on page 3) of \$5.1 million or 14.5% of trailing four quarter revenues, representing a decrease of \$1.0 million from the \$6.1 million it had at December 31, 2010 (18% of trailing four quarter revenues). This decrease in NIWC is essentially related to timing differences between work in progress, collection of receivables and payment to suppliers, and reflects the high volatility of amounts required to support outstanding contracts. Management actively monitors NIWC to ensure it remains as low as possible.



As shown above, the level of NIWC can be quite volatile depending on the structure and progress of contracts. 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 letters of guarantee using the DnB NOR NOK 15 million credit facility (approximately \$2.6 million at March 31, 2011), financial assistance provided by Export Development Canada (“EDC”), or simply the pledging of cash to secure the issuance of such letters of guarantee. At March 31, 2011, the total outstanding letters of guarantee (DnB NOR, EDC and letters of guarantee secured by restricted cash) amounted to \$2.1 million (\$2.5 million at December 31, 2010). As more sales occur in countries where the Company does not have a physical presence, it is anticipated that increased levels of NIWC and letters of guarantee may be required. ProSep Inc. is a company with limited business operations, sources of income or operating assets other than those of its operating subsidiaries. ProSep's cash flow and, consequently, its ability to meet its debt service obligations is highly dependent upon the receipt of funds from its subsidiaries in the form of loans, dividends, advances or otherwise. Under the current debt agreement with DnB NOR, ProSep is subject to certain financial and negative covenants including limitations from the operating subsidiaries of the Company to transfer funds in the form of management fees, dividends or otherwise to the Company in excess of \$3,750,000 million for each fiscal year. The Company intends to finance its operations and NIWC using cash on hand, cash flow from operating activities, bank credit lines, financial assistance from EDC and funds from external sources.

9.3. Bank Senior Overdraft Facility and Obligations under Financial Liabilities

ProSep's Bank Credit Facilities at March 31, 2011

Lender	Description	Currency	Capacity	Drawn	Available
			\$ millions	\$ millions	\$ millions
DnB NOR	Senior Overdraft Facility	NOK/USD	5.3	4.3	1.0
	Guarantee facility	NOK	2.6	1.8	0.8

9.3.1. Financial Covenants

Other than as stated below, the Company is in full compliance with its financial covenants.

At March 31, 2011, one of the Company's wholly-owned subsidiaries was in breach of a covenant to maintain one of the financial ratios stipulated in the Senior Acquisition Term Loan Facility (the "Facility") dated October 23, 2007 between DnB NOR, as Lender, and said subsidiary, as Borrower. This situation stems from the Company's decision to accelerate its pace of growth in view of the opportunities offered in the marketplace as outlined in Section 4.2, and more specifically to the up-front investments in hiring and related operating expenses that were approved as part of this strategy. The Company anticipates that its subsidiary will still be in breach of this covenant at the quarter-end dates of June 30, 2011, and September 30, 2011.

A covenant waiver whereby the Lender confirmed that the breached covenant is not deemed to constitute an event of default has been obtained for the March 31 breach and covering the June 30, 2011 anticipated breach as well. A new waiver request will be presented later in the year with respect to the anticipated breach at the quarter-end date of September 30, 2011.

9.3.2. Obligations under Financial Liabilities

The Company's debt and credit facility repayment schedule as at March 31, 2011, and for further periods is provided in the table below.

ProSep's Debt and Credit Facility Repayment Schedule

	Carrying Amount	Nominal Amount	One to three months	Four to twelve months	One to five years	More than five years
	\$ millions	\$ millions	\$ millions	\$ millions	\$ millions	\$ millions
DnB NOR Senior overdraft facility	4.3	4.3	-	4.3	-	-
DNB NOR Senior Acquisition Term Loan Facility	3.2	3.2	3.2	-	-	-
Convertible unsecured debenture maturing in 2014	3.7	4.0	-	-	4.0	-
Convertible unsecured debenture maturing in 2015	0.6	1.0	-	-	1.0	-
Revolving credit with National Bank of Canada	4.6	4.6	-	-	4.6	-
Total	16.4	17.1	3.2	4.3	9.6	-

10. RELATED-PARTY TRANSACTIONS

Note 5.2.5 to the Company's Unaudited Interim Consolidated Financial Statements outline the Company's related-party transactions. ProSep did not enter into any related-party transactions outside the normal course of business during the quarter ended March 31, 2011.

11. DESCRIPTION OF CAPITAL STRUCTURE

ProSep's authorized share capital consists of an unlimited number of common shares without par value, of which 191,798,008 common shares were issued and outstanding as of March 31, 2011, unchanged from December 31, 2010. The holders of the common shares are entitled to receive notice of and to attend all annual and special meetings of shareholders and to one vote in respect of each common share held at all such meetings. The holders of the common shares are entitled, at the discretion of the Company's Board of Directors, to receive any or all of the profits or surplus properly available for the payment of dividends, as well as any dividend declared by the Board of Directors and payable by the Company on the common shares. The holders of the common shares participate rateably in any distribution of the Company's assets upon liquidation, dissolution or winding-up or other distribution of assets among shareholders for the purpose of winding-up the Company's affairs. Such participation is subject to the rights, privileges, restrictions and conditions attached to any securities issued and outstanding at such time ranking in priority to the common shares upon liquidation, dissolution or winding-up.

At March 31, 2011, options to purchase 335,000 common shares of the Company granted under ProSep's stock option plan were outstanding. This compares to 420,000 options outstanding at December 31, 2010 as 85,000 options have been forfeited.

The Company grants restricted share units to attract, retain and motivate key personnel and reward officers and employees for significant performance. Each restricted share unit is equal in value to one common share of the Company. The shares are issued from the treasury of the Company. When combined with all other security-based compensation arrangements, the number of shares reserved at any time must not exceed 10% of the aggregate number of shares.

At March 31, 2011, 8,965,000 restricted share units were issued and outstanding as opposed to 7,190,000 at December 31, 2010.

At March 31, 2011, warrants to purchase 4,460,242 common shares of the Company were outstanding. This number is unchanged from December 31, 2010.

12. CHANGES IN ACCOUNTING POLICIES

Adoption of IFRS

The Canadian Institute of Chartered Accountants Handbook – Accounting, requires that Canadian publicly accountable enterprises, such as the Company, report in accordance with IFRS for years beginning on or after January 1, 2011. IFRS 1, “First-time Adoption of International Financial Reporting Standards”, sets forth guidance for the initial adoption of IFRS.

The principal IFRS accounting policies as set out in Note 3 to the Company's Unaudited Interim Consolidated Financial Statements have been consistently applied to all the periods presented in such financial statements. Note 5 to the Unaudited Interim Consolidated Financial Statements outlines the basis of transition to IFRS, including the relevant mandatory exceptions and certain optional exemptions from full retrospective applications of IFRS adopted by the Company, as well as a description of the significant differences between the previous historical Canadian GAAP accounting policies and the current IFRS accounting policies applied by the Company.

All comparative information presented in the Unaudited Interim Consolidated Financial Statements has been adjusted from information previously reported amounts under Canadian GAAP. IFRS 1 requires an entity to reconcile equity, comprehensive loss and cash flows for those restated prior periods. Note 5.2 to the Unaudited Interim Consolidated Financial Statements provides a reconciliation, from Canadian GAAP to IFRS, of comparative information presented for equity and comprehensive loss. The Company's first time adoption of IFRS did not have a material impact on its total cash flows from operating, investing or financing activities.

Reconciliation of EBITDA

The following represents the reconciliation of EBITDA loss from the previously reported amount in prior periods for the effects of the Company's change in methodology used to calculate EBITDA and the effect of IFRS:

For the three months ended March 31, 2010

EBITDA (loss), as previously reported	(\$ 676,298)
Stock-based compensation	(45,794)
Pension obligation	<u>41,466</u>
Subtotal - IFRS adjustments	<u>(4,328)</u>
EBITDA (loss), as currently reported	<u>(\$ 680,626)</u>

The description of adjustments impacting EBITDA further to the Company's adoption of IFRS, specifically relating to stock-based compensation and pension obligation, is presented in Note 5.2.3 to the Unaudited Interim Consolidated Financial Statements.

Impact of IFRS Adoption

The differences between IFRS and Canadian GAAP have not had a material impact on ProSep's reported results and financial position and as a result there are no material differences in the majority of the line items appearing in the Company's consolidated statements of financial position and consolidated statements of comprehensive loss from what was reported under Canadian GAAP in terms of recognition and measurement. 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 minor.

13. INTERNAL CONTROLS

In order to comply with the Canadian Securities Administrator's Multilateral Instrument 52-109 ("MI 52-109"), the Company performs regular evaluations of its disclosure controls and procedures and internal controls. The implementation of MI 52-109 involves a continuous improvement process, which has led the Company to ensure that all relevant processes and controls are documented.

13.1. Disclosure Controls and Procedures

The Company's disclosure controls and procedures are designed to provide reasonable assurance that material information required to be disclosed is recorded, processed, summarized and reported within the time periods specified under Canadian securities laws, and include controls and procedures that are designed to ensure that information is accumulated and communicated to the management committee members, including the President & Chief Executive Officer and the Chief Financial Officer, to allow timely decisions regarding required disclosure.

13.2. 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 Unaudited Interim Consolidated Financial Statements for external purposes in accordance with IFRS. As previously discussed in section 12, the adoption of IFRS had very limited effects on the Company's accounting policies and accordingly had minimal impacts on the Company's internal control over financial reporting.

As of December 31, 2010, management assessed the design of internal control over financial reporting as defined in MI 52-109, and based on that evaluation determined that certain aspects of internal control over financial reporting were not designed effectively but were mitigated by additional compensating procedures. As part of the assessment, the Company has continued to implement entity-level controls, which are now 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 its consolidated Unaudited Interim Consolidated Financial Statements for the quarter ended March 31, 2011.

14. SELECTED RISKS

Please refer to ProSep's Annual Information Form dated March 9, 2011, for a description of the most important risks associated with the Company's business operations.




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ProSep Inc. is traded on the Toronto Stock Exchange under the symbol "PRP".

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