Consolidated Financial Statements of

DYNETEK INDUSTRIES LTD.

Years ended December 31, 2008 and 2007
(audited)

Auditors’ Report

To the Shareholders of
Dynetek Industries Ltd.:

We have audited the consolidated balance sheets of Dynetek Industries Ltd. (the “Company”) as at December 31, 2008 and 2007 and the consolidated statements of net loss and comprehensive loss and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(signed) “DELOITTE & TOUCHE LLP”

Chartered Accountants
Calgary, Canada
March 19, 2009

Dynetek Industries Ltd.
Consolidated Balance Sheets
December 31
(thousands of Canadian dollars)

	2008	2007
ASSETS		
Current assets		
Cash and cash equivalents	**3797**	1348
Restricted cash (note 4)	**408**	408
Accounts receivable (note 5)	**6141**	5121
Inventory (note 6)	**12994**	10304
Prepaids and other	**437**	557
	23777	17738
Intangible assets and deferred costs (note 7)	**4871**	5560
Capital assets (note 8)	**15474**	16594
	44122	39892
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	**6420**	4127
Deferred revenue	**1051**	1403
Current portion of long-term debt and capital lease (note 10)	**536**	370
	8007	5900
Long-term debt and capital lease (note 10)	**7096**	2120
Commitments (note 15)		
Shareholders' equity		
Share capital (note 12)	**52418**	52418
Contributed surplus (note 14)	**2727**	2638
Deficit	**(26126)**	(23184)
Accumulated other comprehensive income	**-**	-
	29019	31872
	44122	39892

See accompanying notes to the consolidated financial statements

Approved by the Board of Directors

“Heinz Portmann”
Director

“Christian Rasche”
Director

Dynetek Industries Ltd.
Consolidated Statements of Net Loss and Comprehensive Loss and Deficit
Years Ended December 31

(thousands of Canadian dollars except share capital and per share amounts)

	2008	2007
Revenue		
Sales	**19014**	29008
Research and development	**5315**	5649
Investment and other	**257**	373
	24586	35030
Expenses		
Cost of goods sold	**15479**	23346
General and administrative	**3387**	3817
Research and product development	**4707**	4659
Marketing	**1566**	1791
Interest	**395**	219
Depreciation	**1504**	1586
Amortization	**1168**	1372
Foreign exchange (gain) loss	**(767)**	345
Stock based compensation (note 13)	**89**	247
	27528	37382
Loss before taxes	**(2942)**	(2352)
Provision for income taxes (note 11)		
Future income tax	**-**	2355
NET LOSS AND COMPREHENSIVE LOSS	**(2942)**	(4707)
Deficit, beginning of year	**(23184)**	(18477)
Deficit, end of year	**(26126)**	(23184)
Per Share Information		
Loss per share (basic and diluted) (note 12(d))	**(0.14)**	(0.22)
Weighted average number of common shares outstanding	**20936500**	20940464

See accompanying notes to the consolidated financial statements

Dynetek Industries Ltd.
Consolidated Statements of Cash Flows
Years Ended December 31
(thousands of Canadian dollars)

	2008	2007
Cash flows provided by (used for) operating activities		
Net loss	**(2942)**	(4707)
Items not involving cash		
Depreciation	**1504**	1586
Amortization	**1168**	1372
Stock based compensation	**89**	247
Gain on sale of assets	**-**	(9)
Future income tax	**-**	2355
Unrealized foreign exchange (gain) loss	**(516)**	259
	(697)	1103
Changes in non-cash working capital		
Accounts receivable	**(1101)**	3110
Inventory	**(2690)**	1555
Prepaid and other	**120**	139
Accounts payable and accrued liabilities	**2293**	(3044)
Deferred revenue	**(352)**	683
Unrealized foreign exchange (gain) loss relating to non-cash working capital	**63**	(118)
	(2364)	3428
Investing Activities		
Additions to intangible assets and deferred costs	**(398)**	(1015)
Additions to capital assets	**(384)**	(938)
Proceeds on disposal of asset	**-**	30
	(782)	(1923)
Financing Activities		
Advances of long-term debt and capital lease	**5146**	1039
Repayment of capital lease	**(101)**	(27)
Operating bank line	**-**	(2650)
	5045	(1638)
Unrealized foreign exchange gain (loss) on cash held in foreign currency	**550**	(141)
Increase (decrease) in cash and cash equivalents	**2449**	(274)
Cash and cash equivalents, beginning of year	**1348**	1622
Cash and cash equivalents, end of year	**3797**	1348

See accompanying notes to consolidated financial statements

Interest income received during the year was $73 thousand (2007 – $33 thousand) and interest paid during the year was $365 thousand (2007 – $176 thousand). Income taxes paid during the year was nil (2007 - nil).

1. Basis of presentation

The consolidated financial statements have been prepared by management of Dynetek Industries Ltd. ("Dynetek" or the "Company") in accordance with Canadian generally accepted accounting principles ("GAAP").

2. Significant accounting policies

(a) Description of business
Dynetek designs, manufactures and markets complete lightweight compressed gas fuel storage systems for alternative fuel technologies and industrial gas suppliers. The Company's principal customers are Original Equipment Manufacturers ("OEM").

(b) Consolidation
The consolidated financial statements include the accounts of Dynetek and its wholly owned subsidiary Dynetek Europe GmbH ("Dynetek Germany"). There has been no change to the method of foreign currency translation for its wholly owned subsidiary in 2008.

(c) Use of estimates
The preparation of financial statements in conformity with Canadian GAAP requires the Company's management to make estimates and assumptions that affect the amounts reported in these financial statements and notes thereto. Actual results could differ from those estimates. Significant estimates made by the Company included allowances for doubtful accounts receivable, net realizable value of inventory, net recoverable amounts of long lived and intangible assets, amortization periods of capital and intangible assets, valuation of allowance for future income tax and the fair value of stock options granted.

(d) Cash and cash equivalents
Cash and cash equivalents consist of cash on deposit and highly liquid short-term interest bearing securities with maturities of three months or less at the date of purchase. At December 31, 2008 and 2007, the Company had no cash equivalents, other than described in Note 4.

(e) Inventory
Inventory, which includes materials, labour, and overhead, are valued at the lower of cost and net realizable value, with cost being determined on a weighted average basis. Effective January 1, 2008, the Company adopted the recommendations from the Canadian Institute of Chartered Accountant ("CICA"), CICA Handbook Section 3031, Inventories (see Note 3(a)).

(f) Intangible assets and deferred costs
Intangible assets are comprised of patents and certification costs. Patent costs are initially recorded at cost and are amortized on a straight-line basis over a period of 17 years from the date of acquisition. Certification costs are costs associated with obtaining product certification and are amortized on a straight-line basis over five years. Deferred costs represent capitalized start-up costs and are amortized on a straight-line basis over five years, beginning in the first year of commercial operations. Intangible assets are tested for impairment when conditions exist which may indicate that the estimated future net cash flows from the asset will be insufficient to cover its carrying value.

2. Significant accounting policies (continued)

(g) Capital assets
Capital assets are initially recorded at cost and are depreciated from the date of acquisition or, in respect of manufacturing equipment under construction, from the time an asset is completed and ready for commercial production. Depreciation is provided over the useful lives of the asset as follows:

Building	declining balance	4%
Leaseholds	straight-line	5 years
Manufacturing equipment	declining balance	15%
Manufacturing equipment	unit of production	
Office furniture and other equipment	declining balance	4% to 30%
Computer Hardware	declining balance	30%
Computer Software	declining balance	25%

(h) Impairment of long-lived assets
The Company reviews long-lived assets such as property, plant and equipment, and intangible assets with finite useful lives for impairment whenever events or changes in circumstances indicate that the carrying amount may not
be recoverable. If the fair value of the undiscounted future cash flows is less than the carrying amount of the asset, an impairment is recognized in the consolidated statement of net loss for the difference.

(i) Research and development costs
Research and development costs are expensed as incurred.

(j) Future income taxes
The Company uses the liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on "temporary differences" (differences between the accounting bases and the tax bases of the assets and liabilities) and are measured using enacted or substantively enacted tax rates and laws expected to apply when these differences reverse. Income tax expense is the sum of the Company's provision for current income taxes and the differences between opening and ending balances of the future income tax assets and liabilities.

(k) Government assistance
Government assistance is received from Natural Resources Canada and is recorded as non-interest bearing long-term debt (see note 10).

(l) Revenue recognition
Cylinder and system revenue is recognized when finished goods are shipped and invoiced to the customer. Research and development revenue is generated by projects co-funded with the original equipment manufacturers (OEMs). This revenue is recognized when contractual deliverables are met. Timing differences can occur between when costs are incurred and when revenue is earned.

(m) Foreign currency
Monetary balances denominated in foreign currencies are translated into Canadian dollars at exchange rates in effect at the balance sheet date. Transactions and non-monetary items are translated at exchange rates in effect on the dates of the transactions. Foreign exchange gains and losses are included in the results of operations.

The Company's foreign operation is integrated and is translated into Canadian dollars using the temporal method. Translation adjustments are reflected in the consolidated statement of net loss, comprehensive loss and deficit.

2. Significant accounting policies (continued)

(n) Per common share amounts
Amounts per common share are based on the weighted average number of common shares outstanding during the year. Diluted per share amounts are calculated using the treasury stock method, which assumes that any proceeds obtained on exercise of options would then be used to purchase common shares at the weighted average market price during the year. The weighted average number of common shares outstanding is then adjusted by the net change.

(o) Stock option plan
The Company recognizes compensation expense in each reporting period based on the fair value of the stock options granted during that period, amortized over the stock options vesting period. The Company determines the fair value of each stock option grant using the Black-Scholes option pricing model (see note 13).

(p) Financial Instruments
All financial assets and liabilities are recognized when the Company becomes a party to the contract creating the item. Financial assets and financial liabilities are initially recognized at fair value and are subsequently accounted for based on their classification. The classification depends on the purpose for which the financial instruments were acquired and their characteristics. Except in very limited circumstances, the classification is not changed subsequent to initial recognition.

The Company has applied the following classifications to each of its significant categories of financial instruments:

Cash and cash equivalents	Held-for-trading
Accounts receivable	Loans and receivables
Accounts payable and accrued liabilities	Other liabilities
Operating bank line	Other liabilities
Long-term debt and capital leases	Other liabilities
Derivative instruments	Held-for-trading

Financial instruments that are classified as held-for-trading are re-measured each reporting period at fair value with the resulting gain or loss recognized immediately in net income. All other financial instruments are accounted for at amortized cost with foreign exchange gains and losses recognized immediately in net income.

Derivative instruments are recorded on the consolidated balance sheet at fair value, including those derivatives that are embedded in financial contracts. Changes in the fair values of derivative instruments are recognized through net income.

Derivatives embedded in other financial instruments or contracts are separated from their host contracts and accounted for as derivatives when their economic characteristics and risks are not closely related to those of the host contract. If the terms of the embedded derivative are the same as those of a free standing derivative, and the combined instrument or contract is not measured at fair value, any changes in fair value are recognized in net income (See Note 17(d)).

(q) Comparatives
Certain comparative figures have been reclassified to conform to the financial statement presentation adopted in the current year.

3. Changes in accounting policies

As required by the Canadian Institute of Chartered Accountants ("CICA"), on January 1, 2008, the Company adopted new accounting requirements for CICA Handbook Section 3031, Inventories; Section 1535, Capital Disclosures; Section 3862, Financial Instruments – Disclosures; Section 3863, Financial Instruments – Presentation and Section 1400 – General Standards of Financial Statement presentation.

(a) Inventories
The Company adopted the recommendations of the CICA Handbook Section 3031, Inventories, which replaces Section 3030. The new section provides additional guidance on the measurement and disclosure requirements for inventories. The standard requires inventory to be measured at the lower of cost and net realizable value. Cost of inventories shall be composed of all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. When inventories are sold, the carrying amounts of those inventories shall be recognized as an expense in the period in which the related revenue is recognized. The amount of any write-down of inventories to net realizable value and all losses of inventories shall be recognized as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories, arising from an increase in net realizable value, shall be recognized as a reduction in the amount of inventories recognized as an expense in the period in which the reversal occurs. The new disclosures are included in Note 6. There has been no quantitative impact on these consolidated financial statements related to the adoption of this new policy on January 1, 2008.

(b) Capital disclosures
The Company adopted the CICA Handbook Section 1535, Capital Disclosures. This Section establishes standards for disclosing information about an entity's capital and how it is managed. It requires the disclosure of information about: (i) an entity's objectives, policies and processes for managing capital; (ii) qualitative data about what the entity regards as capital; (iii) whether the entity has complied with any capital requirement, and if it has not complied, the consequences of such non-compliance. The new disclosures are included in Note 18. There has been no quantitative impact on these consolidated financial statements, other than additional disclosures in Note 18, related to the adoption of this new policy on January 1, 2008 as the standard only addresses disclosure requirements.

(c) Financial instruments
The Company adopted the new recommendations of CICA Handbook Section 3862, Financial Instruments – Disclosures ("Section 3862") and CICA Handbook Section 3863, Financial Instruments – Presentation ("Section 3863").

Section 3862 requires entities to provide disclosures in their financial statements that enable users to evaluate the significance of financial instruments on the entity's financial position and its performance and the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and how the entity manages those risks.

Section 3863 establishes standards for presentation of financial instruments and non-financial derivatives. It deals with the classification of non-financial instruments, from the perspective of the issuer, between liabilities and equities, the classification of related interest, dividends, losses and gains, and circumstances in which financial assets and financial liabilities are offset.

The adoption of these standards did not have impact on the classification and valuation of the Company's financial instruments. The Company has included disclosures recommended by these new Handbook Sections in Note 17.

3. Changes in accounting policies (continued)

(d) General Standards of Financial Statement presentation, Section 1400
Effective January 1, 2008, the Company adopted the revised recommendations of the CICA Handbook Section 1400, General Standards of Financial Statement Presentation. This Section was amended to include requirements to assess and disclose an entity's ability to continue as a going concern. There has been no impact on these consolidated financial statements related to the adoption of this new policy on January 1, 2008.

Future accounting standard changes

The following is an overview of accounting standard changes that the Company will be required to adopt in future years:

(e) Goodwill and Intangible Assets
The CICA issued Section 3064, Goodwill and Intangible Assets, replacing Section 3062, Goodwill and Other Intangible Assets and Section 3450, Research and Development costs. Various changes have been made to other sections of the CICA Handbook for consistency purposes. The revisions are intended to align the definition of an intangible asset in Canadian GAAP with that in International Financial Reporting Standards. The new Section will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Company will adopt the new standards for its fiscal year beginning January 1, 2009. Section 3064 establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. The Company is currently evaluating the impact of the adoption of this new Section on its consolidated financial statements.

(f) International Financial Reporting Standards (“IFRS”)
In 2005, the Accounting Standards Board announced that accounting standards in Canada are to converge with IFRS and confirmed the conversion to IFRS in February 2008. The use of IFRS will be required by January 1, 2011 with appropriate comparative data from the prior year. While IFRS uses a conceptual framework similar to Canadian GAAP, there are significant differences in accounting policy that must be addressed.

The Company is in the process of transitioning to IFRS and designing the implementation process. It is expected there will be changes to the Company’s current accounting policies and processes and information systems to implement the transition to IFRS. Conversion to IFRS will also consider analysis of key GAAP differences, required resources and training. The full impact of adopting IFRS on the Company’s future financial position and results cannot be reasonably determined at this time.

4. Restricted cash

The Company has $408 thousand (2007 - $408 thousand) in restricted cash, invested in a guaranteed investment certificate bearing interest at 0.75%, representing funds used as security for loans between officers of the Company and a major chartered bank for the purchase of common shares of the Company.

(tabular amounts in thousands of Canadian dollars, except where noted)

5. Accounts receivable

	2008	2007
Accounts receivable – trade	**5434**	3983
Accounts receivable - other	**707**	1138
Allowance for doubtful accounts	**-**	-
	6141	5121

The aging of trade receivables as at December 31, 2008 is set out below:

Current	2758
Past Due 0 – 30 days	1701
Past Due Other	975
	5434

Accounts receivable - other mainly consist of government funding receivable and value added tax receivable from the government. The Company evaluates the ability to collect each receivable by customer and as at December 31, 2008, the Company believes all its accounts receivable are collectable and, therefore, no provision for doubtful accounts receivables has been made. See note 17(a) for a description of the Company's management of credit risk. Of the amounts above not classified as Current, $1.4 million has been collected subsequent to December 31, 2008.

6. Inventory

	2008	2007
Raw materials	**3044**	3046
Work-in-progress	**6082**	3867
Finished goods	**3868**	3391
	12994	10304

The Company measures its inventory at the lower of cost and net realizable value. Cost includes the costs associated with getting the inventory to the manufacturing plant. Work-in-progress and finished goods inventory include costs associated with direct labour and include an allocation of fixed and variable production overhead associated with converting raw materials into finished goods. The amount of inventory expensed in 2008 is $14.1 million.

During the year ended December 31, 2008, the Company did not write-down any inventory to net realizable value or reverse any write-downs previously taken. Inventory is pledged as security for the Bank of Nova Scotia operating line of credit, which the Company has not drawn down on as at December 31, 2008.

7. Intangible assets and deferred costs

2008 2007

	Cost	**Accumulated Amortization**	**Net book value**	Cost	Accumulated Amortization	Net book value
Patents	**3219**	**1085**	**2134**	3201	909	2292
Certification costs	**4689**	**1955**	**2734**	4311	1043	3268
Deferred costs	**1542**	**15393**		1539	1539	-
	9450	**4579**	**4871**	9051	3491	5560

(tabular amounts in thousands of Canadian dollars, except where noted)

8. Capital assets

	2008			2007		
	Cost	**Accumulated depreciation**	**Net book value**	Cost	Accumulated depreciation	Net book value
Land	**514**	**-**	**514**	514	-	514
Building and leaseholds	**4127**	**1430**	**2697**	4091	1275	2816
Manufacturing equipment	**19238**	**8450**	**10788**	18946	7305	11641
Manufacturing equipment under capital leases [(a)]	**669**	**95**	**574**	658	33	625
Office furniture and other equipment	**1277**	**684**	**593**	1185	594	591
Computer hardware and software	**850**	**542**	**308**	831	489	342
Manufacturing equipment under construction	**-**	**-**	**-**	65	-	65
	26675	**11201**	**15474**	26290	9696	16594

Manufacturing equipment under construction represents capital expenditures associated with asset construction prior to being commissioned into the production line. Assets are depreciated when they have been commissioned and are available for use.

[(a)] Included in capital leases as at December 31, 2008 is a winding machine located at Dynetek Germany with a cost of $669 thousand (2007 - $669 thousand) less accumulated depreciation of $95 thousand (2007 - $33 thousand). The Company completed a sale-leaseback of this equipment in October 2007.

9. Operating bank line

The Company has a $3.5 million (2007 – $5.0 million) line of credit with the Bank of Nova Scotia, which is payable on demand and bears interest at the bank prime rate plus 1.25% per annum. The bank line is secured by an assignment of book debts, inventory and a collateral mortgage. On August 14, 2008, the Company agreed with the lender to reduce the line of credit to $3.5 million. The credit agreement requires the Company to meet tangible net worth and working capital ratios of 1.5 : 1.0 and maintain shareholders' equity above $28.5 million. At December 31, 2008, the Company had drawn $nil on this facility (December 31, 2007 – $nil) and was in compliance with all bank covenants. During 2008, $10 thousand of interest and standby fees were paid on the operating line (2007 – $0.2 million).

10. Long-term debt and capital lease

	2008	2007
Loans, unsecured, non-interest bearing, repayment based on 3% to 5% of product related sales, payable in the following fiscal period [(a)]	**2014**	1869
Capital lease obligation [(b)]	**618**	621
Mortgage [(c)]	**5000**	–
Total debt and capital lease	**7632**	2490
Less: current portion	**(536)**	(370)
Long term debt and capital lease	**7096**	2120

(a) The repayment of unsecured repayable loans beyond the current year is indeterminable. Repayments of amounts owing are based on future sales of specific related commercial products over a specified period of time. As such, the Company cannot determine the amount to be paid over the next five years.

(b) The Company completed a sale-leaseback in October 2007 for manufacturing assets located Dynetek Germany. The capital lease obligation bears interest at 7.3% per annum, is repayable on a monthly basis and amortized over a 72 month term. Upon completion of the lease, the Company has the option to purchase the assets for EUR 14 thousand. During 2008, $56 thousand (2007 – $8 thousand) of interest was paid on the capital lease. Current portion of the capital lease obligation is $127 thousand at December 31, 2008.

(tabular amounts in thousands of Canadian dollars, except where noted)

10. Long-term debt and capital lease (continued)

(c) The Company completed a $5.0 million mortgage of its Calgary production facility with the Business Development Bank of Canada in March 2008. The mortgage has a term of 15 years and bears interest at the bank prime rate plus 1.50% per annum. During the first 18 months, with the option to extend for an addition 6 months, the mortgage payments are interest only and do not include repayment of principal. All financing transactions costs have been expensed. During 2008, $283 thousand of interest was paid on the mortgage loan. Current portion of the mortgage loan is $98 thousand at December 31, 2008.

The fair value of long-term debt and the capital lease is disclosed in Note 17(d).

The Company's principal repayment obligations as at December 31, 2008 on the mortgage and capital lease obligation over the next five years are as follows:

2009	227
2010	473
2011	484
2012	467
2013	399
Thereafter	3568
Total repayment obligation	**5618**

11. Provision for income taxes

The provision for income taxes differs from the amount, which would be obtained by applying the expected Canadian income tax rate as follows:

	2008	2007
Loss before income taxes	**(2942)**	(2352)
Statutory income tax rate	**29.5%**	32.12%
Expected income tax recovery	**(868)**	(756)
Add (deduct):		
Non-deductible stock based compensation	**26**	79
Impairment of future income tax asset	**-**	2355
Losses not previously recognized	**842**	677
Future income tax (benefit)	**-**	2355
Large corporations tax	**-**	-
Income taxes	**-**	2355

(tabular amounts in thousands of Canadian dollars, except where noted)

11. Provision for income taxes (continued)

The components of the net future income tax asset at December 31, 2008 and 2007 are as follows:

	2008	2007
Research and development costs	**1705**	2194
Capital assets	**1413**	1825
Non-capital losses	**2670**	1927
Cumulative eligible capital	**(75)**	(142)
Valuation allowance	**(5713)**	(5804)
Future income tax asset	**-**	-

The Company has determined that the future income tax assets of $5.7 million are not more likely than not to be recoverable and have been offset by a valuation allowance. However, the future tax deductions underlying the future tax assets remain available for use in the future to reduce taxable income.

The Company has non-capital losses carried forward in Canada of $6.6 million, expiring over a period from 2009 through 2015 and investment tax credits carried forward in Canada of $2.2 million, expiring over a period from 2010 through 2028. The European operations have corporate and trade income tax losses carried forward of $3.7 million (EUR 2.1 million) and $3.1 million (EUR 1.8 million) respectively, each of which can be utilized over an indefinite period.

12. Share capital

(a) Authorized: Unlimited common shares with no par value
Unlimited preferred non-voting shares, issuable in series, at no par value

(b) Issued and outstanding:

	Number of common shares	**Consideration**
Balance December 31, 2007 and 2008	**20936500**	**$52418**

(c) Warrants
On August 21, 2000, the Company issued warrants to Ford Motor Company to purchase 1,174,294 common shares. The warrants have an exercise price of $3.68 per share and vested one third immediately and thereafter in accordance with a formula based on revenue received by the Company. No warrants have been exercised to date. The warrants expire on the date which is the later of five years from the date of issuance and three years from the date such portion of the warrants become vested and provided that no expiration date shall be later than January 31, 2014. At December 31, 2008 there are 680,117 warrants outstanding and, of those, 578,795 have vested. The vested warrants will expire over a period from 2009 through 2011.

(d) Income per share
The weighted average number of shares outstanding for purposes of calculating basic income per share at December 31, 2008 was 20,936,500 (2007 – 20,940,464). The number of common shares used in the dilution calculation in 2008 was also 20,936,500 (2007 – 20,940,464). Diluted net loss per common share is not presented, for the years ended December 31, 2008 and 2007, as the effects of the outstanding items are not dilutive.

(tabular amounts in thousands of Canadian dollars, except where noted)

13. Stock based compensation

The Company has one employee stock option plan under which employees, directors and key consultants are eligible to receive grants. Under the stock option plan, the granted stock options will vest to the grantee over a three or four year period and the grantee has the right to exercise those stock options for a period of 5 to 10 years from the date of grant. The maximum number of outstanding stock options under the plan is limited to 2,306,625 common shares (representing approximately 11% of the 20,936,500 common shares issued and outstanding as at December 31, 2008). Any options that are exercised, expire unexercised, terminated, forfeited or cancelled are available to be re-granted under the plan. At December 31, 2008, 1,561,500 (2007 – 984,500) options to purchase common shares were outstanding. An additional 745,125 options may be granted in future years under this plan, excluding those options that are available for re-granting. A summary of the Company's employee stock option plan activity is as follows:

	Number of Options	**Weighted Average Price per share**
Balance December 31, 2006	1170500	$2.35
Options granted	76500	$1.64
Options cancelled	(262500)	($2.35)
Balance December 31, 2007	984500	$2.29
Options granted	823500	$0.20
Options cancelled	(246500)	($2.30)
Options re-priced [1]	-	($1.63)
Balance December 31, 2008	**1561500**	**$1.01**

[1] The Company received approval from the Toronto Stock Exchange for the re-pricing of 180,500 options held by employees defined as non-insiders on October 23, 2008. These options were formerly granted under the Company's Stock Option Plan and were re-priced at $0.20 per share.

Details of the stock options outstanding at December 31, 2008 are as follows:

	Options Outstanding at December 31, 2008			Options Exercisable at December 31, 2008	
Range of Exercise Prices	Number of Options	Weighted average remaining contractual life	Weighted average exercise price	Number of Options	Weighted average exercise price
$0.20-$1.50	949000	4.9	$0.20	66900	$0.20
$1.51-$2.35	447500	2.6	$2.00	301000	$2.04
$2.36-$2.95	165000	4.0	$2.95	99000	$2.95
	1561500	**4.1**	**$1.01**	**466900**	**$1.97**

(tabular amounts in thousands of Canadian dollars, except where noted)

13. Stock based compensation (continued)

Details of the stock options outstanding at December 31, 2007 are as follows:

	Options Outstanding at December 31, 2007			Options Exercisable at December 31, 2007	
Range of Exercise Prices	Number of Options	Weighted average remaining contractual life	Weighted average exercise price	Number of Options	Weighted average exercise price
$0.20-$1.50	38500	5.1	$1.38	19500	$1.37
$1.51-$2.35	607500	3.6	$2.29	524625	$2.00
$2.36-$4.35	338500	4.1	$2.96	337750	$2.95
	984500	3.8	$2.29	881875	$2.35

For the year ended December 31, 2008, 823,500 stock options were granted to employees in accordance with the terms of the employee stock option plan. Stock options are valued using the Black-Scholes option pricing model with the following assumptions:

	2008	2007
Weighted average risk-free interest rate	**2.50**	3.85
Weighted average expected life	**5 years**	5 years
Estimated volatility in the market price of the common shares	**104**	82
Dividend yield	**0%**	0%

The weighted average fair value per option granted in 2008 is $0.14 (2007 - $0.98).

14. Contributed surplus

The following table summarizes information about contributed surplus.

Balance December 31, 2006	2391
Stock-based compensation expense	247
Balance December 31, 2007	2638
Stock-based compensation expense	89
Balance December 31, 2008	**2727**

15. Commitments

The Company has an obligation under an operating lease which requires the following minimum annual payments during the respective fiscal years:

2009	364
2010	364
2011	364
2012	364
2013	364
Thereafter	181

16. Related party transaction

For the year ended December 31, 2008, the Company purchased under normal terms and conditions $3.6 million, (2007 - $5.2 million) of material used in the production of lightweight fuel storage systems from Mitsubishi Rayon Corporation, a shareholder of the Company.

17. Financial risk management and financial instruments

(a) Credit risk

The Company is exposed to credit risk as it grants unsecured credit to its customers. Certain European customers' accounts are insured through Export Development Canada. All customers are subject to credit approval prior to acceptance of a purchase order. Credit terms vary from cash on delivery to 90 days depending on the credit risk of each customer as assessed by management. Each customer has a credit limit established by management and once the customer reaches the credit limit, shipments are halted until payments are made. At December 31, 2008, the Company has receivables outstanding from two customers each greater than 10% of the Company's outstanding receivable balance. These receivables have been collected in full subsequent to December 31, 2008.

The Company assesses quarterly if there has been any impairment of financial assets. As at December 31, 2008, management determined there was no impairment of any of the financial assets of the Company.

The carrying value of the accounts receivable approximates their fair value due to the relatively short periods to maturity on these instruments. The maximum exposure to credit risk is represented by the carrying amount on the balance sheet. There are no material financial assets that the Company considers past due.

The Company's cash is on deposit with a Canadian chartered bank and a German financial institution.

(b) Market risk

Interest rate risk

Interest rate risk refers to the risk that cash flows associated with a financial instrument will fluctuate due to changes in market interest rates. The Company is exposed to interest rate cash flow risk on floating interest rate bank debt due to fluctuations in market interest rates.

As at December 31, 2008, the Company has a $3.5 million line of credit with the Bank of Nova Scotia, which is payable on demand and bears interest at the bank prime rate plus 1.25% per annum. As at December 31, 2008 the Company had not drawn any amount on this facility. The credit agreement requires the Company to meet specified tangible net worth ratios and working capital ratios (1.5:1.0) and maintain Shareholders' equity above $28.5 million. As at December 31, 2008 the Company is in compliance with all covenants.

The Company has a $5.0 million mortgage of its Calgary production facility with the Business Development Bank of Canada. The mortgage has a term of 15 years and bears interest at the bank prime rate plus 1.50% per annum. During the first 18 months, with the option to extend for an additional six months, the mortgage payments are interest only and do not include principal.

The remainder of the Company's financial assets and liabilities are not exposed to interest rate risk. The Company currently does not use interest rate hedges or fixed interest rate contracts to manage the Company's exposure to interest rate fluctuations.

A 0.25% change in the interest rate would have impacted the net loss of the Company during the year ended December 31, 2008 by approximately $9 thousand. A sensitivity of 0.25% was selected, as this is considered reasonable given the current lending rates available.

Dynetek Industries Ltd.
Notes to Consolidated Financial Statements

(tabular amounts in thousands of Canadian dollars, except where noted)

17. Financial risk management and financial instruments – Market risk (continued)

Foreign currency risk

The Company is exposed to foreign currency risk arising from operations and sales outside of Canada. A significant portion of the Company's revenues and expenses are denominated in United States ("US") dollars and Euros. The Company's cash flow from sales will therefore be impacted by fluctuations in foreign exchange rates.

The Company does not use foreign exchange rate hedges or fixed foreign exchange contracts to manage the Company's exposure to foreign exchange rate fluctuations.

A $0.05 increase or decrease in the Canadian / EURO exchange rate would have impacted the net loss of the Company by $69 thousand. A sensitivity of five percent was selected, as this is considered reasonable given the current level of the Canadian to EURO exchange rate and market expectations for future movements.

A $0.05 increase or decrease in the Canadian / US exchange rate would have impacted the net loss of the Company by $267 thousand. A sensitivity of five percent was selected, as this is considered reasonable given the current level of the Canadian to US dollar exchange rate and market expectations for future movements.

(c) Liquidity risk

Liquidity risk includes the risk that, as a result of the Company's operational liquidity requirements:

- The Company will not have sufficient funds to settle a transaction on the due date;
- The Company will be forced to sell financial assets at a value which is less than what they are worth; or
- The Company may be unable to settle or recover a financial asset at all.

The Company's operating cash requirements including amounts projected to complete its existing capital expenditure program are continuously monitored and adjusted as input variables change. These variables include but are not limited to, available bank lines, order back log from existing customers, ability of the Company to develop new customers, raw material pricing, competitors entering the market resulting in the Company reducing sales prices in order to maintain market share, and cost overruns in capital projects. As these variables change, liquidity risks may necessitate the need for the Company to conduct equity issues or obtain project debt financing. .

The following table provides Dynetek's mortgage and capital lease obligations at December 31, 2008 for each of the next five years and thereafter.

(thousands of Canadian dollars)

	Total	2009	2010	2011	2012	2013	Thereafter
Capital lease obligation	720	170	170	170	143	67	-
Mortgage obligation	7777	435	655	632	610	587	4858
Total contractual obligations	8497	605	825	802	753	654	4858

d) Fair values of financial instruments

The Company's financial instruments are classified as cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, operating bank line, capital lease, mortgage and loans. The carrying value and fair value of these financial instruments at December 31, 2008 is disclosed below by financial instrument category.

(tabular amounts in thousands of Canadian dollars, except where noted)

17. Financial risk management and financial instruments – Fair values of financial instruments (continued)

Financial Instrument	Carrying Value	Fair Value	Foreign Exchange
Assets held for Trading			
Cash and cash equivalents and restricted cash	4205	4205	
Loans and Receivables			
Accounts receivables (1)	6141	6141	19
Other Liabilities			
Accounts payable and accrued liabilities	6380	6380	
Operating bank line	-	-	
Loans(2)	2014	1934	
Mortgage	5000	5000	
Capital lease	618	639	

(1) Included in Accounts receivables is $19 thousand relating to contracts with customers that had not been fulfilled as at December 31, 2008 and contain embedded derivatives as the Company has sale contracts in currencies (US dollars and Euros) that are not the functional currency of either the customer or the Company.
(2) The fair values of the loans are measured using the Company's cost of borrowing at December 31, 2008.

18. Capital risk management

The Company's objective when managing capital is to safeguard its accumulated capital in order to maintain its ability to continue as a going concern and to provide returns to shareholders and benefits to other stakeholders. The capital structure of the Company consists of equity and debt and is summarized in the table below;

	2008	2007
Shareholders' equity	**29140**	31872
Long-term debt and capital lease, including current portion	**7632**	2490
Total Capital	**36772**	34362

The Company manages its capital structure and makes adjustments to it in light of economic conditions. The Company, upon approval from its Board of Directors, will balance its overall capital structure through new share or debt issuances or by undertaking other activities as deemed appropriate under the specific circumstances.

The Company is not subject to externally imposed capital requirements other than covenants in the operating line of credit agreement which requires the Company to meet specified tangible net worth and working capital ratios (1.5:1.0) and maintain Shareholders' equity above $28.5 million. The Company complied with these covenants at December 31, 2008 (see Note 9). The Company's overall strategy with respect to capital risk management remains unchanged from the year ended December 31, 2007.

(tabular amounts in thousands of Canadian dollars, except where noted)

19. Segmented information

The Company currently operates in one operating segment, which involves the manufacture and sale of lightweight fuel storage systems. The majority of the Company's operations and assets relating to commercial production were located in Canada at December 31, 2008. Revenues attributed to foreign countries are based on the location of the customer.

	2008	2007
Revenue:		
North America	**4610**	9777
European Union [1]	**12988**	16268
Other	**1416**	2963
	19014	29008

[1] 2008 revenue includes one customer who comprises 10% or more (2007- three customers) of revenue from the European Union.

Under a development contract, the Company has one customer who comprises 10% or more (2007 – one customer) of revenue from the European Union.

20. Subsequent event

On January 31, 2009, a financial covenant under the Company's $3.5 million line of credit was breached. The breached covenant requires Dynetek to maintain shareholders' equity above a specified level. All other financial covenants under the lender's agreement were in compliance. At the time of the covenant breach, the Company had not utilized the lender's line of credit and owes $nil to the lender which was the same as the outstanding balance at December 31, 2008. The Company may not comply with the same financial covenant in the near future and will arrange with the lender to resolve the current and any future breach of this financial covenant.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following sets out management's discussion and analysis of Dynetek's financial position and results of operations for the years ended December 31, 2008 and 2007 and is based on information available as at March 27, 2009. All financial information is presented in Canadian dollars. Dynetek's consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles (Canadian GAAP).

Non-GAAP Financial Measures

Dynetek Industries Ltd. ('the Company") reports its financial results in accordance with generally accepted accounting principles (GAAP). It also occasionally uses certain non-GAAP financial measures, such as EBITDA, non-cash working capital and working capital. Dynetek defines EBITDA as earnings before interest, taxes, stock based compensation, foreign exchange gain or loss, depreciation, and amortization. Dynetek defines non-cash working capital as current assets less cash, restricted cash and current liabilities and working capital as current assets less current liabilities. These non-GAAP financial measures are always clearly indicated. The Company believes that these non-GAAP financial measures provide investors and analysts with useful information so that they can better understand the financial results and perform a better analysis of the Company's growth and profitability potential. Since non-GAAP financial measures do not have a standardized definition, they may differ from the non-GAAP financial measures used by other companies. The Company strongly encourages investors to review its financial statements and other publicly filed reports in their entirety and not rely on a single non-GAAP financial measure. A reconciliation of non-GAAP financial measure from the Consolidated Balance Sheets and Consolidated Statements of Net Loss and Comprehensive Loss and Deficit is provided in the section Reconciliation of non-GAAP Financial Measures.

Forward looking statements

In addition to historical information, this Annual Report and the following discussion and analysis of financial condition and results of operations contains forward-looking statements and should be read in conjunction with the consolidated financial statements and related notes as at and for the years ended December 31, 2008 and 2007. Forward-looking statements are based upon current assumptions, expectations and estimates that involve numerous risks and uncertainties and actual results could differ materially from those discussed in the forward-looking statements. Readers are encouraged to review the section in the Management's Discussion and Analysis titled 'Principal Risks and Uncertainties' for a discussion of factors that could affect Dynetek's future operations and financial results. Forward-looking statements are based upon management's assumptions, expectations and estimates at the time the statements are made. Dynetek does not update forward-looking statements should circumstances or management's assumptions, expectations or estimates change, except as required by securities laws.

Business Summary

Dynetek Industries Ltd. is a leading international company engaged in the design, production and marketing of Advanced Lightweight Fuel Storage Systems™, including lightweight storage cylinders and high pressure components including valves and regulators. The key component of the storage system is the DyneCell® cylinder, capable of storing high pressure gases including compressed natural gas (CNG), hydrogen, and various industrial gases. Dynetek's DyneCell cylinder and fuel storage system applications include, but are not limited to: the transportation industry, including passenger automobiles, light and heavy-duty trucks, transit and school buses; the bulk hauling of compressed gases; and stationary storage or ground storage refueling applications.

The current growth market for Dynetek's compressed gas fuel systems for alternative fuel applications is the expanding global market for passenger and fleet vehicles powered by internal combustion engines using CNG. Based on the size and growth rate of the market for alternative fuel vehicles, Dynetek has focused its marketing efforts in these markets. Dynetek continues to pursue the industrial compressed gas market for bulk hauling applications. Dynetek is currently targeting international markets with its large bulk hauling trailer applications, which have received both Transport Canada and United States Department of Transportation certification.

Inspite of a lull in hydrogen market activities in 2008, Dynetek believes that the market for our compressed hydrogen enabling technologies will continue to develop over the next 5 to 10 years in conjunction with nearer term hydrogen industry energy applications and longer term expectation of the commercialization of hydrogen fuel cells and internal combustion engine vehicles. The Company's plan to continue the development of its enabling technologies to meet this market opportunity. Dynetek plans to focus its marketing efforts in regions where the majority of Dynetek's original equipment manufacturer (OEM) and other hydrogen related technology partners are today.

Dynetek's products and services consist primarily of fuel storage, fuel delivery and system integration for alternative compressed gas vehicles, fuel cell applications and hydrogen refueling trailers and stationary storage products. Dynetek offers the following products and services to enable the development and commercialization of these systems:

- Fuel storage – advanced thin-walled lightweight storage cylinders that provide cost effective storage for CNG, compressed hydrogen and other industrial compressed gases, such as oxygen and helium;
- Fuel delivery – pressure regulators, valves and other components designed to control the pressure and flow of compressed gas; and
- System integration – services to design and integrate complete fuel storage systems to meet OEM requirements.

Highlights of 2008

- Revenue increased quarter over quarter, from $4.4 million in the first quarter to $8.1 million in the fourth quarter.
- During the last six months of 2008, the Company realized EBITDA of $0.9 million, the result of new business development plans and major improvements in production capabilities, which resulted in increased productivity.
- Dynetek Europe GmbH (Dynetek GmbH) received a CNG complete system order from a major European bus manufacturer in June. The systems represented revenue of CDN $10 million and the systems will continue to be delivered in 2009. At December 31, 2008 Dynetek GmbH had delivered 50% of the system.
- Completed the second milestone in its contract for compressed hydrogen system sales under the Magna Steyr contract in connection with Daimler's automotive fuel cell program. The contract involves the development, certification and supply of 700bar compressed hydrogen fuel storage systems, including related engineering.
- Delivery of new products such as the Mobile Gas Distribution System (MGDS) trailer, a lightweight tube trailer designed for the gas utility industry. The MGDS trailer is used as an emergency gas supply during pipeline interruptions. Dynetek has entered into an agreement to market the MGDS trailer in the United States.
- Introduced to the heavy-duty truck market, the Dynetek BTC fuel storage system for the CNG vocational truck market. In 2008, Dynetek also began to deliver the fully customizable CNG storage system, mounted behind the cab of heavy-duty vehicles.
- Delivered significant orders to Freightliner Custom Chassis for CNG delivery vans purchased by UPS Courier Services.

Selected Consolidated Financial Information

(Thousands of Canadian dollars, except share capital and per share data)

December 31

	2008	2007	2006
Revenue			
Cylinder and system sales	**19014**	29008	35932
Research and development income	**5315**	5649	2409
Investment and other income	**257**	373	84
	24586	35030	38425
Loss before taxes	**(2942)**	(2352)	(1301)
Loss before taxes per common share (basic and fully diluted)	**(0.14)**	(0.11)	(0.06)
Net loss	**(2942)**	(4707)	(1451)
Net loss per common share (basic and fully diluted)	**(0.14)**	(0.22)	(0.07)
EBITDA [1]	**(553)**	1417	1857
Cash flow (deficiency) from operations	**(2364)**	3428	968
Capital expenditures	**384**	938	2804
Cash and cash equivalents	**3797**	1348	1622
Non-cash working capital [1]	**11565**	10082	10075
Working capital[1]	**15770**	11838	12105
Total assets	**44122**	39892	48366
Operating bank line	**-**	-	2650
Long-term debt and capital lease	**7096**	2120	1293
Common shares outstanding	**20936500**	20936500	20940576
Weighted average common shares outstanding	**20936500**	20940464	20940295

[1] EBITDA, non-cash working capital and working capital are defined in the Reconciliation of non-GAAP Financial Measures section of the Management's Discussion and Analysis.

Results of Operations

Revenues
(thousands of Canadian dollars)

	$2008	**% of revenues**	$2007	% of revenues
Cylinder and system sales	**19014**	**77%**	29008	83%
Research and development income	**5315**	**22%**	5649	16%
Investment and other income	**257**	**1%**	373	1%
	24586	**100%**	35030	100%

Cylinder and system sales for the year ended December 31, 2008 were $19.0 million, down 34% from $29.0 million for 2007. This decrease is the result of reduced tender activities and deliveries to the European bus market in the fourth quarter of 2007 that persisted through the first two quarters of 2008, increased North American competition and reduction to customers' capital expenditures. Dynetek's Canadian operation invoices the majority of its revenue in US dollars and Dynetek GmbH invoices in Euros. During 2008, a selection of customers who purchased the DyneCell fuel storage systems for CNG included customers involved in the heavy-duty truck and bulk transport industry in North America and bus manufacturers in Europe. A selection of customers who purchased hydrogen and other compressed gas fuel storage systems included Daimler, Ford Motor Company (United States) and Magna Steyr (Austria).

Research and development income for the year ended December 31, 2008 was $5.3 million compared to $5.6 million from 2007. During 2008, Dynetek continued to be involved with Natural Resources Canada (NRCan) and different Original Equipment Manufacturers (OEMs), such as Ford, Daimler, and Magna Steyr, to design, manufacture and deliver hydrogen storage solutions for various development programs. Revenues received from the OEMs regarding these projects are recorded on billing milestones outlined in the contracts and, therefore, timing differences occur between when costs are incurred and funding is received. Non-repayable funding received from NRCan is recorded as revenue in the period it is invoiced. The repayable funding received from NRCan is recorded as a loan.

During 2007 Dynetek obtained an order for approximately $7.0 million (CAD) in compressed hydrogen system sales with Magna Steyr. The order involves the development, certification and supply of 700 bar compressed hydrogen fuel storage systems, including related engineering. Dynetek continued to supply Magna Steyr with product and services in 2008, completing its second milestone, and expects to complete the third milestone in 2009.

Research and development income is dependent on OEM and government cost shared monies. It is difficult to predict the timing and demand of these customers and therefore research and development income can vary significantly from year to year.

Investment and Other Income
(thousands of Canadian dollars)

	2008	2007
Investment and other income	**257**	373

Investment and other income for the year ended December 31, 2008 was $0.3 million, compared to $0.4 million in 2007. This decrease is the result of the sale of shares of a private company in 2007 purchased as a passive investment in 2002.

Investment income is dependent on the amount of cash Dynetek has to invest. Dynetek only invests in triple A rated securities and therefore earns interest at these associated rates.

Costs of Goods Sold and Contribution Margin
(thousands of Canadian dollars)

	2008	2007
Cost of goods sold	**15479**	23346
Contribution Margin	**3535**	5662
Percentage of Sales	**19%**	20%

Cost of goods sold was $15.5 million for the year ended December 31, 2008 compared to $23.3 million for the same period in 2007. Corresponding contribution margins for 2008 were $3.5 million, or 19% of sales compared to $5.7 million or 20% of sales in 2007.

Cost of goods sold comprises materials, direct labour costs and benefits, and indirect labour costs and overhead associated with the production.

The reduction in contribution margin for 2008 is a result in the reduction of overall sales. As the Company has grown, it has added certain fixed costs and when cylinder and system sales decrease this negatively affects the Company's contribution margin.

General and Administrative
(thousands of Canadian dollars)

	2008	2007
General and administrative expense	**3387**	3817

General and administrative expense was $3.4 million in 2008 compared to $3.8 million for 2007. General and administrative expense includes labour and benefits for corporate staff, professional fees, insurance, travel and statutory expenses associated with being a public company. The decrease in 2008 general and administrative expense was mainly a result of cost savings strategies implemented in the second quarter in response to decreased revenue in 2008. General and administration costs as a percentage of revenue was 14% in 2008 compared to 11% in 2007, reflecting a large portion of General and administration costs being fixed costs.

Research and Development
(thousands of Canadian dollars)

	2008	2007
Research and development expense	**4707**	**4659**

Research and development expense was $4.7 million in 2008 and remained unchanged from $4.7 million in 2007. Research and development expense consists of materials, labour and benefit costs and the overhead related to research and development activity. Research and development expense in 2008 was slightly higher as a percentage of 2008 research and development revenue as the Company incurred costs related to reorganizing the department. During 2007 Dynetek obtained an order for approximately $7.0 million (CAD) in compressed hydrogen system sales with Magna Steyr. The order involves the development, certification and supply of 700 bar compressed hydrogen fuel storage systems, including related engineering. By December 31, 2008 the Company has completed two of three milestones in the project.

The majority of Dynetek's research and development programs are co-funded with major OEMs and government grants (NRCan). Dynetek receives subsidies from the OEMs regarding projects based on completion of the project and therefore timing differences can occur between when costs are incurred and funding is received**.** The funding from the OEMs is recorded as research and development revenue. The non-repayable cost shared monies received from NRCan are recorded as revenue. The repayable NRCan funding is recorded as debt.

Research and development expense is dependent on OEM projects and government funding. It is difficult to predict the timing and demand of these customers and therefore research and development expense can vary significantly from year to year.

Marketing
(thousands of Canadian dollars)

	2008	2007
Marketing expense	**1566**	1791

Marketing expense was $1.6 million in 2008 compared to $1.8 million in 2007. Marketing expense relates to labour and benefits of sales personnel, travel, attendance at tradeshows, agents commissions and promotional collateral. Marketing expense decreased by $0.2 million in 2008 due to a decrease in commissions paid as a result of decreased revenue. Overall marketing expense as a percentage of sales increased to 6% in 2008 compared to 5% in 2007.

Interest
(thousands of Canadian dollars)

	2008	2007
Interest expense	**395**	219

Interest expense was $0.4 million in 2008 compared to $0.2 million in 2007. The year over year increase of $0.2 million was attributable to the $5.0 million mortgage completed on March 24, 2008. At December 31, 2008 and 2007, the Company had drawn down $nil million on its operating line of credit.

The Company currently has a $3.5 million operating line of credit with a major Canadian Chartered Bank, which is payable on demand and bears interest at the bank prime rate plus 1.25% per annum. On March 24, 2008 the Company completed a $5.0 million mortgage of its Calgary production facility with the Business Development Bank of Canada ('BDC'). The mortgage has a term of 15 years and bears interest at the bank prime rate plus 1.50% per annum. For the first 24 months the payments are interest only.

Depreciation
(thousands of Canadian dollars)

	2008	2007
Depreciation expense	**1504**	1586

Depreciation expense was $1.5 million in 2008, compared to $1.6 million in 2007. Depreciation expense decreased in 2008 as a result of lower capital additions in 2008 compared to 2007 and a lower net book value in 2008 as compared to 2007.

Amortization
(thousands of Canadian dollars)

	2008	2007
Amortization	**1168**	1372

Amortization was $1.2 million in 2008, compared to $1.4 million in 2007. Items included in amortization relate to certification costs, patents and deferred start-up costs. The decrease is due to the recording of impairment in the deferred costs associated with the project in Brazil in 2007.

Foreign Exchange
(thousands of Canadian dollars)

	2008	2007
Foreign exchange (gain) loss	**(767)**	345

Foreign exchange for the year ended December 31, 2008 was a gain of 0.8 million, which was higher by $1.1 million than the loss of $0.3 million in 2007. The Canadian operation invoices the majority of its revenue in US dollars and the European operation invoices in Euros. The Company reports its results in Canadian dollars but the revenues are generated in US dollars, Euros and Canadian dollars. The increase in 2008 is due to a strengthening of the US dollar and the Euro against the Canadian dollar in 2008 compared to the opposite effect in 2007.

At December 31, 2008 the Company held the following amounts in foreign currencies:

(thousands)	US Dollars	Euros
Cash	1441	797
Accounts receivable	1372	2025
Accounts payable	921	1954

Stock based Compensation
(thousands of Canadian dollars)

	2008	2007
Stock based compensation expense	**89**	247

Stock based compensation for the year ended December 31, 2008 was $0.1 million compared to 0.3 million in 2007. The increase in 2007 was due to larger portion of stock options vesting to grantees.

Income Taxes
(thousands of Canadian dollars)

	2008	2007
Future income taxes	**-**	2355

Income taxes were in $2.4 million in 2007 compared to $nil in 2008. During the second quarter of 2007 the Company considered the future income tax asset impaired due to the deferral of sales for the European bus markets into 2008 and reduced the future income tax asset value to $nil. For tax purposes the non-capital losses that the future tax asset represents are still available for use by the Company to reduced taxable income and were not affected by the recorded impairment for book purposes.

NET LOSS
(thousands of Canadian dollars)

	2008	2007
Net loss	**(2942)**	(4707)

Net loss for the year ended December 31, 2008 was ($2.9) million or ($0.14) per common share compared to a loss of ($4.7) million or ($0.22) per share in 2007. The decrease in Net loss by $1.8 million in 2008, is a result of recognizing the future income tax expense of $2.3 million in 2007 and foreign exchange gain of $0.8 million in 2008, offset by the decrease in the 2008 contribution margin.

Summary of Quarterly Results
The following tables show selected unaudited financial information for the past eight quarters ending December 31, 2008. The information has been obtained from our quarterly unaudited financial statements which have been prepared in accordance with Canadian GAAP and, in the opinion of management, have been prepared using accounting policies consistent with the annual audited financial statements and include all adjustments necessary for the fair presentation of the results of the interim periods. We expect our operating results to vary significantly from quarter to quarter and they should not be relied upon to predict future information.

2008 Quarter Ended (unaudited)
(thousands of Canadian dollars – except per share amounts)

	Three months ended				
	March 31	**June 30**	**September 30**	**December 31**	**Year Ended**
Revenues					
Cylinder and system sales	3242	3517	5484	6771	19014
Research and development income	1196	1443	1399	1277	5315
Investment & other income	11	55	122	69	257
	4449	5015	7005	8117	24586
Operating expenses					
Cost of goods sold	2776	3247	4119	5337	15479
Marketing & general and admin.	1186	1251	1221	1295	4953
Research & product development	1186	1312	1009	1200	4707
	5148	5810	6349	7832	25139
Earnings before interest, taxes, stock based compensation, non-cash foreign exchange, depreciation & amortization [1]	(699)	(795)	656	285	(553)
Interest	68	108	106	113	395
Foreign exchange (gain)	(347)	(93)	(64)	(263)	(767)
Depreciation & amortization	619	649	629	775	2672
Stock based compensation	21	21	21	26	89
Income taxes	-	-	-	-	-
	361	685	692	651	2389
Net loss	(1060)	(1480)	(36)	(366)	(2942)
Loss per share					
Basic and fully diluted	(0.05)	(0.07)	0.00	(0.02)	(0.14)

1 EBITDA is defined in the Reconciliation of non-GAAP Financial Measures section of the Management's Discussion and Analysis.

2007 Quarter Ended (unaudited)
(thousands of Canadian dollars – except per share amounts)

	Three months ended				
	March 31	**June 30**	**September 30**	**December 31**	**Year Ended**
Revenues					
Cylinder and system sales	9322	5838	8481	5367	29008
Research & development income	918	2259	1322	1150	5649
Investment and other income	270	38	33	32	373
	10510	8135	9836	6549	35030
Operating expenses					
Cost of goods sold	7630	4817	6581	4318	23346
Marketing & general and admin.	1312	1350	1489	1457	5608
Research & product development	658	1184	1391	1426	4659
	9600	7351	9461	7201	33613
Earnings before interest, taxes, stock based compensation, non-cash foreign exchange, depreciation & amortization[1]	910	784	375	(652)	1,417
Interest	68	33	58	60	219
Foreign exchange (gain) loss	(1)	115	34	197	345
Depreciation & amortization	568	642	666	1082	2958
Stock Based compensation	28	28	29	162	247
Income taxes	80	2275	-	-	2355
	743	3093	787	1501	6124
Net income (loss)	167	(2309)	(412)	(2153)	(4707)
Earnings (loss) per share					
Basic and fully diluted	0.01	(0.11)	(0.02)	(0.10)	(0.22)

1 EBITDA is defined in the Reconciliation of non-GAAP Financial Measures section of the Management's Discussion and Analysis.

Seasonality and Cycles

Over the last five years, Dynetek has experienced an increase in cylinder and system sales in the third and fourth quarters of the calendar year. This demand pattern is principally a result of when municipalities require products from the OEMs. However, in 2007 this pattern did not continue as a result of the slow down in the European bus market.

Fourth Quarter Results

Cylinder and system sales for the three months ended December 31, 2008 were $6.8 million, an increase from $5.4 million or 26% for the same period in 2007. The quarter over quarter increase in fourth quarter revenue reflects the slow down of the tenders from European bus manufacturers in the fourth quarter of 2007.

Research and development income for the fourth quarter was $1.3 million, up from $1.2 million or 11% for the same period in 2007. The increase is the result of recognizing revenue under the Magna Steyr contract discussed above under "Results of Operations – Research and Development Income".

Investment and other income in the fourth quarter of 2008 was $69 thousand compared to $32 thousand for the same period of 2007.

Cost of goods sold was $5.3 million for the three months ended December 31, 2008 compared to $4.3 million for the same period in 2007. Corresponding contribution margins for the three months ended December 31, 2008 were $1.4 million or 21% of sales compared to $1.0 million or 20% of sales for the same period of 2007. The increase in contribution margin as a percentage is due mainly to increased revenue in the fourth quarter of 2008.

General and administrative expense was $0.8 million for the three months ended December 31, 2008 compared to $0.9 million for the same period of 2007. The $0.1 million decrease is mainly due cost saving strategies implemented during the second quarter of 2008 and Dynetek's Board of Directors suspending payment of director fees.

Research and development expense was $1.2 million for the quarter ended December 31, 2008 compared to $1.4 million for the same period in 2007. The increase in 2007 was the result of increases in deliverable to projects compared to 2008.

Marketing expense was $0.5 million for the quarter ended December 31, 2008, which is comparable to the fourth quarter of 2007.

Interest expense was $113 thousand for the fourth quarter of 2008, compared to $60 thousand for the same quarter of 2007. The increase was due to interest expense from the $5.0 million mortgage completed in March 2008.

Depreciation expense was $0.4 million for the quarter ended December 31, 2008, remaining unchanged from $0.4 million for the same period of 2007.

Amortization expense was $0.4 million for the quarter ended December 31, 2008, compared to $0.7 million for the same period of 2007. The increase is due to the impairment in the deferred costs associated with the Brazil project due to continued delays in the Delphi production schedule.

Foreign exchange for the fourth quarter was a gain of $0.3 million compared to a loss of $0.2 million for the same period of 2007. The increase is due to a strengthening of the US dollar and the Euro against the Canadian dollar in the fourth quarter of 2008 compared to 2007.

Stock based compensation for the fourth quarter of 2008 was $26 thousand compared to $162 thousand for the same period of 2007. This increase is the result of more stock options vesting to grantees during 2007.

Net loss for the quarter ended December 31, 2008 was $0.4 million or ($0.02) per common share compared to a loss of $2.2 million or ($0.10) per common share for the same period of 2007. The decrease in the 2008 fourth quarter loss is a result of the increase in contribution margin, foreign exchange gain and a decrease in amortization expense.

Intangible Assets and Deferred Costs
(thousands of Canadian dollars)

	2008	2007
Patents	**18**	81
Deferred Costs	**2**	107
Certification Costs	**378**	827
	398	1015

Intangible asset expenditures for the year ended 2008 were $0.4 million compared to $1.0 million in 2007. The variance compared to 2007, was related to Dynetek spending funds on registering new patents, maintaining existing patents, deferred costs associated with the development of the Company's Brazil project and costs associated with new product certification in 2007. The Company will invest additional resources to maintain and register patents and product certification in future years to ensure protection from competitors of our intellectual property, developed products and production processes. There are no current future plans to acquire any intellectual property from third parties.

Capital Expenditures
(thousands of Canadian dollars)

	2008	2007
Building and leaseholds	**36**	188
Manufacturing equipment	**248**	866
Manufacturing equipment under capital leases	**-**	658
Office furniture and other equipment	**91**	248
Computer hardware and software	**19**	34
Manufacturing equipment under construction	**(10)**	(1056)
	384	938

Capital expenditures for the year ended 2008 were $0.4 million compared to $0.9 million for 2007. There were fewer capital projects in 2008 as major capital projects were completed in 2007. During 2007, the Company commissioned $1.1 million of manufacturing equipment previously included in assets under construction into the production line. The majority of the expenditures incurred relate to expansion of production assets. The efficiencies and higher production capabilities of the new manufacturing process will contribute directly to cost reductions and higher production output. With the additional infrastructure necessary to manage the Company, additions were made to the building, office furniture and computer hardware and software.

The Company completed a sale leaseback during 2007 of a winding machine located at the German operations with a cost of $0.7 million.

The Company's capital resource requirements currently consist of capital expenditures to maintain and improve the existing production line.

Off Balance Sheet Financing
The Company does not have any Off Balance Sheet Financing arrangements.

Financial Resources and Liquidity

The Company's principle source of liquidity is cash generated from operations. The Company's principal liquidity requirements relate to the increase in working capital required to maintain our production, sales and research and development projects. The Company's actual funding requirements and financing alternatives could vary depending on a number of factors, including CNG system sales on a global basis, the progress of research and development projects, the Company's ability to improve controllable costs and the development of additional relationships with strategic partners.

Proceeds from the $5.0 million mortgage facility with Business Development Bank of Canada, completed in March 2008, was used to fund new projects and general working capital purposes. The mortgage has a term of 15 years and bears interest at the bank prime rate plus 1.50% per annum.

As at December 31, 2008 Dynetek had cash and cash equivalents of $3.8 million, compared to $1.3 million at December 31, 2007. Dynetek had a cash flow deficiency from operations of $2.4 million for the year ended December 31, 2008 compared to cash flow from operations of $3.4 million for the year ended December 31, 2007.

At December 31, 2008, the Company has a $3.5 million operating line of credit with Bank of Nova Scotia. The Company has the ability to fund liquidity requirements though its $3.5 million operating bank line of credit facility. As of December 31, 2008 and 2007, no amounts were drawn down on this credit facility. At January 31, 2009, the Company has not drawn on this credit facility but breached a financial covenant (see Subsequent Event). The Company and the lender are currently attempting to resolve the covenant breach.

The following table provides additional information on its working capital balances at December 31, 2008 as compared to December 31, 2007.

(thousands of Canadian dollars)	**December 31, 2008**	December 31, 2007	Change in working capital
Cash and cash equivalents	**3797**	1348	2449
Accounts receivable	**6141**	5121	1020
Inventory	**12994**	10304	2690
Prepaids and other	**437**	557	(120)
Operating bank line	**-**	-	-
Accounts payable and accrued liabilities	**(6420)**	(4127)	(2293)
Deferred revenue	**(1051)**	(1403)	352
Current portion of long-term debt and capital leases	**(536)**	(370)	(166)
	15362	11430	3932

At December 31, 2008 accounts receivable were $6.1 million representing an increase of $1.0 million compared to December 31, 2007. This increase is representative of the increase in cylinder and system sales in the fourth quarter of 2008 compared to 2007.

The Company's investment in inventory resulted in an increase of $2.7 million to $13.0 million at December 31, 2008 from December 31, 2007. This increase is reflective of more inventory required in Germany to complete significant CNG system orders.

The following table summarizes the inventory balance at December 31, 2008 compared to December 31, 2007.

(thousands of Canadian dollars)	**December 31 2008**	December 31 2007	Change
Raw materials	**3044**	3046	(2)
Work-in-progress	**6082**	3867	2215
Finished goods	**3868**	3391	477
	12994	10304	2690

Work-in-progress substantially represented by confirmed orders, increased to $6.1 million at December 31, 2008 from $3.9 million in 2007. The increase was the result of significant CNG system orders at December 31, 2008 compared to 2007. Raw material levels at December 31, 2008 remained virtually identical to 2007 levels. Finished goods inventory increased by $0.5 million to $3.9 million from amounts at December 31, 2007.

Accounts payable at December 31, 2008 were $6.4 million, compared to $4.1 million as at December 31, 2007. This increase is representative of the increases in production in the fourth quarter of 2008 when compared to the same period of 2007.

The current portion of long-debt and capital leases relates to repayable research and development funding supplied by NRCan, the capital lease obligation and the $5.0 million mortgage. The NRCan agreements allow Dynetek to retain the intellectual property and to receive long-term funding. The debt is repayable only in the form of royalties based on specific related commercial product sales and is interest free. The Company has $0.3 million to be repaid in 2009. During 2008 the Company received $5.1 million in funding in the form of long-term debt, primarily from the $5.0 million mortgage.

Dynetek continues to build on the strong strategic alliances with several major OEMs whereby confidential joint funding has been obtained to develop complete hydrogen fuel storage systems. Other research programs with strategic partners, such as government bodies, who provide financial and technical support, are also in place to explore other storage applications in the energy marketplace.

Contractual Obligations and Commitments

The following table provides Dynetek's contractual obligations at December 31, 2008 for each of the next five years and after 2013. The table also includes long-term debt and capital lease obligation repayments

(thousands of Canadian dollars)

	Total	2009	2010	2011	2012	2013	Thereafter
Operating lease obligations	2001	364	364	364	364	364	181
Capital lease obligations	720	170	170	170	143	67	-
Mortgage obligation	7777	435	655	632	610	587	4858
Total contractual obligations	10498	969	1189	1166	1117	1018	5039

Market Volatility

The global financial markets have experienced significant volatility in 2008 and it cannot be reasonability determined when such volatility would subside in the future. This has created an uncertain environment, which could impact many companies in varying degrees including Dynetek, its customers and suppliers.

One major impact will be assessing new customer markets and the credit risk presented by existing and new customers. Currently, Dynetek issues a credit limit to each customer and once the customer reaches the credit limit, deliveries are halted until payments are received. Within the last two years, Dynetek has not experienced material bad debts in its accounts receivable and will continue to monitor its credit policies in a volatile environment. Dynetek does have major credit exposure to bus manufacturers, transit operators and fleet operators as the Company focuses on marketing its CNG cylinders to this segment. The Company has previously disclosed the reduced tender activities and deliveries to the European bus market and the Company continues to monitor this particular segment. In addition, the Company has exposure to the automotive industry through their transactions with various OEMs.

The Company does anticipate new legislation to improve and maintain the North American environment, which could lead to increased sales of its CNG systems which utilizes natural gas, a cleaner burning hydrocarbon. With the strategies to reduce costs and improve efficiencies, Dynetek feels it is in a better position to increase its productivity in the future.

In regards to the turbulent financial markets, Dynetek expects financing alternatives will become more restricted. Sourcing new capital markets, whether equity or debt, is expected to be difficult and there will be more reliance on cash generated from operations and managing its working capital. Dynetek will continue to closely monitor its cash generating potential, its cash utilization requirements and working capital requirements. With the heavier reliance on internal cash sources, the potential for major capital expenditures will decrease. The Company will continue to review strategic ventures such as new alliances, joint ventures and new partners, licensing arrangements and product offerings.

Transactions with Related Parties

For the year ended December 31, 2008, the Company purchased under normal terms and conditions $3.6 million (2007 - $5.2 million) of material used in the production of lightweight fuel storage systems from Mitsubishi Rayon Corporation, a shareholder of the Company.

Outstanding Share Data

(thousands of Canadian dollars except share amounts)

Issued and outstanding:

	Number of Shares	Amount
Balance at December 31, 2008 and 2007	**20936500**	**52418**

	2008	2007
Securities convertible into common shares:		
Stock options	**1561500**	984500
Warrants	**680117**	737509

Common shares and securities convertible into common shares as at March 27, 2009 were as follows: common shares outstanding 20,936,500, options of 1,561,500 and warrants of 680,117.

Critical Accounting Estimates

The preparation of the Company's financial statements requires management to make estimates and judgments that affect the reported amounts. On an ongoing basis, the Company evaluates its estimates, including those related to bad debts, inventories, fixed asset useful lives, impairment of assets, stock-based compensation and income taxes. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Accounts receivable are recorded as bad debts when they are deemed to be uncollectible. Management reviews specific information on each customer to determine whether collection is an issue.

The Company reviews its inventory for obsolescence and to ensure that the cost of inventory is not in excess of the net realizable value. There was no write-down of inventory to net realizable value during 2008 or reversal of write-downs previously taken.

Subsequent Event

On January 31, 2009, a financial covenant under the Company's $3.5 million line of credit was breached. The breached covenant requires Dynetek to maintain shareholders' equity above a specified level. All other financial covenants under the lender's agreement were in compliance. At the time of the covenant breach, the Company had not utilized the lender's line of credit and owes $nil to the lender which was the same as the outstanding balance at December 31, 2008. The Company may not comply with the same financial covenant in the near future and will arrange with the lender to resolve the current and any future breach of this financial covenant.

Changes in Accounting Policies

As required by the Canadian Institute of Chartered Accountants ("CICA"), on January 1, 2008, the Company adopted new accounting requirements for CICA Handbook Section 3031, Inventories; Section 1535, Capital Disclosures; Section 3862, Financial Instruments – Disclosures; Section 3863, Financial Instruments – Presentation and Section 1400 – General Standards of Financial Statement presentation.

(a) Inventories

The Company adopted the recommendations of the CICA Handbook Section 3031, Inventories, which replaces Section 3030. The new section provides additional guidance on the measurement and disclosure requirements for inventories. The standard requires inventory to be measured at the lower of cost and net realizable value. Cost of inventories shall be composed of all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. When inventories are sold, the carrying amounts of those inventories shall be recognized as an expense in the period in which the related revenue is recognized. The amount of any write-down of inventories to net realizable value and all losses of inventories shall be recognized as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories, arising from an increase in net realizable value, shall be recognized as a reduction in the amount of inventories recognized as an expense in the period in which the reversal occurs. The new disclosures are included in Note 6. There has been no quantitative impact on these consolidated financial statements related to the adoption of this new policy on January 1, 2008.

(b) Capital disclosures
The Company adopted the CICA Handbook Section 1535, Capital Disclosures. This Section establishes standards for disclosing information about an entity's capital and how it is managed. It requires the disclosure of information about: (i) an entity's objectives, policies and processes for managing capital; (ii) qualitative data about what the entity regards as capital; (iii) whether the entity has complied with any capital requirement, and if it has not complied, the consequences of such non-compliance. The new disclosures are included in Note 18. There has been no quantitative impact on these consolidated financial statements, other than additional disclosures in Note 18, related to the adoption of this new policy on January 1, 2008 as the standard only addresses disclosure requirements.

(c) Financial instruments
The Company adopted the new recommendations of CICA Handbook Section 3862, Financial Instruments – Disclosures ("Section 3862") and CICA Handbook Section 3863, Financial Instruments – Presentation ("Section 3863").

Section 3862 requires entities to provide disclosures in their financial statements that enable users to evaluate the significance of financial instruments on the entity's financial position and its performance and the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and how the entity manages those risks.

Section 3863 establishes standards for presentation of financial instruments and non-financial derivatives. It deals with the classification of non-financial instruments, from the perspective of the issuer, between liabilities and equities, the classification of related interest, dividends, losses and gains, and circumstances in which financial assets and financial liabilities are offset.

The adoption of these standards did not have impact on the classification and valuation of the Company's financial instruments. The Company has included disclosures recommended by these new Handbook Sections in Note 17.

(d) General Standards of Financial Statement presentation, Section 1400
Effective January 1, 2008, the Company adopted the revised recommendations of the CICA Handbook Section 1400, General Standards of Financial Statement Presentation. This Section was amended to include requirements to assess and disclose an entity's ability to continue as a going concern. There has been no impact on these consolidated financial statements related to the adoption of this new policy on January 1, 2008.

Future accounting standard changes

The following is an overview of accounting standard changes that the Company will be required to adopt in future years:

(e) Goodwill and Intangible Assets
The CICA issued Section 3064, Goodwill and Intangible Assets, replacing Section 3062, Goodwill and Other Intangible Assets and Section 3450, Research and Development costs. Various changes have been made to other sections of the CICA Handbook for consistency purposes. The revisions are intended to align the definition of an intangible asset in Canadian GAAP with that in International Financial Reporting Standards. The new Section will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Company will adopt the new standards for its fiscal year beginning January 1, 2009. Section 3064 establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. The Company is currently evaluating the impact of the adoption of this new Section on its consolidated financial statements.

(f) International Financial Reporting Standards (IFRS)
In 2005, the Accounting Standards Board announced that accounting standards in Canada are to converge with IFRS and confirmed the conversion to IFRS in February 2008. The use of IFRS will be required by January 1, 2011 with appropriate comparative data from the prior year. While IFRS uses a conceptual framework similar to Canadian GAAP, there are significant differences in accounting policy that must be addressed.

The Company is in the process of transitioning to IFRS and designing the implementation process. It is expected there will be changes to the Company's current accounting policies and processes and information systems to implement the transition to IFRS. Conversion to IFRS will also consider analysis of key GAAP differences, required resources and training. The full impact of adopting IFRS on the Company's future financial position and results cannot be reasonably determined at this time.

Financial Instruments

(a) Credit risk
The Company is exposed to credit risk as it grants unsecured credit to its customers. Certain European customers' accounts are insured through Export Development Canada. All customers are subject to credit approval prior to acceptance of a purchase order. Credit terms vary from cash on delivery to 90 days depending on the credit risk of each customer as assessed by management. Each customer has a credit limit established by management and once the customer reaches the credit limit, shipments are halted until payments are made. At December 31, 2008, the Company has receivables outstanding from two customers each greater than 10% of the Company's outstanding receivable balance. These receivables have been collected in full subsequent to December 31, 2008.

The Company assesses quarterly if there has been any impairment of financial assets. As at December 31, 2008, management determined there was no impairment of any of the financial assets of the Company.

The carrying value of the accounts receivable approximates their fair value due to the relatively short periods to maturity on these instruments. The maximum exposure to credit risk is represented by the carrying amount on the balance sheet. There are no material financial assets that the Company considers past due.

The Company's cash is on deposit with a Canadian chartered bank and a German financial institution.

(b) Market risk

Interest rate risk
Interest rate risk refers to the risk that cash flows associated with a financial instrument will fluctuate due to changes in market interest rates. The Company is exposed to interest rate cash flow risk on floating interest rate bank debt due to fluctuations in market interest rates.

As at December 31, 2008, the Company has a $3.5 million line of credit with the Bank of Nova Scotia, which is payable on demand and bears interest at the bank prime rate plus 1.25% per annum. As at December 31, 2008 the Company had not drawn any amount on this facility. The credit agreement requires the Company to meet specified tangible net worth ratios and working capital ratios (1.5:1.0) and maintain Shareholders' equity above a specified level. As at December 31, 2008 the Company is in compliance with all covenants.

The Company has a $5.0 million mortgage of its Calgary production facility with the Business Development Bank of Canada. The mortgage has a term of 15 years and bears interest at the bank prime rate plus 1.50% per annum. During the first 18 months, with the option to extend for an additional six months, the mortgage payments are interest only and do not include principal.

The remainder of the Company's financial assets and liabilities are not exposed to interest rate risk. The Company currently does not use interest rate hedges or fixed interest rate contracts to manage the Company's exposure to interest rate fluctuations.

A 0.25% change in the interest rate would have impacted the net loss of the Company during the year ended December 31, 2008 by approximately $9 thousand. A sensitivity of 0.25% was selected, as this is considered reasonable given the current lending rates available.

Foreign currency risk
The Company is exposed to foreign currency risk arising from operations and sales outside of Canada. A significant portion of the Company's revenues and expenses are denominated in United States ("US") dollars and Euros. The Company's cash flow from sales will therefore be impacted by fluctuations in foreign exchange rates.

The Company does not use foreign exchange rate hedges or fixed foreign exchange contracts to manage the Company's exposure to foreign exchange rate fluctuations.

A $0.05 increase or decrease in the Canadian / EURO exchange rate would have impacted the net loss of the Company by $69 thousand. A sensitivity of five percent was selected, as this is considered reasonable given the current level of the Canadian to EURO exchange rate and market expectations for future movements.

A $0.05 increase or decrease in the Canadian / US exchange rate would have impacted the net loss of the Company by $267 thousand. A sensitivity of five percent was selected, as this is considered reasonable given the current level of the Canadian to US dollar exchange rate and market expectations for future movements.

(c) Liquidity risk

Liquidity risk includes the risk that, as a result of the Company's operational liquidity requirements:

- The Company will not have sufficient funds to settle a transaction on the due date;
- The Company will be forced to sell financial assets at a value which is less than what they are worth; or
- The Company may be unable to settle or recover a financial asset at all.

The Company's operating cash requirements including amounts projected to complete its existing capital expenditure program are continuously monitored and adjusted as input variables change. These variables include but are not limited to, available bank lines, order back log from existing customers, ability of the Company to develop new customers, raw material pricing, competitors entering the market resulting in the Company reducing sales prices in order to maintain market share, and cost overruns in capital projects. As these variables change, liquidity risks may necessitate the need for the Company to conduct equity issues or obtain project debt financing. .

d) Fair values of financial instruments

The Company's financial instruments are classified as cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, operating bank line, capital lease, mortgage and loans. The carrying value and fair value of these financial instruments at December 31, 2008 is disclosed below by financial instrument category.

Financial Instrument	Carrying Value	Fair Value	Foreign Exchange
Assets held for Trading			
Cash and cash equivalents and restricted cash	4205	4205	
Loans and Receivables			
Accounts receivables (1)	6141	6141	19
Other Liabilities			
Accounts payable and accrued liabilities	6380	6380	
Operating bank line	-	-	
Loans(2)	2014	1934	
Mortgage	5000	5000	
Capital lease	618	639	

(1) Included in Accounts receivables is $19 thousand relating to contracts with customers that had not been fulfilled as at December 31, 2008 and contain embedded derivatives as the Company has sale contracts in currencies (US dollars and Euros) that are not the functional currency of either the customer or the Company.

(2) The fair values of the loans are measured using the Company's cost of borrowing at December 31, 2008.

Principal Risks and Uncertainties

Development of the Alternate Fuel Industry and Infrastructure: Our future performance depends upon the development of the alternate fuel industry and the establishment of the necessary infrastructure. While we believe that the alternate fuel industry will continue to develop and that the necessary infrastructure will be established, we cannot control if, when and how quickly this will happen. The failure or delay in the development of the alternate fuel industry and the establishment of the necessary infrastructure would have a material adverse effect on our operations and financial position.

Competition in the Fuel Storage Industry: The gaseous fuel storage industry is highly competitive. The Company produces a type III cylinder and competes against other manufacturers of type III cylinders, and in some markets the Company will directly compete with type I, II and IV cylinders. We endeavor to offer products that are more advanced and that are cost competitive with our competitors. We also market our products globally and we endeavor to establish strategic relationships with our principal customers. However, our competitors may have greater resources and may develop and introduce competing products that are more advanced and less expensive than our products. In emerging markets, we compete against type II cylinders for CNG storage, which are less advanced but are less expensive than type III cylinders.

Dependence upon Transportation OEMs: Our principal markets are currently automotive OEMs, heavy truck manufacturers and bus manufacturers. We depend upon their continuing development of alternate fuel vehicles and their continuing purchase of our products. We establish strategic relationships with our principal customers and we endeavour to identify new global markets for our products other than transportation OEMs. However, the failure or delay by the transportation OEMs to develop and produce alternate fuel vehicles, or their decision to purchase products from our competitors, would have a material adverse effect on our operations and financial position.

Technological Changes: There is significant and rapid technological change in the alternate fuel industry and in the gaseous fuel storage industry. We depend upon our ability to develop, manufacture and sell new products which meet such changes.

Government and Regulatory Changes: The development of the alternate fuel industry is driven in part by government laws and regulations concerning the environment, government initiatives concerning greenhouse gases and climate change, and government funding for the alternate fuel industry. Changes in such laws and regulations, initiatives and funding would have a material adverse effect on the alternate fuel industry, which in turn would have a material adverse effect on our operations and financial position.

Certification: Our products must be certified in the countries in which they are sold. Certification requirements are evolving and in some cases have not yet been established. While we believe that our products will meet these certification requirements, we cannot control if, when and how quickly this happens. The delay or failure to obtain certifications could have a material adverse effect on our operations and financial position.

Protection of Intellectual Property Rights: We depend upon the ownership and protection of our proprietary technology. We endeavor to protect our intellectual property rights through the registration of patents and the protection of trade secrets. However, the loss or unenforceability of any intellectual property rights could have a material adverse effect on our competitive position.

Dependence upon Suppliers: We depend upon certain key suppliers for the supply of key materials, components and services at competitive prices. We choose our key suppliers carefully and endeavor to enter into strategic alliances with them. However, the loss of any key supplier or pricing structure could have a material adverse effect on our costs, operations and financial position.

The Company currently has one major supplier of carbon fibre, Mitsubishi Rayon, who is also a significant shareholder of Dynetek. In 2008, the Company contracted additional supplies of carbon fibre and qualified the new products for use. The Company continues to seek to identify additional sources of carbon fibre that meet the Company's quality, certification, delivery and pricing requirements. However, any shortage or delay in obtaining carbon fibre or any significant increases in price for carbon fibre could have a material adverse effect on our operations, costs, contribution margins and financial position.

The Company currently has only one supplier for aluminum pipe. The Company continues to seek to identify additional sources of aluminum that meet the Company's quality, delivery and pricing requirements. Any delays in obtaining aluminum pipe or any significant increases in price for aluminum pipe could have a material adverse effect on our operations, costs, contribution margins and financial position.

Contribution Margins: Our contribution margin decreased from 20% in 2007 to 19% in 2008. Our ability to continue to generate EBITDA and positive cash flow from operations depends in part upon our ability to increase and maintain our contribution margins.

Dependence upon Key Personnel: We depend upon certain key management, operations and research and development personnel. We endeavor to obtain written employment agreements with such personnel containing confidentiality and non-competition provisions. However, the loss of any such personnel or the unenforceability of such confidentiality and non-competition provisions could have a material adverse effect on our operations, competitive position and financial position.

The ability of the Company to attract and retain general labourers affects our ability to manufacture and deliver product to the Company's customers.

Credit Risks: We are exposed to credit risk for payments by customers for our products. We manage this risk by primarily dealing with large, credit worthy customers and governments and by obtaining credit approval before accepting a purchase order. However, a failure to pay by any significant customer could have a material adverse effect on our financial position.

Foreign Exchange: We are exposed to US Dollar to Canadian dollar exchange rate fluctuations, since a majority of our Canadian operation's accounts receivable are in US dollars. We endeavor to manage this risk by matching our US dollar balances to planned purchases in US dollars, and by keeping a minimum of the balance of our cash in US dollars. However, significant fluctuations in US dollar to Canadian dollar exchange rates have had and could continue to have a material adverse effect on our financial position.

We are also exposed to Euro to Canadian dollar exchange rate fluctuations, since a majority of our European operation's accounts receivable are in Euros. We endeavor to manage this risk by ensuring that our European payables are denominated in Euros. However, significant fluctuations in Euro to Canadian dollar exchange rates have had and could continue to have a material adverse effect on our financial position.

Product Liability and Insurance: We carry insurance that we consider appropriate, considering the nature of risks and the costs of insurance. However, all such insurance is subject to deductibles and exclusions and is not always available for all risks or at affordable prices. An uninsured or excluded loss could have a material adverse effect on our financial position.

Research and Development: Dynetek's research and development programs are co-funded with major OEMs and government (NRCan). The funding from the OEMs for the research and development programs is recorded as research and development revenue based on billing milestones outlined in the contracts. This can result in timing differences between when costs are incurred and funding is received. The ability of Dynetek to generate EBITDA and positive cash flow from operations for any specific quarter may depend upon whether the research and development revenue exceeds costs incurred in the period.

Transfer Pricing: Dynetek has adopted transfer pricing practices for product transfers between its Canadian and European operations that it believes comply with transfer pricing rules and regulations of the applicable tax authorities. However, any challenge of such transfer pricing practices by tax authorities could have a material adverse effect on Dynetek's tax and financial position.

Length of Sales Cycle: Our current sales cycle is approximately 16 weeks from the signature of purchase order to the delivery of product to the customer. Any increase in such sales cycle due to delays in obtaining raw materials or components, manufacturing or shipping could have a material adverse effect on our operations, competitive position and financial position.

Disclosure Controls and Procedures and Internal Control over Financial Reporting

Disclosure controls and procedures are designed to provide reasonable assurance that material information is gathered and reported to senior management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding public disclosure.

Management including the Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures as of December 31, 2008. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures, as defined in Multilateral Instrument 52-109 Certificate of Disclosure in Issuer's Annual and Interim Filings ("MI 52-109"), as of December 31, 2008 are effective to provide reasonable assurance that the information required to be disclosed in reports that are filed or submitted under Canadian Securities legislation are recorded, processed, summarized and reported within the time period specified in those rules.

The CEO and CFO are responsible for designing internal control procedures over financial reporting ("ICFR") or causing it to be designed under their supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of Financial Statements for external purposes in accordance with Canadian generally accepted accounting principles (GAAP).

No material changes in the Company's internal controls and procedures have occurred during the Company's most recent interim period, which have materially affected, or are reasonably likely to materially affect, the Company's ICFR.

Management including the Chief Executive Officer and Chief Financial Officer, has evaluated the design and the effectiveness of the Company's ICFR as of December 31, 2008. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that, similar to other small companies, certain inherent weaknesses in the Company's ICFR exist due to its small size and its inability to segregate incompatible functions. The risk associated with these weaknesses is associated with the Company's ability to safeguard assets.

These weaknesses in ICFR result in a more than remote likelihood that a material misstatement would not be prevented or detected on a timely basis.

The existence of these weaknesses is being compensated for by senior management review to mitigate the risk of material misstatement. The Company currently has no plans to fully remediate these weaknesses, however, the Company does continue to take steps to augment and improve the design of procedures and controls impacting these areas of weakness in ICFR. Management believes that it is not currently economically feasible to achieve complete segregation of incompatible duties. It should be noted that a control system, no matter how well conceived or operated, can only provide reasonable assurance, not absolute assurance, that the objectives of the control system are met.

International Financial Reporting Standards

The Canadian Accounting Standards Board confirmed in February 2008 that publicly accountable entities will be required to adopt International Financial Reporting Standards (IFRS) for interim and annual financial statements beginning January 1, 2011. Dynetek has initiated plans to convert its basis accounting to IFRS and is in the process of evaluating the impact that the conversion will have on the financial results of the Company. The Company has concentrated on identifying differences in the basis of accounting in accounts determined to be significant to the Company's operations. When this identification of differences is completed, the Company will advance with the development of specific accounting policies and implementation plans. It is anticipated this process will continue throughout 2009. Areas of interest for the Company include accounting for capital and intangible assets and revenue recognition. During the transition to IFRS, further disclosures regarding the financial and operational impacts to the Company will be made.

Oversight role of Audit Committee

The Audit Committee reviews, with Management and the external auditor, the Company's quarterly MD&A and related consolidated financial statements and recommends them for approval by the Board of Directors. The external auditor periodically prepares a report for Management on internal control weaknesses noted, if any, identified during the course of the auditor's annual audit, which is reviewed by the Audit Committee.

Safety and Environment

Dynetek employees' safety is of paramount concern in all facets of our operations and in all regions where we operate. The Company has developed and rigidly enforces formal safety policies and procedures. The Company's policy is to operate its business in a manner that maintains compliance with the relevant safety legislation, and preventive action is taken to satisfy ourselves that safety hazards do not exist. Dynetek uses environmentally friendly products that pose less of a safety risk or risk of pollution wherever possible. The Company does not emit any greenhouse gases during the production of its product.

Outlook

The Company remains committed to continuing to grow its CNG and Hydrogen revenue streams globally through targeted marketing initiatives and introduction of new products which utilize CNG or Hydrogen technology.

In 2009, the Company expects to continue its focus on international revenue growth opportunities in the CNG market for bus and heavy-duty truck applications and for bulk hauling of larger quantities of compressed gas. Economic and environmental factors worldwide are contributing to growth in natural gas demand for vehicles as follows:

- The high growth rate in demand for natural gas stems from the comparative advantages of natural gas compared to diesel, gasoline and bio-fuels;
- Natural gas is cleaner with less toxic emissions than diesel or gasoline and is currently less costly;
- A growing natural gas infrastructure. Continuing investment in infrastructure is adding to the number of compressed natural gas refueling centers; and
- CNG will continue to develop as a transportation fuel as it currently is less costly than oil based fuels which are also becoming supply constrained in developing economies.

The above trends and related market opportunities were expected to create a positive intermediate and longer-term outlook for Dynetek. However, recent turbulence in the global financial markets has negatively impacted the financial abilities of OEMs. This condition could impact Dynetek's future sales to OEMs. Current reports are new vehicle sales have substantially decreased for the automotive industry and the Company has exposure to the automotive industry through transactions with various OEMs. It cannot be reasonably determined if or when this impact will be resolved. The Company will continue to monitor this particular segment in 2009.

The Company is currently reviewing strategies to grow the compressed gas system revenue and is evaluating additional product development and sales in order to penetrate price sensitive markets that are actively developing CNG as a transportation fuel. To accomplish this product development and market penetration, the Company will also be evaluating strategic alliances, new joint ventures, new partners and customers, licensing arrangements, new manufacturing techniques and additional product offerings. The Company is committed to change where appropriate to attain its goals of revenue growth and net income.

Dynetek expects to incur a loss and negative EBITDA in the first quarter of 2009 due to slowdown in the demand for its products as a result of the worldwide financial market crisis. Currently, Dynetek is seeing an increase in customer enquiries and expects to see an increase in new orders in the second quarter of 2009. The Company will continue to manage its costs responsibly and improve production efficiencies where possible.

The Company will continue to develop its hydrogen storage technologies to assist in commercializing the hydrogen economy. This includes working with OEMs to implement their hydrogen vehicle strategies and sales to energy-related companies that require mobile refueling units, stationary storage for refueling, and bulk hauling of hydrogen.

Reconciliation of non-GAAP Financial Measures

EBITDA

GAAP Measures from Consolidated Statements of Net Loss and Comprehensive Loss and Deficit	Three months ended December 31		Year ended December 31	
(thousands of Canadian dollars – unaudited)	**2008**	2007	**2008**	2007
Net loss and Comprehensive Loss	**(366)**	(2153)	**(2942)**	(4707)
Future income tax	**-**	-	**-**	2355
Stock based compensation	**26**	162	**89**	247
Net foreign exchange (gain) loss	**(263)**	197	**(767)**	345
Depreciation and Amortization	**775**	1082	**2672**	2958
Interest	**113**	60	**395**	219
Non-GAAP measure - EBITDA	**285**	(652)	**(553)**	1417

Working Capital and Non-Cash Working Capital

GAAP Measures from Consolidated Balance Sheets (thousands of Canadian dollars – unaudited)	**December 31, 2008**	**December 31, 2007**
Accounts receivable	**6141**	5121
Inventory	**12994**	10304
Prepaids and other	**437**	557
Accounts payable and accrued liabilities	**(6420)**	(4127)
Operating bank line	**-**	-
Deferred revenue	**(1051)**	(1403)
Current portion of long-term debt and capital leases	**(536)**	(370)
Non-GAAP measure – Non-Cash Working Capital	**11565**	10082
Add: Cash and cash equivalents and Restricted cash	**4205**	1756
Non-GAAP measure - Working Capital	**15770**	11838

Management believes that presentation of these non-GAAP financial measures provides useful information to investors and shareholders._

Additional Information

Additional information relating to Dynetek, including Dynetek's Annual Information Form, is on SEDAR at www.sedar.com.