

ProSep Inc.
Unaudited Interim Condensed Consolidated Financial Statements
For the three and six-month periods ended June 30, 2011
(In Canadian dollars)

ProSep Inc.
Consolidated statements of comprehensive loss
(Unaudited)

(In Canadian dollars)	Notes	Three months ended June 30,		Six months ended June 30,	
		2011	2010	2011	2010
		\$	\$	\$	\$
Revenue		9,615,419	8,652,996	19,501,465	18,060,686
Cost of goods sold	6	7,410,309	6,081,680	15,105,002	12,911,061
Sales and marketing	6	833,356	498,580	1,750,472	1,009,668
Research and development	6	79,919	90,129	159,309	151,919
General and administrative	6	3,032,383	2,212,733	6,456,245	4,898,790
Share of loss in a joint venture		54,842	-	162,646	-
Amortization	6	591,902	366,193	926,096	744,700
Loss (gain) on disposal of property and equipment		(10,643)	26,268	(10,643)	26,268
Operating loss		(2,376,649)	(622,587)	(5,047,662)	(1,681,720)
Finance income	6	(345,298)	(382,345)	(409,668)	(393,552)
Finance costs	6	542,615	371,864	951,234	1,185,381
Finance costs - net		197,317	(10,481)	541,566	791,829
Loss before income taxes		(2,573,966)	(612,106)	(5,589,228)	(2,473,549)
Current tax provision (recovery)		13,417	(371,870)	41,328	(369,819)
Deferred tax provision (recovery)		(229,595)	43,701	(239,979)	(510,760)
Income taxes		(216,178)	(328,169)	(198,651)	(880,579)
Loss for the period		(2,357,788)	(283,937)	(5,390,577)	(1,592,970)
Other comprehensive income (loss) for the period, net of tax					
Currency Translation Adjustments		(362,154)	1,196,832	(1,033,269)	1,294,736
Total comprehensive income (loss) for the period		(2,719,942)	912,895	(6,423,846)	(298,234)
Weighted average number of shares		192,507,623	176,393,780	192,154,776	169,861,137
Basic and diluted loss per share		(0,01)	(0,00)	(0,03)	(0,01)

The accompanying notes are an integral part of these unaudited interim condensed consolidated financial statements.

ProSep Inc.
Consolidated statements of financial position
(Unaudited)

(In Canadian dollars)	<u>Notes</u>	<u>June 30, 2011</u>	<u>December 31, 2010</u>
		\$	\$
ASSETS			
Current			
Cash		2,175,619	3,703,155
Restricted cash		-	226,046
Trade and other receivables	7	11,538,768	12,938,294
Current tax assets		790,729	617,600
Inventories		2,188,709	282,346
Prepaid expenses		676,111	585,068
Total current assets		<u>17,369,936</u>	<u>18,352,509</u>
Non current			
Investments	9 & 11	4,054,775	3,729,775
Investment in a joint venture	8	898,076	-
Deferred income tax assets		11,904	-
Property and equipment		2,052,046	2,472,720
Other intangible assets		6,469,368	6,851,132
Goodwill		14,378,167	14,644,186
Total assets		<u>45,234,272</u>	<u>46,050,322</u>
EQUITY AND LIABILITIES			
LIABILITIES			
Current			
Bank and other credit facilities and current portion of other borrowing facilities	11	8,078,173	6,302,622
Trade and other liabilities	10	10,489,952	7,714,728
Provisions		110,432	340,429
Deferred revenue		1,843,688	71,164
Total current liabilities		<u>20,522,245</u>	<u>14,428,943</u>
Non current			
Borrowings	11	9,756,592	10,437,101
Deferred tax liabilities		400,232	555,000
Pension obligation		604,792	503,968
Total liabilities		<u>31,283,861</u>	<u>25,925,012</u>
EQUITY			
Share capital	12	75,817,574	75,725,324
Contributed surplus		12,577,138	12,420,441
Accumulated other comprehensive loss		(1,128,893)	(95,624)
Deficit		(73,315,408)	(67,924,831)
Total equity		<u>13,950,411</u>	<u>20,125,310</u>
Total equity and liabilities		<u>45,234,272</u>	<u>46,050,322</u>

Approved by the Board

" Jacques L. Drouin "

Jacques L. Drouin, Director

" David H. Laidley "

David H. Laidley FCA, Director

The accompanying notes are an integral part of these unaudited interim condensed consolidated financial statements.

ProSep Inc.
Consolidated statements of changes in equity
(Unaudited)

(In Canadian dollars)	Number of common Shares	Share Capital	Contributed Surplus	Deficit	Accumulated Other Comprehensive Income (Loss)	Total Equity
		\$	\$	\$	\$	\$
Balance on January 1, 2010	163,255,910	72,010,934	11,648,802	(63,519,701)	-	20,140,035
Loss for the period		-	-	(1,592,970)	-	(1,592,970)
Other comprehensive income						
Change in cumulative currency translation adjustments		-	-	-	1,294,736	1,294,736
Total comprehensive loss		-	-	(1,592,970)	1,294,736	(298,234)
Issuance of shares (net costs reflected in deficit)	28,465,385	3,700,501		(137,159)		3,563,342
Stock based compensation		-	284,142	-	-	284,142
Vested restricted share units settled in cash		-	(68,670)	-	-	(68,670)
Total transactions with owners		3,700,501	215,472	(137,159)	-	3,778,814
Balance on June 30, 2010	191,721,295	75,711,435	11,864,274	(65,112,671)	1,294,736	23,620,615
Balance on January 1, 2011	191,798,008	75,725,324	12,420,441	(67,924,831)	(95,624)	20,125,310
Loss for the period		-	-	(5,390,577)	-	(5,390,577)
Other comprehensive loss						
Change in cumulative currency translation adjustments		-	-	-	(1,033,269)	(1,033,269)
Total comprehensive loss		-	-	(5,390,577)	(1,033,269)	(6,423,846)
Stock-based compensation		-	156,697	-	-	156,697
Vested restricted share units	1,025,000	92,250	-	-	-	92,250
Total transactions with owners	1,025,000	92,250	156,697	-	-	248,947
Balance on June 30, 2011	192,823,008	75,817,574	12,577,138	(73,315,408)	(1,128,893)	13,950,411

At June 30, 2011, the sum of Deficit and Accumulated other comprehensive loss is \$74,444,301 (At December 31, 2010, the amount was \$68,020,455).
The accompanying notes are an integral part of these unaudited interim condensed consolidated financial statements.

ProSep Inc.
Consolidated statements of cash flow
(Unaudited)

(In Canadian dollars)

Six months ended June 30,
2011 2010
\$ \$

Cash flows from operating activities

Loss for the period	(5,390,577)	(1,592,970)
Adjustments for		
Stock-based compensation	248,947	284,142
Share of loss in a joint venture	162,646	-
Amortization of property and equipment	571,304	385,445
Amortization of other intangible assets	354,792	359,255
Finance costs	723,395	655,439
Finance income	(30,871)	(18,552)
Loss (gain) on sale of asset	(10,417)	26,268
Decrease (increase) in fair value of investment	(325,000)	(375,000)
Income taxes	(198,651)	(880,579)
Contribution to defined benefit pension plan	61,265	36,967
Currency exchange gain	120,756	483,335
	<u>(3,712,411)</u>	<u>(636,250)</u>

Changes in operating working capital items

Trade and other receivables	1,058,737	(1,994,539)
Inventories	(1,906,455)	(61,111)
Prepaid expenses	(91,495)	(20,369)
Trade and other liabilities	2,564,955	(543,052)
Provision	(229,931)	(73,363)
Deferred revenue	1,772,196	310,704

Cash used in operating activities

(544,404) (3,017,980)

Taxes recovered (paid)	(247,006)	31,347
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Net cash used in operating activities

(791,410) (2,986,633)

Cash flows from investing activities

Restricted cash	226,046	(3,042,539)
Acquisition of property and equipment	(92,370)	(244,812)
Disposal of tangibles and intangibles	10,417	554
Subsidies on intangible assets	-	44,918
Investment in a joint venture	(1,060,721)	-
Interest received	30,871	18,552
Net cash used in investing activities	<u>(885,757)</u>	<u>(3,223,327)</u>

Cash flows from financing activities

Interest paid	(557,233)	(525,642)
Bank and other credit facilities	1,557,674	1,295,814
Shares issued (net of expenses)	-	3,563,344
Repayment of borrowings	(828,356)	(789,892)
Net cash provided by financing activities	<u>172,085</u>	<u>3,543,624</u>

Net decrease in cash

(1,505,082) (2,666,336)

Effect of currency exchange rate on cash

(22,454) (153,116)

Cash beginning of the period

3,703,155 7,689,701

Cash end of the period

2,175,619 4,870,249

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ProSep Inc.
Notes to the unaudited interim condensed consolidated financial statements
For the three-month and six-month periods ended June 30, 2011 and 2010
(In Canadian dollars)

1. GENERAL INFORMATION AND NATURE OF BUSINESS

ProSep Inc. was incorporated under the Canada Business Corporations Act. The Company's executive offices are in Montreal, Quebec, Canada. Its shares are traded on the Toronto Stock Exchange ("TSX") under the symbol PRP.

ProSep Inc. and its subsidiaries (the "Company") design, develop, manufacture and commercialize technologies to separate oil, water and gas generated by oil and gas production. The Company is a technology-focused process solutions provider to the upstream oil & gas ("O&G") industry. The Company offers a wide range of process equipment sold in units or packages to O&G producers and engineering procurement and construction firms with or without process warranties. The Company has over 60 patents and has developed one of the industry's most comprehensive suites of produced water treatment solutions, including polishing equipment. The Company 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. The Company and its joint venture operate around the world in the most important O&G service hubs with operations in Houston (USA), Haugesund (Norway), Kuala Lumpur (Malaysia), Manama (Bahrain) and Seoul (South Korea). During the quarter, the Company has relocated its Norwegian operations previously based in the cities of Bergen and Fusa to the city of Haugesund.

2. GOING CONCERN

The Company incurred a loss of \$5,390,577 for the six-month period ended June 30, 2011, it has a negative working capital of \$3,152,309 and an accumulated deficit of \$73,315,408 and it has not yet generated positive cash flows from operations. The Company is also subject to certain restrictive covenants; it was in breach of one of these covenants at June 30, 2011, but has obtained a short-term waiver in this regard. Accordingly, there was significant doubt that the Company would be able to continue as a going concern as at June 30, 2011. This situation requires that the Company seek non-operational sources of financing, and succeed in making its operations profitable in the future.

On April 4, 2011, the Company concluded a \$2.5 million unsecured revolving loan agreement with Fondation, the Company's largest shareholder (Note 11). The Company believes that it has sufficient funds to meet its current obligations and continue as a going concern for the next twelve months.

As the Company believes the use of the going concern assumption is appropriate, the unaudited interim condensed consolidated financial statements do not include any adjustments or disclosures that may be necessary should the Company not be able to continue as a going concern. If this were the case, these adjustments could be material.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The unaudited interim condensed consolidated financial statements have been prepared using accounting policies specified by those International Financial Reporting Standards (IFRS) expected to be in effect for the year ending December 31, 2011.

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated.

3.1 Basis of Preparation and Statement of Compliance with IFRS

The Handbook of the Canadian Institute of Chartered Accountants ("CICA Handbook) has been revised to incorporate IFRS, and requires publicly accountable companies to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, the Company has commenced reporting on this basis in the unaudited interim condensed consolidated financial statements for the three-month period ended March 31, 2011. In these unaudited interim condensed consolidated financial statements, the term "Canadian GAAP" refers to Canadian GAAP before the adoption of IFRS. The unaudited interim condensed consolidated financial statements for the three-month period ended March 31, 2011 as well as those for the six-month period ended June 30, 2011 have been prepared in accordance with IFRS applicable to the preparation of interim financial statements, and specifically with IAS 34 and IFRS 1. The accounting policies for June remain unchanged from March 31, 2011.

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Subject to certain transition elections disclosed in Note 5, the Company has consistently applied its accounting policies in its opening IFRS statements of financial position at January 1, 2010 and throughout all periods presented, as if these policies had always been in effect. These unaudited interim consolidated financial statements disclose the impact of the transition to IFRS on the Company's reported financial position, financial performance and cash flows, including the nature and effect of significant changes in accounting policies from those used in the Company's consolidated financial statements for the year ended December 31, 2010. Comparative figures for 2010 in these financial statements have been restated to give effect to these changes.

The accounting policies applied in these unaudited interim condensed consolidated financial statements are based on IFRS issued and outstanding as of August 9, 2011, the date the Board of Directors approved the statements and applicable on December 31, 2011. Any subsequent changes to IFRS that are given effect in the Company's annual consolidated financial statements for the year ending December 31, 2011 could potentially impact these unaudited interim condensed consolidated financial statements, including the transition adjustments recognized on transition to IFRS.

The unaudited interim condensed consolidated financial statements should be read in conjunction with the Company's Canadian GAAP annual financial statements for the year ended December 31, 2010 and the unaudited interim condensed consolidated financial statements for the three month period ended March 31, 2011. Note 5 to these unaudited interim condensed consolidated financial statements provides supplementary IFRS information for the year ended December 31, 2010.

The preparation of the unaudited interim condensed consolidated financial statements in accordance with IAS 34 requires the use of certain critical accounting estimates. It also requires management to exercise judgment in the process of applying the Company's accounting policies. The areas involving a higher degree of judgment or complexity or areas where assumptions and estimates are significant to the unaudited interim condensed consolidated financial statements are disclosed in Note 4.

3.2 New IFRS and IFRIC Interpretations Not Yet Adopted

Certain new standards, interpretations, amendments and improvements to existing standards have been issued by the International Accounting Standards Board ("IASB") or International Financial Reporting Interpretations Committee ("IFRIC"). The Company has not elected to early adopt any of these standards. The new standards which could potentially impact the Company's consolidated financial statements are detailed as follows:

IFRS 9 – Financial Instruments: The IASB aims to replace IAS 39 Financial Instruments: Recognition and Measurement in its entirety. The replacement standard (IFRS 9) is being issued in phases. To date, the chapters dealing with recognition, classification, measurement and derecognition of financial assets and liabilities have been issued. These chapters are effective for annual periods beginning on or after January 1, 2013. Further chapters dealing with impairment methodology and hedge accounting are still being developed. Management has yet to assess the impact that these amendments are likely to have on the financial statements of the Company. Furthermore, the Company does not intend to implement this new standard until all phases have been published and it can comprehensively assess the impact of all changes.

IFRS 10 – Consolidated Financial Statements; IFRS 11 – Joint Arrangements; and IFRS 12 – Disclosure of Interests in Other Entities: IFRS 10 provides a single consolidation model that identifies control as the basis for consolidation for all types of entities. IFRS 10 replaces IAS 27 Consolidated and Separate Financial Statements and SIC-12 Consolidation – Special Purpose Entities. IFRS 11 Joint Arrangements establishes principles for the financial reporting by parties to a joint arrangement. Among other things, the use of the proportionate consolidation method is no longer permitted for interests in joint ventures. IFRS 11 supersedes IAS 31 Interests in Joint Ventures and SIC-13 – Jointly Controlled Entities–Non-monetary Contributions by Ventures. IFRS 12 combines and replaces the disclosure requirements for subsidiaries, joint arrangements, associates and unconsolidated structured entities. As a consequence of these new IFRSs, the IASB also issued amended and retitled IAS 27 Separate Financial Statements and IAS 28 Investments in Associates and Joint Ventures. The new requirements are effective for annual periods beginning on or after January 1, 2013. These new standards are unlikely to have an impact on the Company's consolidated financial statements, given that it has interests in fully owned subsidiaries and a joint venture accounted for using the equity method.

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IFRS 13 – Fair Value Measurement: IFRS 13 defines fair value, sets out in a single IFRS framework for measuring fair value and requires disclosures about fair value measurements. IFRS 13 applies when other IFRS standards require or permit fair value measurements. It does not introduce any new requirements to measure an asset or a liability at fair value, change what is measured at fair value in IFRS standards or address how to present changes in fair value. The new requirements are effective for annual periods beginning on or after January 1, 2013. This new standard is unlikely to have a significant impact on the Company's consolidated financial statements as the Company has very few assets that are measured at fair value.

Amendment to IAS 1 - Presentation of Items of other comprehensive Income: IAS 1 has been amended to change the disclosure of items presented in Other Comprehensive Income ("OCI"), including a requirement to separate items presented in OCI into two groups based on whether or not they may be recycled to profit or loss in the future. This amendment is effective for years beginning on or after July 1, 2012.

IAS 19 - Employee benefits: IAS 19 has been amended to reflect (i) significant changes to recognition and measurement of defined benefit pension expense and termination benefits, and (ii) expanded disclosure requirements. In particular, actuarial gains and losses (to be referred to as "remeasurements" under the amended standard) must now be recorded directly in OCI and will not be recycled to profit or loss in the future, as has already been elected by the Company under the current IAS 19. Past service costs will be recognized immediately in profit or loss upon plan amendment instead of being recognized over the vesting period. The determination of the periodic benefit expense will no longer involve an estimation of the expected return on plan assets. Instead, the periodic benefit expense for a funded benefit plan will include net interest expense or income, calculated by applying the discount rate to the net defined benefit asset or liability. The amendments are effective for years beginning on or after January 1, 2013.

Certain other new standards and interpretations have been issued but are not expected to have a material impact on the Company's consolidated financial statements.

3.3 Basis of Consolidation

The unaudited interim condensed consolidated financial statements include the accounts of ProSep Inc. and its wholly-owned subsidiaries:

- ProSep (USA) Inc. (formerly ProSep Technologies Inc.), domiciled in the United States
- ProSep (Asia Pacific) Sdn Bhd (formerly ProSep AP Sdn Bhd), domiciled in Malaysia
- ProPure AS, domiciled in Norway
- ProPure ME, domiciled in Bahrain
- Pure Group AS (formerly TORR Acquisition Norway AS), domiciled in Norway
- TORR Finance Group LLC, domiciled in the United States
- ProSep Korea Holding Inc., domiciled in Canada

All subsidiaries have annual reporting dates of December 31.

All intercompany transactions and accounts were eliminated on consolidation, including unrealized gains and losses on intercompany transactions. Where unrealized losses on intercompany asset sales are reversed on consolidation, the underlying asset is also tested for impairment from a Company perspective. Accounting policies of subsidiaries have been adapted where necessary to ensure consistency with the policies adopted by the Company.

Profit or loss and other comprehensive income of subsidiaries acquired or disposed of during the year are recognized from the effective date of acquisition, or up to the effective date of disposal, as applicable.

As per its credit facility agreement, Pure Group AS together with its subsidiaries (ProSep (USA) Inc., ProSep (Asia Pacific) and ProPure AS), (collectively "the borrower") shall not, without prior approval from DnB NOR Bank ASA, pay management fees (current or unpaid from previous years) to ProSep Inc. in excess of \$3,750,000 per year. The borrower can repay advances existing at December 31, 2008 before repaying current advances as long as it is within the agreed limit. In addition, intercompany advances shall at no time be lower than NOK 45,500,000 (\$8,135,460) unless the bank gives a written waiver.

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3.4 Investment in a Joint Venture

The Company's interest in a jointly controlled entity is accounted for using the equity method, a method by which an investment is initially recorded at cost and subsequently adjusted to reflect the Company's share of the profit or loss and other comprehensive income of the joint venture. These changes include subsequent amortization or impairment of the fair value of assets and liabilities. Any goodwill or fair value adjustment attributable to the Company's share in the joint venture is included in the amount recognized as investment in a joint venture.

Unrealized gains and losses on transactions between the Company and its joint venture are eliminated to the extent of the Company's interest. Where unrealized losses are eliminated, the underlying asset is also tested for impairment.

Amounts reported in the financial statements of the joint venture have been adjusted where necessary to ensure consistency with the Company's accounting policies.

3.5 Translation of Foreign Currency Balances

The financial statements of each of the Company's subsidiaries are established using the currency of the primary economic environment in which the entity operates (the "functional currency") including the goodwill and fair value adjustments that arose on the acquisition of such entities. These unaudited interim condensed consolidated financial statements are presented in Canadian Dollars, which is ProSep Inc.'s functional currency.

Transactions in foreign currency are translated into the functional currency of the respective Company entity using the exchange rate in effect on the transaction date. Foreign currency exchange gains and losses resulting from the settlement of such transactions and from the re-measurement of monetary items at the reporting date are recognized in profit or loss. Non-monetary items measured at historical cost are translated using the currency exchange rate at the date of the transaction. The functional currency of the Company's entities remained unchanged during the reporting period.

The financial position and results of operations of all subsidiaries included in these unaudited interim condensed consolidated financial statements that have a functional currency different from the presentation currency are translated to the presentation currency as follows:

- (i) Assets and liabilities are translated at the closing rate prevailing at the reporting date;
- (ii) Income and expenses are translated at monthly average exchange rates over the reporting period; and
- (iii) Exchange differences are recognized in other comprehensive income and as a component of accumulated other comprehensive income within equity.

On disposal of a foreign operation, the cumulative foreign currency translation differences recognized in equity are reclassified to profit or loss and recognized as part of the gain or loss on disposal.

3.6 Operating Segment

Segments are based on geographic locations: United States, European & Middle East and Asia Pacific. Each of the operating segments is managed separately and all inter-segment transfers are carried out at arm's length prices. Operating segments are reported in a manner consistent with the internal reporting provided to the Company's Chief Executive Officer.

The measurement policies used by the Company for segment reporting are the same as those used in its financial statements, except Finance costs-net and Amortization, which are not included in the operating profit of the operating segments. In addition, assets and expenses not directly attributable to the business activities of an operating segment are not allocated to a segment. Items unallocated to a segment consist mainly of head office assets and expenses.

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Segment information is presented in accordance with *IFRS 8 – Operating Segments* for all periods presented. IFRS 8 only requires disclosure of segment information. There was no effect on the recognition and measurement of financial statements items upon transition to IFRS.

3.7 Revenue Recognition

The Company's revenues are derived principally from manufacturing contracts. The Company recognizes revenue when realized, which is when the following criteria have all been met:

- a) The entity has transferred to the buyer the significant risks and rewards of ownership of the goods;
- b) The entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
- c) The amount of revenue can be measured reliably;
- d) It is probable that the economic benefits associated with the transaction will flow to the entity;
- e) The stage of completion of the transaction at the end of the reporting period can be measured reliably;
- f) The costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

Manufacturing contracts are within the scope of *IAS 11 – Construction contracts*. The Company recognizes revenues on manufacturing contracts using the percentage of completion method of accounting, measured by the value of tasks completed. Cost of goods sold (excluding amortization) is also based on the degree of completion. Any excess of cost of goods sold (excluding amortization) over cost incurred to close date is reported as a liability on the statements of financial position under trade and other liabilities. If the degree of completion of a project cannot be established reliably, only revenue up to an amount corresponding to expenses incurred, when representing a valid proxy of the estimated degree of completion, will be recognized. Any loss on projects is fully recognized when it is ascertained that the project will incur a loss.

The degree of completion of manufacturing contracts is assessed by management by taking into consideration all information available at the reporting date. The degree of completion is determined by comparing the overall value of the tasks completed to the overall revenue the Company expects from its manufacturing contract. The Company offers complete and integrated solutions to meet customer needs. These solutions may involve the delivery of multiple services and products occurring at different points in time. As appropriate, these multiple element arrangements are separated into their units of accounting based upon their relative fair values when the delivered item has value to the customer on a stand-alone basis. If the fair value of the delivered item is not reliably measurable then revenue is allocated based on the difference between the total arrangement consideration and the fair value of the undelivered item.

3.8 Warranty Expenses

Provisions for warranty are generally established based on management's best estimates as to the amounts that could be required, or contract terms, as the case may be. Expenditure for warranties is charged against associated provision when the claim from the customer is deemed relevant, in accordance with the contract terms and conditions.

3.9 Borrowing Costs

Borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset are capitalized during the period of time that is necessary to complete and prepare the asset for its intended use. Other borrowing costs are expensed in the period in which they are incurred and reported in finance costs.

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3.10 Financial Instruments – Recognition and Measurement

When the Company becomes a party to the contractual provisions of the financial instruments, these are initially recorded on the statements of financial position at fair value plus transactions costs, except for financial assets and financial liabilities carried at fair value through profit or loss, which are measured initially at fair value. After initial recognition, the financial instruments are measured according to their classification or designation as described below.

Financial assets are derecognized when the contractual rights to the cash flows from the financial asset expire, or when the financial asset and all substantial risks and rewards are transferred. Financial liabilities are derecognized when they are extinguished, discharged, cancelled or expire.

The Company has made the following classifications and designations:

- i) The put options embedded in the revolving credit facilities with National Bank of Canada (Note 9) are classified as held for trading. The investments are designated as financial assets at fair value through profit and loss. These investments were designated as such because they include embedded derivatives that transfer the credit risk of the underlying assets to the Company and these embedded derivatives are not closely related to the investments. Financial assets at fair value through profit and loss are measured at fair value and any gains or losses resulting from subsequent measurements at the end of each period are recognized in profit and loss.
- ii) Trade receivables, cash and restricted cash are classified as loans and receivables. Subsequent measurement of trade accounts receivable is at amortized cost using the effective interest method, which corresponds to the amount initially recorded less any allowance for doubtful accounts, is recognized in profit or loss.
- iii) Trade and other liabilities and borrowings are classified as other financial liabilities. Any adjustment resulting from subsequent measurement at amortized cost using the effective interest method at the end of each period is recognized in profit or loss.

3.11 Financial Assets

All income and expenses relating to financial assets that are recognized in profit or loss are presented within “finance costs” or “finance income”, except for impairment of trade receivables which is presented within “general and administrative” expenses.

Loans and Receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

In the normal course of business, trade receivables do not carry any interest. Unbilled receivables and trade accounts receivable are included in trade receivables. Unbilled receivables consist of revenues recognized by the Company in accordance with the revenue recognition method as work is performed, in excess of amounts billed to clients.

An allowance for doubtful accounts is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of the receivables. Significant financial difficulties of the debtor, the probability that the debtor will enter into bankruptcy or financial reorganization, and default or delinquency in payments (more than 90 days overdue) are considered indicators that the receivable is impaired. The allowance for doubtful accounts is estimated based on the Company’s historical losses, review of specific problem accounts, existing economic conditions in the oil and gas industry, and the financial stability of its customers. Delinquent receivables are provided for based on individual credit evaluation and specific circumstances of the Company’s customers. The carrying amount of the receivable is reduced through the use of an allowance account, and the amount of the loss is recognized in the statements of comprehensive loss within “general and administrative” expenses.

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Financial Assets at Fair Value Through Profit and Loss

Financial assets at fair value through profit and loss include financial assets that are either classified as held-for-trading or that meet certain conditions and are designated at fair value through profit and loss upon initial recognition. All derivative financial instruments fall into this category, except for those designated and effective as hedging instruments, for which the hedge accounting requirements apply.

The fair value of derivative financial instruments is determined by reference to active market transactions or using a valuation technique where no active market exists.

Available-for-Sale Financial Assets

Available-for-sale financial assets are non-derivative financial assets that are either designated to this category or do not qualify for inclusion in any of the other categories of financial assets.

Changes in the fair value of monetary and non-monetary securities classified as available-for-sale are recognized in accumulated other comprehensive income in equity. When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments recognized in equity are included in profit or loss and presented as a reclassification adjustment within other comprehensive income. Reversals of impairment losses are also recognized in other comprehensive income in profit or loss, or equity, as required.

Impairment of Financial Assets

At each reporting date, the Company assesses whether there is objective evidence that a financial asset or a group of financial assets is impaired, except for those at fair value through profit or loss. A financial asset is impaired and impairment losses are incurred only if there is objective evidence of impairment that can be reliably estimated, resulting from one or more events that occurred after the initial recognition of the financial asset that would have a negative impact on the estimated future cash flows of the asset. Impairments are then measured as the excess of the carrying amount over the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's effective interest rate. Impairment losses are recognized in profit or loss. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be objectively related to an event occurring after the impairment loss was recognized in profit or loss, the impairment loss, or fraction thereof, is reversed through profit and loss.

3.12 Financial Liabilities and Compound Financial Instruments

Financial Liabilities

Borrowings are classified as current liabilities unless the Company has an unconditional right to defer settlement of the liability for at least 12 months after the end of the reporting period.

All interest-related charges and, if applicable, changes in an instrument's fair value that are reported in profit or loss are included within "finance costs" or "finance income".

Compound Financial Instruments

Compound financial instruments issued by the Company comprise convertible debentures that can be converted into share capital at the option of the holder, and for which the number of shares to be issued does not vary with changes in their fair value.

The liability component of a compound financial instrument is initially recognized at the fair value, which is determined by discounting cash flows using the discount rate of similar notes that do not have an equity conversion option. The equity component is initially recognized as the difference between the fair value of the compound financial instrument as a whole and the fair value of the liability component. Any directly attributable transaction costs are allocated to the liability component and equity components in proportion to their initial carrying amounts.

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Subsequent to initial recognition, the liability component of a compound financial instrument is measured at amortized cost using the effective interest method. The equity component of a compound financial instrument is not re-measured subsequent to initial recognition except on conversion or on expiry.

3.13 Equity

Common shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

Contributed surplus within equity includes amounts in connection with conversion options embedded in compound financial instruments, stock-based compensation and warrants issued.

Accumulated other comprehensive income includes all adjustments from the IFRS transition date relating to the foreign currency translation of assets and liabilities of subsidiaries and joint ventures, as well as actuarial gains and losses from the defined benefit pension plan, net of any related tax effect.

Deficit includes all current and prior period losses and transaction costs associated with the issuance of shares, net of any related tax effect.

3.14 Restricted Cash

Restricted cash represents cash collateral for standby letters of credit which normally expire within 12 months.

3.15 Inventories

Inventories are stated at the lower of cost or net realizable value. Cost is determined using the average cost method. The cost of raw material and spare parts includes expenditures incurred in acquiring the inventories and bringing them to their existing location and condition. The cost of finished goods comprises raw materials and consumables, direct labour, direct costs and related production overheads, based on normal operating capacity. Net realizable value represents the estimated selling price at which the inventories can be sold in the normal course of business less the estimated cost of completion and any applicable selling costs.

3.16 Current and Deferred Income Taxes

The tax expense recognized in profit or loss comprises the sum of deferred tax and current tax not recognized in other comprehensive income or directly in equity.

The tax currently payable is based on the taxable income or loss for the period. The taxable income or loss differs from the income or loss for the period as reported in the consolidated statement of comprehensive loss because it excludes income or expense items that are taxable or deductible in other periods, as well as items that are not taxable or deductible. The Company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

Deferred tax is recognized using the liability method on differences between the carrying amounts of assets and liabilities in the consolidated financial statements and their corresponding tax bases. Deferred tax liabilities are generally recognized for all taxable temporary differences, and deferred tax assets are generally recognized for all deductible temporary differences to the extent that it is probable that future taxable income will be available against which those deductible temporary differences can be utilized. Such assets and liabilities are not recognized if the taxable temporary difference arises from the initial recognition of goodwill or the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable income or loss, nor the income or loss for the period reported in the Company's statements of comprehensive loss.

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Deferred tax liabilities are recognized for taxable temporary differences associated with investments in subsidiaries and joint venture, except where the Company is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments are only recognized to the extent that it is probable that there will be sufficient taxable income against which to utilize the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

Deferred tax assets and liabilities are measured, without discounting, at the tax rates that have been enacted or substantively enacted by the end of the reporting period and applicable in the period in which the liability is expected to be settled or the asset realized. Deferred tax liabilities are always recognized in full.

The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Company expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities. The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable income will be available to allow the benefit of all or part of the asset to be utilized. Any such reduction is reversed to the extent that it becomes probable that sufficient taxable income will be available.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Company intends to settle its current tax assets and liabilities on a net basis.

Changes in deferred tax assets or liabilities are recognized as a component of taxable income or expense in profit or loss, except where they relate to items that are recognized in other comprehensive income or directly in equity, in which case the related deferred tax is also recognized in other comprehensive income or equity, respectively.

3.17 Property and Equipment

Property and equipment are stated at acquisition cost or construction cost, including an appropriate portion of borrowing costs on qualifying assets, less accumulated amortization and impairment losses. Subsequent costs are included in the asset's carrying amount or recognized as a component of the asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognized. All other repairs and maintenance costs are charged to profit or loss during the period in which they are incurred. Construction in progress is not amortized. When the asset under construction is completed, it is transferred to the appropriate property and equipment category and amortized.

Plant equipment that is leasehold property is also included in property and equipment if it is held under a finance lease. Such assets are amortized over their expected useful lives (determined by reference to comparable owned assets) or over the term of the lease, if shorter.

The Company amortizes property and equipment using the straight-line method over the estimated useful lives as follows:

Computer equipment	3 to 5 years
Furniture and fixtures	3 to 10 years
Research and development ("R&D") equipment	3 to 5 years
Machinery and other equipment	3 to 5 years
Leasehold improvements	Term of lease to a maximum of 5 years
Vehicles	3 to 5 years

The residual value, amortization method and useful life of the assets are reviewed and adjusted, if necessary, at least annually.

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Gains and losses on retirement or other disposition of property and equipment are determined by comparing the proceeds with the carrying amount and are recognized within profit or loss.

3.18 Leased Assets

In accordance with IAS 17 - *Leases*, the economic ownership of a leased asset is transferred to the lessee if the lessee bears substantially all the risks and rewards related to ownership of the leased asset. The related asset is then recognized at the inception of the lease at the fair value of the leased asset or, if lower, the present value of the lease payments plus incidental payments, if any. A corresponding amount is recognized as a finance leasing liability.

Amortization methods and useful lives for assets held under finance lease agreements correspond to those applied to comparable assets legally owned by the Company. The corresponding finance leasing liability is reduced by lease payments less finance charges, which are expensed as part of finance costs.

The interest element of leasing payments represents a constant proportion of the capital balance outstanding and is charged to profit or loss over the lease period.

All other leases are treated as operating leases. Payments on operating lease agreements are recognized as an expense on a straight-line basis over the lease term. Associated costs, such as maintenance and insurance, are expensed as incurred.

3.19 Government Grants

Government grants are recorded when received or when it is reasonably certain a grant will be received and when the Company complies with the conditions associated with the grant. Grants are presented as a deduction from the expenses or assets to which they relate.

3.20 Goodwill

Goodwill represents the future economic benefits arising from a business combination that are not individually identified and separately recognized. Goodwill is stated after separate recognition of identifiable intangible assets. It is calculated as the excess of the fair value of the consideration transferred, over a) the fair value of the identifiable net assets at the date of acquisition, b) the recognized amount of any non-controlling interest in the acquiree, if any, c) the acquisition-date fair value of any existing equity interest in the acquiree, if any. If fair values of identifiable net assets exceed the sum calculated above, the excess amount is recognized in profit or loss immediately. Goodwill is carried at cost less accumulated impairment losses. Refer to Note 3.22 for a description of impairment testing procedures. Impairment losses on goodwill are not reversed.

3.21 Other Intangible Assets

Other intangible assets include internally developed technology used in production, intranet as well as customer relationships, trade names and patents that qualify for recognition as an intangible asset acquired in a business combination.

An intangible asset shall be recognized if and only if:

- a) it is probable that the expected future economic benefits attributable to the asset will flow to the Company; and
- b) the cost of the asset can be measured reliably.

Expenditure on research (or the research phase of an internal project) is recognized as an expense in the period in which it is incurred.

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An intangible asset arising from development (or from the development phase of an internal project) is recognized if and only if the Company has demonstrated all of the following:

- a) the technical feasibility of completing the intangible asset so that it will be available for use;
- b) its intention to complete the intangible asset and use it;
- c) its ability to use the intangible asset;
- d) how the intangible asset will generate probable future economic benefits. Among other things, the Company can demonstrate the usefulness of the intangible asset to be used internally;
- e) the availability of adequate technical, financial or other resources needed to complete development and use the intangible asset;
- f) its ability to reliably measure the expenditure attributable to the intangible asset during its development.

Development costs not meeting these criteria for capitalization are expensed as incurred.

Other intangible assets are stated at acquisition cost or development cost, less accumulated amortization and impairment losses. Development costs include employee costs incurred on technology development along with an appropriate portion of relevant overheads and borrowing costs on qualifying assets. Internally generated technology developments recognized as intangible assets are subject to the same subsequent measurement method as externally acquired intangible assets. However, the assets are subject to impairment testing only as described below in Note 3.22 up until completion of the development project.

The gain or loss arising on the disposal of an intangible asset is determined as the difference between the proceeds and the carrying amount of the asset, and is recognized in profit or loss.

Intangible assets are classified depending on whether the asset has a specific or indefinite useful life. Intangible assets with a specific useful life are amortized over such life using the straight-line method and are tested for impairment if there are indications of loss of value as indicated in Note 3.22. Residual values, amortization method and useful lives are reviewed at each reporting date. Intangible assets with an indefinite useful life are not amortized but are tested for loss of value at least annually as described in Note 3.22.

Depreciable intangible assets are amortized over the following estimated useful lives once the assets are available for use:

Customer relationships	10 years
Trade names	15 years
Acquired and developed technology	13 to 15 years
Patents	13 years
Intranet	5 years

Amortization is included in "Amortization" in the consolidated statements of comprehensive profit or loss.

3.22 Impairment Testing of Goodwill, Other Intangible Assets and Property and Equipment

Intangible assets that have an indefinite useful life, goodwill and other intangible assets and property and equipment not ready to be used, are not subject to amortization and are tested for impairment at least annually or whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value-in-use. To determine the value-in-use, management estimates expected future cash flows and determines a suitable interest rate in order to calculate the present value of those cash flows.

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The data used for impairment testing procedures are directly linked to the Company's latest approved budget, adjusted as necessary to exclude the effects of future reorganizations and asset enhancements. Discount factors are determined individually for each cash-generating unit ("CGU") and reflect their respective risk profiles as assessed by management.

For the purpose of assessing impairment, assets are grouped at the cash-generating unit level that is the lowest level for which there are largely independent cash inflows. As a result some assets are tested individually for impairment and some are tested at the CGU level. Goodwill is allocated to those CGUs that are expected to benefit from synergies of the related business combination and represent the lowest level within the Company at which management monitors goodwill.

Impairment losses recognized in respect of CGUs are allocated first to reducing the carrying amount of any goodwill allocated to the CGUs (or group of CGUs) and then, to reducing the carrying amount of the other assets in the CGU (or group of CGUs) on a pro rata basis. Long-lived assets other than goodwill that suffered impairment are reviewed for possible reversal of the impairment at each reporting date. For such assets, an impairment charge is reversed if the CGUs or individual asset's recoverable amount exceeds its carrying amount.

3.23 Post-Employment Benefit Plans and Short-Term Employee Benefits

The liability recognized in the consolidated statements of financial position is the present value of the defined benefit pension obligation at the reporting date, net of the fair value of plan assets, together with adjustments for unrecognized past service costs.

The defined benefit pension plan sponsored by the Company for its Norwegian operations defines the amount of pension benefit that an employee will receive on retirement. The legal obligation for any benefits remains with the Norwegian subsidiary, even if plan assets for funding the defined benefit plan have been set aside. The Company also contributes to several state and other insurance plans for individual employees that are considered defined contribution plans. Contributions to the plans are recognized as an expense in the period when relevant employee services are received.

The actuarial determination of the defined benefit obligations for pensions uses the projected unit credit method. This determination incorporates management's best estimate of future salary levels, other cost escalation, retirement ages of employees and other actuarial factors. Discount rates are determined at each year-end by reference to Norwegian government bonds that have a term to maturity approximating the terms of the pension liability.

Actuarial gain or loss arises from the difference between the actual long-term rate of return on plan assets for a period and the expected long-term rate of return on plan assets for that period or from changes in actuarial assumptions used to determine the accrued benefit obligations. Actuarial gains or losses are recognized in other comprehensive income in the period in which they occur. Past service costs are recognized immediately in profit or loss, unless the changes to the pension plan are conditional on the employees remaining employed for a specified period of time (the vesting period). In this case, the past service costs are amortized on a straight-line basis over the vesting period.

Short-term employee benefits are included in "Trade and other liabilities" and they are measured on an undiscounted basis and expensed as the related service is provided. All post-employment benefits expenses are included in "General and administrative" expenses.

3.24 Stock-Based Compensation

The Company accounts for stock-based compensation using the fair value method of accounting. When employees are rewarded using share-based plans, the fair value of employees' services is determined indirectly by reference to the fair value of the equity instruments granted. This fair value is measured at the grant date.

The stock-based compensation cost is recorded as an expense in profit or loss and credited to contributed surplus.

If vesting periods or other vesting conditions apply, the expense is allocated over the vesting period, based on the best available estimate of the number of awards expected to vest. Non-market vesting conditions are included in assumptions about the number of awards that are expected to become exercisable. Estimates are subsequently revised if there is any indication that the number expected to vest differs from previous estimates.

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Any cumulative adjustment prior to vesting is recognized in the current period. No adjustment is made to any expense recognized in prior periods if awards ultimately exercised are different to that estimated on vesting.

Each tranche of an award with different vesting dates is considered a separate grant for the calculation of fair value and the resulting fair value is amortized over the vesting period of the respective tranches.

When stock options are exercised or when restricted share units or deferred share units are vested, any consideration paid by employees is credited to share capital in addition to the amount previously recorded in contributed surplus.

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The Company's unaudited interim condensed consolidated financial statements are prepared in accordance with IFRS recognition and measurement principles that often require management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts presented and disclosed in the consolidated financial statements. Management reviews these estimates and assumptions on an ongoing basis based on historical experience, changes in business conditions and other relevant factors as it believes to be reasonable under the circumstances. Changes in facts and circumstances may result in revised estimates, and actual results could differ from those estimates. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Assessing the Probability of Deferred tax assets

Deferred tax assets are recognized for unused tax losses and credits to the extent that it is probable that taxable income will be available against which the losses can be utilized. These estimates are reviewed at every reporting date. Significant management judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and the level of the reversal of existing timing differences, future taxable income and future tax planning strategies.

Assessing the Percentage of Completion of Manufacturing Contracts

The stage of completion of any construction contract is assessed by management by taking into consideration all information available at the reporting date. In this process, management exercises significant judgment about milestones, actual work performed and the estimated costs to complete work.

Measurement of Fair Value of Investments and Put Options

The fair value of the investments and put options is determined based on management's judgment using the available information and assumptions market participants would use in pricing these investments and put options. Further information is disclosed in Note 9.

5. FIRST TIME ADOPTION OF IFRS

5.1 Basis of Transition to IFRS

5.1.1 Application of IFRS 1

The unaudited interim condensed consolidated financial statements have been prepared using accounting policies specified by published IFRS that are in effect for the year ending December 31, 2011.

The Company's IFRS accounting policies presented in Note 3 have been applied in preparing the unaudited interim condensed consolidated financial statements for the three and six-month periods ended June 30, 2011, the comparative information and the opening statements of financial position at the transition date.

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In preparing these consolidated financial statements in accordance with IFRS 1, the Company has applied the relevant exceptions and certain exemptions from full retrospective applications of IFRS, which are discussed in Notes 5.1.2 and 5.1.3, respectively.

5.1.2 Exceptions Adopted by the Company

- (a) Estimates under IFRS as at January 1, 2010 are consistent with estimates made for the same date under Canadian GAAP (after adjustments to reflect any differences in accounting policies) unless there is objective evidence that such estimates were in error.
- (b) Financial assets and liabilities that were derecognized before January 1, 2010 under Canadian GAAP have not been recognized under IFRS. The Company has applied the amendment to IFRS 1 with respect to the application of this exemption, as of January 1, 2010.

5.1.3 Exemptions Elected by the Company

(a) *Business Combinations*

The Company has applied the business combinations exemption in IFRS 1 to all business combinations that occurred prior to January 1, 2010. Accordingly, it has not restated for business combinations that occurred prior to January 1, 2010 in accordance with IFRS 3 (revised) – Business Combinations.

(b) *Cumulative Foreign Currency Translation Differences (see 5.2.4 a)*

The Company has elected to eliminate the cumulative foreign currency translation differences of \$1,900,511 as of January 1, 2010 under Canadian GAAP through the opening deficit.

(c) *Employee Benefits*

The Company has elected to recognize all cumulative gains and losses for its defined benefit pension plan at the transition date to the opening deficit. Further, the Company has elected to use the exemption not to disclose the defined benefit pension plan surplus/deficit and experience before the date of transition.

(d) *Share-based Payment Transactions (see 5.2.3 b)*

The Company has elected to apply the share-based payment exemption in IFRS 1 and has therefore applied prospectively the requirements to IFRS 2 for all awards granted since July 1, 2002.

(e) *Compound Financial Instruments*

The Company has elected 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 as at January 1, 2010.

All other optional exemptions in IFRS 1 were either not applicable or there were no significant differences with management’s application of Canadian GAAP in these areas.

5.2 Reconciliations between IFRS and Canadian GAAP

IFRS 1 requires an entity to reconcile equity and total comprehensive income as previously reported under Canadian GAAP to IFRS. The Company’s first time adoption of IFRS did not have a material impact on total cash flows from operating, investing and financing activities in prior periods.

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The following represents the reconciliations for equity and total comprehensive loss, from Canadian GAAP to IFRS for the periods noted:

5.2.1 Reconciliation of Total Equity:

	December 31, 2010	June 30, 2010
	\$	\$
Total equity, Canadian GAAP	19,823,346	23,364,682
Pension obligation (see 5.2.3 a)	301,964	255,932
Total equity, IFRS	<u>20,125,310</u>	<u>23,620,614</u>

5.2.2 Reconciliation of Total Comprehensive Loss:

	Three months ended June 30, 2010	Six months ended June 30, 2010
	\$	\$
Comprehensive loss, Canadian GAAP	894,278	(312,073)
Pension obligation (a)	37,513	78,529
Stock-based compensation (b)	(18,896)	(64,690)
Subtotal - IFRS adjustments	<u>18,617</u>	<u>13,839</u>
Total comprehensive loss, IFRS	<u>912,895</u>	<u>(298,234)</u>

5.2.3 Description of Adjustments Impacting Comprehensive Loss and/or Equity

The following explains the significant differences between the previous Canadian GAAP accounting policies and the current IFRS accounting policies applied by the Company. It does not represent a complete summary of all the differences between Canadian GAAP and IFRS. Only the differences having a significant impact on the Company are described below.

(a) Pension obligation and Post-employment Benefits

The Company has elected to recognize all cumulative actuarial gains in connection with its defined benefit pension plan at the transition date. It has therefore recognized \$177,404 to the opening deficit as at January 1, 2010.

Under IFRS, the Company has elected to recognize actuarial gains and losses arising from the re-measurement of employees' future benefit obligations and related costs in other comprehensive income as they arise. Under Canadian GAAP, the Company applied the corridor method to account for such gains and losses. Under this method, gains and losses were recognized only if they exceeded specified thresholds. This change resulted in a \$107,987 reduction in the pension expense for the year ended December 31, 2010 (respectively \$39,638 for the three-month period ended June 30, 2010 and \$81,104 for the six-month period ended June 30, 2010) and a \$16,573 increase in other comprehensive income for the year ended December 31, 2010 (decrease in other comprehensive income for respectively \$2,125 and \$2,575 for the three-month and six-month periods ended June 30, 2010). Consequently, total comprehensive loss was reduced by \$124,560 for the year ended December 31, 2010 (respectively \$37,513 for the three-month period ended June 30, 2010 and \$78,529 for the six-month period ended June 30, 2010).

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(b) Stock-based Compensation

Under Canadian GAAP, the Company recognized the compensation expense associated with stock-based compensation plans with graded vesting features on a straight-line basis over the vesting period. Under IFRS, the Company is required to treat each "tranche" of a stock-based compensation arrangement with a graded vesting schedule as a separate grant, which results in the recognition of a compensation expense on an accelerated basis in comparison with Canadian GAAP. This change resulted in an increase of \$195,440 in both the deficit and the contributed surplus at the transition date. For the year ended December 31, 2010, the change resulted in an \$88,386 increase in the total comprehensive loss (respectively \$18,896 for the three-month period ended June 30, 2010 and \$64,690 for the six-month period ended June 30, 2010) and a corresponding increase in the contributed surplus within equity.

5.2.4 Description of Adjustments or Presentation Changes with no Impact on Comprehensive Loss and Equity

- (a) Under IFRS 1 (see Note 5.1.3(b)), the Company has elected to eliminate all cumulative foreign currency translation differences as of January 1, 2010 through deficit. This adjustment is only a reclassification of the balance of cumulative translation adjustments as of January 1, 2010, within equity.
- (b) Canadian GAAP requires that deferred tax assets and liabilities be presented as current or non-current based on the classification of the underlying asset or liability from which the temporary difference arises. For a deferred tax asset or liability not related to a book asset or liability (for example, a deferred tax asset arising from a net operating loss carry forward), Canadian GAAP required classification as current or non-current based on the expected reversal date of the temporary difference. Under IFRS, all deferred tax assets and liabilities are to be presented as non-current.

6. OTHER SUPPLEMENTAL INFORMATION

	Three months Ended June 30,		Six months Ended June 30,	
	2011	2010	2011	2010
	\$	\$	\$	\$
Finance costs - net				
Other financial liabilities				
Interest on non current borrowings	208,228	240,919	415,831	434,476
Accretion	29,809	13,380	59,513	27,866
Interest charges	201,917	40,218	301,848	193,097
Sub-total	439,954	294,517	777,192	655,439
Held for trading				
Interest revenues on held for trading financial assets	(20,298)	(7,345)	(30,871)	(18,552)
Gain on financial instruments	(325,000)	(375,000)	(378,797)	(375,000)
Loss on foreign currency	102,661	77,347	174,042	529,942
	197,317	(10,481)	541,566	791,829

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Amortization:

Amortization recorded respectively for the three-month and six-month periods ended June 30, 2011 and 2010 is attributable to the following functions:

Amortization by function	Three months Ended June 30,		Six months Ended June 30,	
	2011	2010	2011	2010
	\$	\$	\$	\$
Cost of goods sold	111,431	116,443	224,475	224,905
Sales and marketing	93,783	99,365	191,588	193,998
Research and development	314,465	15,507	357,035	73,332
General and administrative	72,223	134,878	152,998	252,465
	<u>591,902</u>	<u>366,193</u>	<u>926,096</u>	<u>744,700</u>
Cost per function including amortization	Three months Ended June 30,		Six months Ended June 30,	
	2011	2010	2011	2010
	\$	\$	\$	\$
Cost of goods sold	7,521,740	6,198,123	15,329,477	13,135,966
Sales and marketing	927,139	597,945	1,942,060	1,203,666
Research and development	394,384	105,636	516,344	225,251
General and administrative	3,104,606	2,347,611	6,609,243	5,151,255

7. TRADE AND OTHER RECEIVABLES

	June 30, 2011	December 31, 2010
	\$	\$
Unbilled receivables*	3,579,626	8,890,925
Trade accounts receivable, gross	7,895,617	4,016,065
Allowance for doubtful accounts	(23,325)	(19,619)
Trade receivables, net	<u>11,451,918</u>	<u>12,887,371</u>
Sales tax and other	86,850	50,923
Trade and other receivables	<u>11,538,768</u>	<u>12,938,294</u>

*Unbilled receivables represent revenue recorded in accordance with revenue recognition criteria for which the amounts have not yet been invoiced.

8. INVESTMENT IN A JOINT VENTURE

The Company holds an investment in ProSep Kolon Company Limited (ProSep Kolon), a joint venture in South Korea created in January 2011. The joint venture commercializes the Company's process solutions in the Korean and Chinese O&G supply markets. ProSep Kolon is the sole jointly-controlled entity within the Company. The Company owns 51% of ProSep Kolon, and joint control is established through a Joint Venture Agreement.

The Company's interest in ProSep Kolon is accounted for using the equity method. Commercial activities had not yet started as at reporting date and the Company's share of ProSep Kolon's loss is related to overhead expenses. The Company's total cumulative share of the loss amounts to \$162,646, as at June 30, 2011. The joint venture had not incurred any contingent liabilities or other commitments as at June 30, 2011.

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9. INVESTMENTS

At June 30, 2011 the Company held \$4,054,775 (December 31, 2010 – \$3,729,775) in investments (“Notes”) with a total nominal amount of \$5,609,372 (December 31, 2010 – \$5,609,372). The Notes are designated as fair value through profit or loss. These Notes were received in January 2009 in exchange for the Company’s Canadian third party asset-backed commercial paper (“ABCP”) upon the successful implementation of the ABCP restructuring plan.

On June 1, 2011, DBRS placed the MAV 2 A-1 and A-2 Notes Under Review with Positive Implications citing the improvement of the overall credit quality of the underlying assets and the passage of time. At the moment, the MAV 2 A-1 and A-2 Notes remain rated A (high) (sf) and BBB (low) (sf), respectively.

The Company’s long-term investments are as follows:

	June 30, 2011	December 31, 2010
MAV II Notes	\$	\$
Class A-1 Notes	268,000	283,500
Class A-2 Notes	3,101,775	3,069,275
Class B Notes	563,000	359,000
Class C Notes	122,000	18,000
Total	4,054,775	3,729,775

The remaining nominal amount of the Notes initially received by the Company is as follows:

	June 30, 2011	December 31, 2010	January 1, 2010	January 21, 2009
	\$	\$	\$	\$
Class A-1 Notes	370,745	370,745	370,970	371,936
Class A-2 Notes	4,291,318	4,291,318	4,291,318	4,291,318
Class B Notes	778,993	778,993	778,993	778,993
Class C Notes	168,316	168,316	168,316	168,316
Class Ineligible Assets, series 1 and 2 Notes	-	-	1,869,479	3,365,062
Total	5,609,372	5,609,372	7,479,076	8,975,625

Estimation of fair value

Although there have been some isolated transactions subsequent to January 21, 2009, there were no active market quotations available. The Notes held by the Company have not traded in an active market since the restructuring. The valuation methodology used by the Company at June 30, 2011 to value the Notes and the embedded put options further discussed below is consistent with the methodology used at December 31, 2010 and March 31, 2011.

At June 30, 2011, management concluded that the fair value of the Notes increased by \$325,000 compared to March 31, 2011. For the three-month and six-month periods ended June 30, 2011, the Company received respectively \$9,213 and \$18,395 (\$1,073 and \$2,825 for the three and six month periods ended June 30, 2010) in interest payments related to the restructured Notes.

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Credit facility related to Ineligible Assets ("IA") Notes

This credit agreement provided for a \$2,523,797 revolving credit facility representing an amount equal to 75% of the original nominal amount of such Notes. This credit facility expired on March 10, 2011 and bore interest at the prime rate less 1%. On March 10, 2011, the Company exercised its right to settle the full amount of the credit facility by delivering the IA Notes without any cash disbursement.

Credit Facility related to Eligible Notes

This credit agreement provides for a \$4,655,576 revolving credit facility representing an amount equal to 83% of the total nominal amount of the MAV II Class A- 1, A-2, B and C Notes (collectively the "Eligible Notes"). This facility also bears interest at the prime rate less 1%. In March 2011, National Bank of Canada ("National Bank") accepted the extension of the credit facility until March 2013. The agreement grants the Company the right to sell the Eligible Notes to National Bank at their fair market value at the maturity date of the facility, which is now in March 2013. The proceeds from the sale of the Eligible Notes must first be used to settle the first tranche and then the second tranche of the credit facility. Any remaining balance under the first tranche of the credit facility is without recourse to the Company, thus indirectly providing the Company with a guaranteed minimum sales price of 45% of the nominal amount of such Eligible Notes.

10. TRADE AND OTHER LIABILITIES

	June 30, 2011	December 31, 2010
	\$	\$
Trade liabilities	4,440,661	3,606,224
Accrued liabilities and interest payable	6,049,291	4,108,504
Total	<u>10,489,952</u>	<u>7,714,728</u>

11. BORROWINGS

Bank and other credit facilities

The Company has bank credit facilities with DnB NOR consisting of a senior overdraft facility of NOK30,000,000 (\$5,364,039 at June 30, 2011) and a guarantee facility of NOK15,000,000 (\$2,682,020 at June 30, 2011) to be used to provide customer guarantees under manufacturing contracts. The credit facilities are secured by the assets of a wholly-owned subsidiary of the Company, Pure Group AS, which owns the vast majority of the Company's operating assets. The senior overdraft facility bears an interest rate of 4.66%, being the one-month Norwegian Interbank Offered Rate (NIBOR) plus 2% (4.47% as at December 31, 2010). Bank credit facilities are uncommitted credit facilities.

On April 4, 2011, the Company concluded a \$2,500,000 unsecured revolving loan agreement with Fondaction, ProSep's largest shareholder, to finance working capital requirements. The facility bears interest at a monthly rate of 1% with an initial twelve month term and can be renewed annually for up to a total of three years. The outstanding amount is \$2,250,000 at June 30, 2011.

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As at June 30, 2011, the bank and other credit facilities (defined as the senior overdraft facility and the revolving loan) amounted of \$6,440,426 (\$4,666,327 as at December 31, 2010) and the Company had issued letters of guarantee for an amount of \$2,125,466 (\$2,136,000 as at December 31, 2010) under the guarantee facility.

	June 30, 2011	December 31, 2010
	\$	\$
Bank and other credit facilities	6,440,426	4,666,327
Current portion of other borrowing facilities	1,637,747	1,636,295
Total current borrowings	8,078,173	6,302,622

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Other Borrowing Facilities

	June 30, 2011	December 31, 2010
	\$	\$
Convertible unsecured subordinated debenture in the nominal amount of \$3,953,500, bearing interest at 13.25% payable every six months and maturing on July 16, 2014.	3,691,027	3,658,498
Revolving credit facilities with National Bank of Canada bearing interest at the prime rate of 3.00% minus 1% at June 30, 2011, payable monthly (3.00% minus 1% at December 31, 2010, payable monthly).		
- IA Notes facility, matured in March 2011	-	2,523,797
- Less embedded put options (Note 9)	-	(2,470,000)
- Eligible Notes facility, first tranche, maturing in March 2013	2,523,562	2,524,528
- Eligible Notes facility, second tranche, maturing in March 2013	2,132,014	2,132,014
Senior acquisition term loan facility bearing interest at a rate of 5.70% (5.58% at December 31, 2010) being the three month Norwegian Interbank Offered Rate (NIBOR) + 3.00%. The principal amount is payable in equal instalments of NOK4,500,000 (\$804,606 at June 30, 2011) every 6 months. Maturing on October 25, 2012.	2,413,818	3,072,616
Convertible unsecured subordinated debenture in the nominal amount of \$1,009,300, bearing interest at 5% and maturing on December 7, 2015. If unpaid, interest will compound automatically each year.	605,383	578,400
Obligations under finance leases	28,535	53,543
Total other borrowing facilities	11,394,339	12,073,396
Current portion of other borrowings facilities	(1,637,747)	(1,636,295)
Non current portion of other borrowing facilities	9,756,592	10,437,101

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12. SHARE CAPITAL

Authorized

The share capital of the Company consists of an unlimited number of common shares, without par value. All shares are equally eligible to receive dividends and to the repayment of capital and represent one vote at the shareholders' meetings.

None of the Company's shares are held by any entity in the Company or by its joint venture.

Share Purchase Warrants

There were no changes in the number of share purchase warrants issued by the Company in the three-month and six-month periods ended June 30, 2011 and for the year ended December 31, 2010. At the stated dates, there were 4,460,242 share purchase warrants issued and exercisable at an average weighted exercise price of \$0.44.

13. SHARE-BASED PAYMENTS

As at June 30, 2011, the Company maintained three stock-based compensation arrangements:

Stock Option Plan

No stock options were granted, exercised or expired in the three-month and six-month periods ended June 30, 2011 or in the year ended December 31, 2010. For the three-month and six-month periods ended June 30, 2011, respectively, 45,000 options and 130,000 options were forfeited. No stock options were forfeited in the year ended December 31, 2010. As at June 30, 2011, 290,000 stock options are issued and exercisable at an average weighted exercise price of \$0.31. The weighted average remaining contractual life of the stock options is 1.47 years.

Restricted Share Units

During the three-month and six-month periods ended June 30, 2011, the Company granted respectively 300,000 restricted share units at a weighted average fair value of \$0.075 per share for a total of \$22,500, and 2,900,000 restricted share units at a weighted average fair value of \$0.088 per share for a total of \$256,500 (3,650,000 were granted for the three-month and six-month periods ended June 30, 2010 at the \$0.17 fair value per share for a total value of \$620,500).

Changes in the number of RSU are as follow:

	<u>June 30, 2011</u>	<u>December 31, 2010</u>
	Number of	Number of
	Restricted Share Units	Restricted Share Units
Balance, beginning of period	7,190,000	4,161,778
Granted	2,900,000	3,860,000
Forfeited	(1,090,000)	(373,565)
Vested	(1,025,000)	(458,213)
Balance, end of period	<u>7,975,000</u>	<u>7,190,000</u>

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Deferred share units

The Company may grant deferred share units (DSU) to compensate the designated senior officers of the Company who are particularly contributing to the creation of economic value for the Company and its shareholders, and provide benefits to designated directors upon the retirement or death. Each deferred share unit is equal in value to one common share of the Company at the date of grant. The Company has the option to settle the awards by issuing shares from the treasury, purchasing shares on the secondary market or paying the value of awards in cash. The awards are settled at the later of the termination of employment or retirement. The number of shares reserved at any time under this plan must not exceed 5% of the aggregate number of shares issued. The fair value is amortized over the vesting period of two or three years.

During the three-month and six-month periods ended June 30, 2011, the Company granted 2,800,000 deferred share units at the \$ 0.09 fair value per share for a total of \$252,000.

14. SEGMENTED INFORMATION

Operating Segment

Management currently identifies three segments in which it operates, based on geographical locations. The three segments correspond to the definition used by the Company for its business units. These operating segments are monitored and strategic decisions are made on the basis of EBITDA among other factors. The accounting policies of the operating segments are the same as those described in the summary of significant accounting policies. Segmented information for the three-month and six-month periods ended June 30, 2011 and June 30, 2010 is as follows.

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Revenue and expenses by business unit:

For the six-month period ended June 30, 2011							
US Operations	European & Middle East Operations	Asia Pacific Operations	Total Segment	Corporate Office	Consolidation & Inter Segment eliminations	Consolidated Operations	
\$	\$	\$	\$	\$	\$	\$	
Revenue from external customers	14,770,343	594,169	4,136,953	19,501,465	-	-	19,501,465
Revenue inter segment *	55,977	-	-	55,977	-	(55,977)	-
Total revenue	14,826,320	594,169	4,136,953	19,557,442	-	(55,977)	19,501,465
Cost of goods sold (excluding amortization)	10,846,986	662,923	3,651,070	15,160,979	-	(55,977)	15,105,002
Gross margin (excluding amortization)	3,979,334	(68,754)	485,883	4,396,463	-	-	4,396,463
Operating expenses**	3,425,420	1,938,335	842,684	6,206,439	2,159,587	-	8,366,026
Share of loss in a joint venture	-	-	-	-	162,646	-	162,646
EBITDA***	553,914	(2,007,089)	(356,801)	(1,809,976)	(2,322,233)	-	(4,132,209)

Reconciliation to loss before income taxes

EBITDA***	(4,132,209)
Net financial charges	(866,566)
Increase in fair value of long-term investments	325,000
Amortization	(926,096)
Gain on disposal of property and equipment	10,643
Loss before income taxes	(5,589,228)

For the six-month period ended June 30, 2010							
US Operations	European & Middle East Operations	Asia Pacific Operations	Total Segment	Corporate Office	Consolidation & Inter Segment eliminations	Consolidated Operations	
\$	\$	\$	\$	\$	\$	\$	
Revenue from external customers	10,983,551	4,218,099	2,859,036	18,060,686	-	-	18,060,686
Revenue inter segment *	41,565	9,750	-	51,315	-	(51,315)	-
Total revenue	11,025,116	4,227,849	2,859,036	18,112,001	-	(51,315)	18,060,686
Cost of goods sold (excluding amortization)	8,470,261	1,865,491	2,626,624	12,962,376	-	(51,315)	12,911,061
Gross margin (excluding amortization)	2,554,855	2,362,358	232,412	5,149,625	-	-	5,149,625
Operating expenses**	2,642,181	1,346,456	352,032	4,340,669	1,719,708	-	6,060,377
EBITDA***	(87,326)	1,015,902	(119,620)	808,956	(1,719,708)	-	(910,752)

Reconciliation to loss before income taxes

EBITDA***	(910,752)
Net financial charges	(1,166,829)
Increase in fair value of long-term investments	375,000
Amortization	(744,700)
Loss on disposal of property and equipment	(26,268)
Loss before income taxes	(2,473,549)

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For the three-month period ended June 30, 2011

	US Operations	European & Middle East Operations	Asia Pacific Operations	Total Segment	Corporate Office	Consolidation & Inter Segment eliminations	Consolidated Operations
	\$	\$	\$	\$	\$	\$	\$
Revenue from external customers	7,403,162	386,176	1,826,081	9,615,419	-	-	9,615,419
Revenue inter segment *	48,449	-	-	48,449	-	(48,449)	-
Total revenue	7,451,611	386,176	1,826,081	9,663,868	-	(48,449)	9,615,419
Cost of goods sold (excluding amortization)	5,321,422	571,669	1,565,667	7,458,758	-	(48,449)	7,410,309
Gross margin (excluding amortization)	2,130,189	(185,493)	260,414	2,205,110	-	-	2,205,110
Operating expenses**	1,674,938	709,895	493,428	2,878,261	1,067,397	-	3,945,658
Share of loss in a joint venture	-	-	-	-	54,842	-	54,842
EBITDA***	455,251	(895,388)	(233,014)	(673,151)	(1,122,239)	-	(1,795,390)

Reconciliation to loss before income taxes

EBITDA***	(1,795,390)
Net financial charges	(522,317)
Increase in fair value of long-term investments	325,000
Amortization	(591,902)
Gain on disposal of property and equipment	10,643
Loss before income taxes	<u>(2,573,966)</u>

For the three-month period ended June 30, 2010

	US Operations	European & Middle East Operations	Asia Pacific Operations	Total Segment	Corporate Office	Consolidation & Inter Segment eliminations	Consolidated Operations
	\$	\$	\$	\$	\$	\$	\$
Revenue from external customers	5,400,888	1,997,623	1,254,485	8,652,996	-	-	8,652,996
Revenue inter segment *	41,197	150	-	41,347	-	(41,347)	-
Total revenue	5,442,085	1,997,773	1,254,485	8,694,343	-	(41,347)	8,652,996
Cost of goods sold (excluding amortization)	4,094,664	897,571	1,130,792	6,123,027	-	(41,347)	6,081,680
Gross margin (excluding amortization)	1,347,421	1,100,202	123,693	2,571,316	-	-	2,571,316
Operating expenses**	1,261,422	513,344	178,324	1,953,090	848,352	-	2,801,442
EBITDA***	85,999	586,858	(54,631)	618,226	(848,352)	-	(230,126)

Reconciliation to loss before income taxes

EBITDA***	(230,126)
Net financial charges	(364,519)
Increase in fair value of long-term investments	375,000
Amortization	(366,193)
Loss on disposal of property and equipment	(26,268)
Loss before income taxes	<u>(612,106)</u>

* These transactions were carried out at an exchange amount which is the value established and accepted by the parties.

** Operating expenses includes Sales and Marketing (excluding amortization), Research and Development (excluding amortization) and General and administrative (excluding amortization) expenses.

*** EBITDA is a non-IFRS financial measure and the Company defines it as earnings or loss from operations excluding amortization, financial charges and income taxes.

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	June 30, 2011						
	US Operations	European & Middle East Operations	Asia Pacific Operations	Total segment	Corporate Office	Consolidation & Inter Segment eliminations	Consolidated Operations
	\$	\$	\$	\$	\$	\$	\$
Total Assets	25,216,983	5,634,518	8,765,787	39,617,288	6,050,475	(433,491)	45,234,272
Property and equipment	573,942	1,273,503	76,333	1,923,778	128,268	-	2,052,046
Goodwill	10,459,105	1,806,251	2,112,811	14,378,167	-	-	14,378,167
Other intangibles assets	2,576,196	1,671,256	2,064,901	6,312,353	157,015	-	6,469,368
Total selected non current assets	13,609,243	4,751,010	4,254,045	22,614,298	285,283	-	22,899,581

	December 31, 2010						
	US Operations	European & Middle East Operations	Asia Pacific Operations	Total segment	Corporate Office	Consolidation & Inter Segment eliminations	Consolidated Operations
	\$	\$	\$	\$	\$	\$	\$
Total Assets	24,704,574	6,662,774	9,440,147	40,807,495	5,685,842	(443,015)	46,050,322
Property and equipment	708,970	1,558,754	56,977	2,324,701	148,019	-	2,472,720
Goodwill	10,785,757	1,724,420	2,134,009	14,644,186	-	-	14,644,186
Other intangibles assets	2,835,687	1,666,212	2,178,528	6,680,427	170,705	-	6,851,132
Total selected non current assets	14,330,414	4,949,386	4,369,514	23,649,314	318,724	-	23,968,038

Significant customers:

For the six-month period ended June 30 2011, two clients of the US Operations represented respectively 38.1% (\$7,424,009) and 13% (\$2,541,007) of the Company's consolidated revenue and one client from the Asia Pacific Operations represented 15% (\$2,922,789) of the Company's consolidated revenue.

For the six-month period ended June 30 2010, two clients of the US Operations represented respectively 38.9% (\$7,030,970) and 12% (\$2,171,553) of the Company's consolidated revenue and one client from the European and Middle East Operations represented 14.7% (\$2,653,755) of the Company's consolidated revenue.

Geographical information (based on customer's head office):

	Six months Ended June 30,	
	2011	2010
Sales to customers situated in:	\$	\$
United States	11,186,869	2,970,581
Colombia	752,881	7,045,137
Malaysia	3,889,044	1,669,854
Norway	409,693	3,357,320
Other countries	3,262,978	3,017,794
	19,501,465	18,060,686