



Dynetek Industries Ltd.
STORING ENERGY'S FUTURE

Consolidated Financial Statements of

DYNETEK INDUSTRIES LTD.

Years ended December 31, 2010 and 2009
(audited)

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Dynetek Industries Ltd.

We have audited the accompanying consolidated financial statements of Dynetek Industries Ltd., which comprise the consolidated balance sheets as at December 31, 2010 and 2009, and the consolidated statements of operations, comprehensive loss and deficit, and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Dynetek Industries Ltd. as at December 31, 2010 and 2009 and the results of its operations and cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(signed) "Deloitte & Touche LLP"
Chartered Accountants

Calgary, Alberta
March 28, 2011

Dynetek Industries Ltd.
Consolidated Balance Sheets
December 31

(thousands of Canadian dollars)

	2010	2009
ASSETS		
Current assets		
Cash	962	1,040
Restricted cash (note 3)	408	408
Accounts receivable (note 4)	3,737	5,628
Inventory (note 5)	10,593	10,393
Prepaid expenses and other	687	442
	16,387	17,911
Intangible assets (note 6)	3,610	4,452
Capital assets (note 7)	13,270	14,017
	33,267	36,380
LIABILITIES		
Current liabilities		
Bank indebtedness (note 8)	856	–
Accounts payable and accrued liabilities	3,651	2,915
Deferred revenue	483	429
Current portion of long-term debt and capital lease (note 9)	284	841
	5,274	4,185
Long-term debt and capital lease (note 9)	5,078	6,491
Commitments (note 14)		
Shareholders' equity		
Share capital (note 11)	52,423	52,422
Contributed surplus (note 13)	3,005	2,830
Deficit	(32,513)	(29,548)
	22,915	25,704
	33,267	36,380

See accompanying notes to the consolidated financial statements

Approved by the Board of Directors

“John R. Bobenic”
 Director

“Christian Rasche”
 Director

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

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

	2010	2009
Revenue and other income		
Sales	22,272	26,380
Research and development	3,060	3,811
Investment and other income (note 15)	1,495	68
	26,827	30,259
Expenses		
Cost of goods sold	20,342	25,011
General and administrative	4,624	3,525
Marketing	1,383	1,596
Interest	350	335
Depreciation	1,194	1,324
Amortization	1,099	1,266
Loss on equipment disposal	2	299
Foreign exchange loss	623	222
Stock based compensation (note 12)	175	103
	29,792	33,681
Loss before taxes	(2,965)	(3,422)
Provision for income taxes (note 10)	-	-
NET LOSS AND COMPREHENSIVE LOSS	(2,965)	(3,422)
Deficit, beginning of year	(29,548)	(26,126)
Deficit, end of year	(32,513)	(29,548)
Per Share Information		
Loss per share (basic and diluted) (note 11(d))	(0.14)	(0.16)
Weighted average number of common shares outstanding	20,958,686	20,940,062

See accompanying notes to the consolidated financial statements

Dynetek Industries Ltd.
Consolidated Statements of Cash Flows
Years Ended December 31

(thousands of Canadian dollars)

	2010	2009
Cash flows provided by (used for) operating activities		
Net Loss	(2,965)	(3,422)
Items not involving cash		
Depreciation	1,194	1,324
Amortization	1,099	1,266
Stock based compensation	175	103
Contribution agreements settled (note 15)	(1,478)	–
Loss on equipment disposal	2	299
Net inventory write-down	68	–
Unrealized foreign exchange loss	274	696
	(1,631)	266
Changes in non-cash working capital		
Accounts receivable	1,891	513
Inventory	(268)	2,503
Prepaid expenses and other	(245)	(5)
Accounts payable and accrued liabilities	736	(3,505)
Deferred revenue	54	(622)
Unrealized foreign exchange gain relating to non-cash working capital	(149)	(554)
	388	(1,404)
Investing Activities		
Additions to intangible assets	(257)	(750)
Additions to capital assets	(449)	(165)
	(706)	(915)
Financing Activities		
Cash received on exercise of stock options	1	4
Repayment of long-term debt	(445)	(231)
	(444)	(227)
Unrealized foreign exchange loss on cash held in foreign currency	(172)	(211)
Decrease in cash (bank indebtedness)	(934)	(2,757)
Cash (bank indebtedness), beginning of year	1,040	3,797
Cash (bank indebtedness), end of year	106	1,040

See accompanying notes to consolidated financial statements

Dynetek Industries Ltd.

Notes to Consolidated Financial Statements

For the years ended December 31, 2010 and 2009

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

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 2010 and 2009.

(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, intercompany profits (losses) unrealized in inventory, net recoverable amounts of long lived and intangible assets, amortization periods and useful lives of capital and intangible assets, valuation of allowance for future income tax, going concern assessment, and the fair value of stock options granted.

(d) Cash and cash equivalents

Cash and cash equivalents consists 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, 2010 and 2009, the Company had no cash equivalents, other than as described in note 3.

(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. Cost of inventories is 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. 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.

(f) Intangible assets

Intangible assets are comprised of patents, certification and project 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. Project costs represent capitalized project development costs and amortized over the period of benefit.

Intangible assets are tested for impairment when conditions exist which may indicate that the estimated future net undiscounted cash flows from the asset will be insufficient to cover its carrying value.

Dynetek Industries Ltd.
Notes to Consolidated Financial Statements
For the years ended December 31, 2010 and 2009

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

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	
Manufacturing equipment – capital lease	straight-line	10 years
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 undiscounted future cash flow amount is less than the carrying amount of the asset, an impairment is recognized in the consolidated statement of operations, comprehensive loss and deficit for the difference between the carrying value and the discounted future cash amount.

(i) Research costs

Research 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 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 contribution

Government contributions are received from Natural Resources Canada (“NRCan”) and recorded as non-interest bearing long-term debt (see note 9). When NRCan and the Company agree that certain conditions are met under each contribution agreement or if the agreement has expired, the remaining debt balance may be recognized as settled and recorded as income (see note 15).

(l) Revenue recognition

Cylinder and system revenue is recognized when finished goods are shipped and invoiced to the customer and collection is reasonably assured. Research and development revenue is generated by projects co-funded with OEMs. This revenue is recognized when contractual deliverables are met and collection is reasonably assured. Timing differences can occur between when costs are incurred and when revenue is earned.

Dynetek Industries Ltd.

Notes to Consolidated Financial Statements

For the years ended December 31, 2010 and 2009

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

2. Significant accounting policies (continued)

(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 its financial information is translated into Canadian dollars using the temporal method. Translation adjustments are reflected in the consolidated statements of operations, comprehensive loss and deficit.

(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 12).

(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.

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

Cash	Held-for-trading
Restricted cash	Held-for-trading
Accounts receivable	Loans and receivables
Accounts payable and accrued liabilities	Other liabilities
Bank indebtedness	Other liabilities
Long-term debt and capital lease	Other liabilities

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 the consolidated statement of operations, comprehensive loss and deficit.

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 the consolidated statement of operations, comprehensive loss and deficit.

Dynetek Industries Ltd.
Notes to Consolidated Financial Statements
For the years ended December 31, 2010 and 2009

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

2. Significant accounting policies (continued)

(q) Business combinations, consolidated financial statements and non-controlling interests

Business combinations with an acquisition date after January 1, 2011 will be required to adopt CICA Handbook Section 1582, Business Combinations. The effect of this standard requires additional use of fair value measurements, recognition of additional assets and liabilities, and increased disclosure. Handbook Section 1601, Consolidated Financial Statements and Section, 1602, Non-Controlling interests will be adopted in conjunction with Section 1582. These two standards require a change in the measurement of non-controlling interest and presentation as part of shareholders' equity on the balance sheet. In addition, the income statement of the controlling parent will include 100 percent of the subsidiary's results and present the allocation between the controlling interest and non-controlling interest. Changes from adopting Section 1582 will be applied prospectively and changes from adopting Sections 1601 and 1602 will be applied retrospectively.

(r) Comparatives

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

3. Restricted cash

The Company has \$408 thousand (2009 - \$408 thousand) in restricted cash, invested in a guaranteed investment certificate bearing interest at 0.15% per annum (2009 – 0.15% per annum), representing funds used as security for loans between an officer and a director of the Company and a major chartered bank for the purchase of common shares of the Company.

4. Accounts receivable

	2010	2009
Accounts receivable – trade	3,098	4,582
Accounts receivable – other	653	1,046
Allowance for doubtful accounts	(14)	–
	3,737	5,628

The aging of trade receivables as at December 31, 2010 is set out below:

Current	1,465
Past Due 0 – 30 days	1,034
Past Due 31 – 60 days	343
Past Due over 60 days	256
	3,098

The Company evaluates the ability to collect each receivable by counterparty. At December 31, 2010, a provision for doubtful accounts receivable of \$14 thousand (2009 – nil) was recorded and the Company believes all remaining receivables are collectable. See note 18(a) for a description of the Company's management of credit risk. Accounts receivable – trade are pledged as security for the Company's operating bank line of credit under the general security agreement (see note 8). Of the Accounts receivable – trade amounts above not classified as current, \$1.2 million has been collected subsequent to December 31, 2010 and until March 23, 2011.

Accounts receivable - other mainly consists of goods and services and value added tax receivables and government funding receivables.

Dynetek Industries Ltd.
Notes to Consolidated Financial Statements
For the years ended December 31, 2010 and 2009

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

5. Inventory

	2010	2009
Raw materials	2,814	2,126
Work-in-progress	4,424	4,815
Finished goods	3,355	3,452
	10,593	10,393

The Company measures its inventory at the lower of cost and net realizable value. Cost includes the costs associated with delivering 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. 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 realize the sale. The amount of inventory expensed in 2010 was \$14.1 million (2009 - \$18.5 million).

During the year ended December 31, 2010, the Company provided for a write-down of \$87 thousand (2009 – \$97 thousand) of inventory to net realizable value. In 2010, there was a reversal of a write-down previously taken for \$19 thousand (2009 – nil). Inventory is pledged as security for the Company's operating bank line under the general security agreement (see note 8).

6. Intangible assets

	2010			2009		
	Cost	Accumulated Amortization	Net book value	Cost	Accumulated Amortization	Net book value
Patents	3,222	1,429	1,793	3,222	1,258	1,964
Certification costs	5,623	3,877	1,746	5,422	2,949	2,473
Project costs	71	–	71	15	–	15
	8,916	5,306	3,610	8,659	4,207	4,452

7. Capital assets

	2010			2009		
	Cost	Accumulated depreciation	Net book value	Cost	Accumulated depreciation	Net book value
Land	514	–	514	514	–	514
Building and leaseholds	4,129	1,724	2,405	4,120	1,582	2,538
Manufacturing equipment	19,249	10,256	8,993	19,022	9,380	9,642
Manufacturing equipment - capital lease ^(a)	669	205	464	669	153	516
Office furniture and other equipment	1,320	848	472	1,275	767	508
Computer hardware and software	896	636	260	871	591	280
Manufacturing equipment under construction	162	–	162	19	–	19
	26,939	13,669	13,270	26,490	12,473	14,017

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 lease obligation (see note 9) as at December 31, 2010 is a winding machine located at Dynetek Germany with a cost of \$669 thousand less accumulated depreciation of \$205 thousand (2009 - \$153 thousand).

Dynetek Industries Ltd.
Notes to Consolidated Financial Statements
For the years ended December 31, 2010 and 2009

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

8. Bank indebtedness

	2010	2009
Operating line of credit drawn	1,750	245
Less: Canadian cash in bank	894	679
Bank indebtedness	856	–

The Company has a \$2.75 million (2009 - \$2.75 million) operating line of credit with a major Canadian chartered bank, with which it has cash on deposit. Amounts drawn are payable on demand and bear interest at the bank prime rate plus 2.0% per annum. The operating line of credit is secured by a general security agreement, a guarantee from Dynetek Europe GmbH and a collateral mortgage. At December 31, 2010, the Company has drawn \$1.75 million on this facility (December 31, 2009 – \$245 thousand). During 2010, \$67 thousand (2009 - \$34 thousand) of interest and standby fees were paid on the operating line of credit.

At December 31, 2010 the credit agreement requires the Company to maintain a working capital ratio above 2.5:1.0, a debt to tangible net worth ratio not to exceed 1.5:1.0 and shareholders' equity in excess of \$22.0 million. Tangible net worth is defined as shareholders' equity less investments in affiliates and the carrying value of intangible assets. All financial covenants under the credit agreement were in compliance at December 31, 2010 and 2009.

On January 5, 2011, the Company negotiated a revised credit agreement with its lender requiring the Company to maintain a working capital ratio above 2.0:1.0 and shareholders' equity in excess of \$19.0 million compared to the former financial covenants at December 31, 2010 where the Company was required to maintain a working capital ratio above 2.5:1.0 and shareholders' equity in excess of \$22.0 million.

9. Long-term debt and capital lease

	2010	2009
Government contribution ^(a)	537	2,014
Capital lease obligation ^(b)	271	430
Mortgage ^(c)	4,554	4,888
Total debt and capital lease	5,362	7,332
Less: current portion	(284)	(841)
Long term debt and capital lease	5,078	6,491

- (a) Unsecured, non-interest bearing with repayment based on 3% of product related sales, payable in the following fiscal period. Repayments of amounts owing are based on 3% of future sales of specific related commercial products in each calendar year. As such, the Company cannot determine the amount to be paid over the next five years. At December 31, 2010, certain conditions were met under the contribution agreements constituting \$1.5 million (2009 – nil) as settlement of debt (see note 15).
- (b) The capital lease obligation originated from the Company completing a sale-leaseback for manufacturing assets in 2007. 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 14 thousand Euro. During 2010, \$24 thousand (2009 – \$39 thousand) of interest was paid. Current portion of the capital lease obligation is \$0.1 million at December 31, 2010.
- (c) The Company completed a \$5.0 million mortgage of its Calgary production facility with the Business Development Bank of Canada in 2008. The mortgage has a term of 15 years and bears interest at the bank prime rate plus 2.0% per annum. Principal repayments of the mortgage began in September 2009 and the Company has exercised its option to extend repayment of principal for six months beginning February 2011. During 2010, \$0.2 million (2009 - \$0.2 million) of interest was paid on the mortgage loan. Current portion of the mortgage loan is \$0.2 million at December 31, 2010.

Dynetek Industries Ltd.
Notes to Consolidated Financial Statements
For the years ended December 31, 2010 and 2009

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

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

The fair value of long-term debt and the capital lease is disclosed in note 18(d).

The Company's principal repayment obligations as at December 31, 2010 on the mortgage and capital lease obligation over the next five years are as follows:

2011	284
2012	438
2013	385
2014	334
2015	334
Thereafter	3,050
Total repayment obligation	4,825

10. Provision for income taxes

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

	2010	2009
Loss before income taxes	(2,965)	(3,422)
Effective income tax rate	29.9%	29.5%
Expected income tax recovery	(886)	(1,009)
Add (deduct):		
Non-deductible stock based compensation	52	30
Losses not recognized	834	979
Income taxes	-	-

The components of the net future income tax asset at December 31, 2010 and 2009 are as follows:

	2010	2009
Research and development costs	2,093	1,861
Capital assets	1,909	1,738
Non-capital losses	1,407	1,861
Cumulative eligible capital and other	278	45
Valuation allowance	(5,687)	(5,505)
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 \$3.9 million, expiring over a period from 2014 through 2030 with 25% expiring in 2014 – 2015 and 75% expiring in 2028 – 2030. The Company has investment tax credits carried forward in Canada of \$2.5 million, expiring over a period from 2021 through 2030 with 60% expiring in 2021 – 2025 and 40% expiring in 2026 - 2030. The European operations have corporate and trade income tax losses carried forward of \$1.7 million (EUR 1.3 million) and \$1.2 million (EUR 0.9 million) respectively, each of which can be utilized over an indefinite period.

Dynetek Industries Ltd.
Notes to Consolidated Financial Statements
For the years ended December 31, 2010 and 2009

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

11. 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	Dollars
Balance December 31, 2008	20,936,500	52,418
Stock options exercised	20,000	4
Balance December 31, 2009	20,956,500	52,422
Stock options exercised	3,000	1
Balance December 31, 2010	20,959,500	52,423

(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, 2010 there are 592,564 warrants (2009 – 593,792) outstanding with 581,730 (2009 – 580,502) having vested. The vested warrants will expire over a period from 2011 through 2013.

(d) **Income per share**

The weighted average number of shares outstanding for purposes of calculating basic and diluted loss per share at December 31, 2010 was 20,958,686 (2009 – 20,940,062). The dilutive effect of stock options was anti-dilutive for the years ended December 31, 2010 and 2009, resulting in 205,225 (2009 – 112,737) being excluded from calculating diluted loss per share and using the same weighted average common shares outstanding on both a basic and diluted basis.

12. Stock based compensation

The Company has one employee stock option plan under which certain employees and directors are eligible to receive grants. Under the stock option plan, the granted stock options will vest to the holder over a three or four year period and the holder has the right to exercise those stock options for a period of 5 to 10 years from the date of grant. Any options that are exercised, expire unexercised, terminated, forfeited or cancelled are available to be re-granted under the plan.

The Company's stock option plan was amended on June 16, 2010 subsequent to receiving shareholder approval at the Company's annual and special meeting. The major amendments were to increase the number of common shares that could be granted under the plan and increase the amount of common shares that can be issued to insiders of the Company. The amended maximum number of common shares that can be issued is the "Share Cap" which is defined as the greater of 3,252,622 common shares or 10% of the issued and outstanding common shares at the date of grant. Prior to the amendment, the maximum number of common shares that could be issued was 2,306,625, representing approximately 11% of the 20,959,500 common shares issued. In addition, the amended number of common shares that may be issued to insiders of the Company is the "Share Cap".

Dynetek Industries Ltd.
Notes to Consolidated Financial Statements
For the years ended December 31, 2010 and 2009

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

12. Stock based compensation (continued)

At December 31, 2010, 2,889,880 (2009 – 1,214,500) options to purchase common shares were outstanding. An additional 362,742 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 Option
Balance December 31, 2008	1,561,500	\$1.01
Options granted	150,000	\$0.23
Options exercised	(20,000)	(\$0.20)
Options forfeited	(477,000)	(\$1.83)
Balance December 31, 2009	1,214,500	\$0.60
Options granted	1,740,880	\$0.32
Options exercised	(3,000)	(\$0.20)
Options forfeited	(62,500)	(\$1.84)
Balance December 31, 2010	2,889,880	\$0.41

Details of the stock options outstanding at December 31, 2010 are as follows:

Range of Exercise Prices	Options Outstanding at December 31, 2010		Options Exercisable at December 31, 2010		
	Number of Options	Weighted average remaining contractual life	Weighted average exercise price	Number of Options	Weighted average exercise price
\$0.20-\$1.50	2,714,880	4.3	\$0.28	612,012	\$0.20
\$1.51-\$2.35	80,000	2.9	\$1.75	80,000	\$1.75
\$2.36-\$2.95	95,000	2.0	\$2.95	95,000	\$2.95
	2,889,880	4.2	\$0.41	787,012	\$0.69

Details of the stock options outstanding at December 31, 2009 are as follows:

Range of Exercise Prices	Options Outstanding at December 31, 2009		Options Exercisable at December 31, 2009		
	Number of Options	Weighted average remaining contractual life	Weighted average exercise price	Number of Options	Weighted average exercise price
\$0.20-\$1.50	994,500	4.0	\$0.21	333,504	\$0.20
\$1.51-\$2.35	105,000	3.9	\$1.75	101,667	\$1.75
\$2.36-\$2.95	115,000	3.0	\$2.95	115,000	\$2.95
	1,214,500	3.9	\$0.60	550,171	\$1.06

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12. Stock based compensation (continued)

For the year ended December 31, 2010, 1,740,880 stock options (2009 – 150,000 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:

	2010	2009
Weighted average risk-free interest rate	0.82%	0.49%
Weighted average expected life	5 years	5 years
Estimated volatility in the market price of the common shares	112%	108%
Expected dividend yield	0%	0%

The weighted average fair value per option granted in 2010 is \$0.27 (2009 - \$0.19).

13. Contributed surplus

The following table summarizes information about contributed surplus.

Balance December 31, 2008	2,727
Stock-based compensation expense	103
Balance December 31, 2009	2,830
Stock-based compensation expense	175
Balance December 31, 2010	3,005

14. Commitments

The Company has obligations under various operating leases which requires the following minimum annual payments during the respective fiscal years:

2011	307
2012	286
2013	284
2014	47

15. Investment and other income

The settlement and expiration of Natural Resources Canada contribution agreements resulted in the reduction of long-term debt of \$1.5 million (2009 – nil) which has been recorded as Investment and other income. The Company originally recorded the contribution agreements from Natural Resources Canada as long-term debt as the contribution amounts were unsecured, non-interest bearing and repayable annually based on 3% - 5% of related product sales. Certain conditions of these contribution agreements were met constituting settlement of long-term debt during 2010 and one other contribution agreement expired in 2010.

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16. Supplemental cash flow information

	2010	2009
Interest received	7	7
Interest paid	309	288
Income taxes paid	–	–

17. Related party transactions

- (a) For the year ended December 31, 2010, the Company purchased under normal terms and conditions \$1.7 million, (2009 - \$4.3 million) of material used in the production of lightweight fuel storage systems from Mitsubishi Rayon Corporation, a shareholder of the Company.
- (b) During 2009, the Company's Board of Directors agreed to contract the services of its Chairman to provide financial consulting and strategic planning services to the Company. The agreement for the services was effective from August 2009 through January 2010. Under this contract, the Company paid \$29 thousand to a company controlled by the Chairman in 2010 (2009 - \$28 thousand). The Company recognized this amount as a general and administrative expense. Beginning February 5, 2010, the Company has employed its Chairman as Executive Chairman.

All related party transactions were in the normal course of business and have been measured at the exchange amount.

18. Financial risk management and financial instruments

The objective of the Company's financial risk management practises is to reduce volatility in cash flow and earnings. The Company does not use derivative financial instruments to manage its risks.

(a) Credit risk

The Company is exposed to credit risk through: the possibility that certain customers may default on their financial obligations; concentration of transactions with the same party; or concentration of financial obligations which have similar economic characteristics which can be similarly affected by changes in economic conditions.

Customers are granted unsecured credit 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. The Company can request collateral such as a guarantee or letter of credit, before acceptance of a purchase order. In addition, certain European customers' accounts are insured through Export Development Canada. Management believes its concentration of credit risk with respect to accounts receivable is limited due to the credit quality of its customers.

At December 31, 2010 and 2009, the Company's cash and restricted cash is on deposit with a Canadian chartered bank and two German financial institutions. Trade accounts receivable are normally from OEMs, the majority being bus manufacturers. At December 31, 2010, the Company has trade receivables outstanding from three customers (2009 – three customers) each greater than 10% of the Company's outstanding trade receivable balance.

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18. Financial risk management and financial instruments – credit risk (continued)

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 for cash, restricted cash and accounts receivable is represented by the carrying amount on the balance sheet.

The Company assesses on a quarterly basis whether there has been any impairment of financial assets. As at December 31, 2010 and 2009, management determined there was no impairment of any of the financial assets of the Company, other than as reflected in note 4.

(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, 2010, the Company has a \$2.75 million (2009 - \$2.75 million) line of credit with a major Canadian chartered bank. Amounts drawn on the operating bank line are payable on demand and bear interest at the bank's prime rate plus 2.0% per annum. The Company has drawn \$1.75 million on this credit facility at December 31, 2010 (2009 – \$245 thousand). The credit agreement requires the Company to be below a specified tangible net worth ratio, and above a specified working capital ratio and maintain shareholders' equity above \$22 million. On January 5, 2011, the Company negotiated a revised credit agreement with its lender reducing the former working capital ratio and maintaining shareholders' equity in excess of \$19.0 million (see note 8).

The Company has a \$4.6 million mortgage on 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's prime rate plus 2.0% per annum. Repayment of principal began in September 2009 and an option to extend repayment of principal for an additional six months was elected in February 2011. Another option to extend repayment of principal for an additional six months is available under the agreement.

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.

Based on the outstanding amounts as at December 31, 2010, a 0.25% change in the interest rate would have changed the net loss of the Company during the year ended December 31, 2010 by \$15 thousand (2009 - \$12 thousand) before tax effect. 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 did not use foreign exchange rate hedges or fixed foreign exchange contracts to manage the Company's exposure to foreign exchange rate fluctuations for the years ended December 31, 2010 and 2009.

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18. Financial risk management and financial instruments – Foreign currency risk (continued)

Based on foreign denominated financial instruments outstanding as at December 31, 2010, a \$0.05 increase or decrease in the CAD / Euro exchange rate would have changed the net loss of the Company by \$0.1 million (2009 - \$0.2 million) before tax effect. 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.

Based on foreign denominated financial instruments outstanding as at December 31, 2010, a \$0.05 increase or decrease in the CAD / USD exchange rate would have changed the net loss of the Company by \$0.3 million (2009 - \$0.2 million) before tax effect. 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 meets its liquidity requirements by preparing and monitoring detailed forecasts of cash flows from operations and analyzing its investing and financing requirements. Operating cash requirements can fluctuate due to amounts projected to complete its existing capital expenditure program and adjustments to input variables. These input variables include but are not limited to: available bank lines, order backlog from existing customers, ability of the Company to develop new customers, raw material pricing, competitors entering the market. As these variables change, liquidity risks may necessitate the need for the Company to conduct equity issues or obtain project debt financing.

As described in note 8, the Company has a short-term operating bank line in place to meet short-term fluctuations in cash requirements.

The following table provides Dynetek's mortgage and capital lease obligations, including interest, at December 31, 2010 for each of the next five years and thereafter.

	Total	2011	2012	2013	2014	2015	Thereafter
Capital lease obligation	297	133	111	53	–	–	–
Mortgage obligation	6,228	392	546	529	512	496	3,753
Total contractual obligations	6,525	525	657	582	512	496	3,753

(d) Fair values of financial instruments

The Company's financial instruments are classified as cash and restricted cash, accounts receivable, accounts payable and accrued liabilities, bank indebtedness, capital lease and long-term debt. All financial instruments are measured at amortized costs except for cash and restricted cash which are measured at fair value. The carrying value and fair value of these financial instruments at December 31, 2010 is disclosed below by financial instrument category.

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18. Financial risk management and financial instruments – Fair value of financial instruments (continued)

Financial Instrument	2010 Carrying Value	2010 Fair Value	2009 Carrying Value	2009 Fair Value
Assets held for Trading				
Cash and restricted cash	1,370	1,370	1,448	1,448
Loans and Receivables				
Accounts receivables	3,737	3,737	5,628	5,628
Other Liabilities				
Accounts payable and accrued liabilities	3,651	3,651	2,915	2,915
Bank indebtedness	856	856	–	–
Contribution agreement ^(a)	537	509	2,014	1,967
Mortgage	4,554	4,554	4,888	4,888
Capital lease ^(b)	271	282	430	459

(a) The fair value of the contribution agreement is measured using the Company's risk-free cost of borrowing at December 31, 2010, which was 1.09% (2009 – 0.65%) per annum.

(b) The fair value of the capital lease is measured using the Company's cost of borrowing for equipment at December 31, 2010 and 2009, which was Euribor plus 3% per annum.

The three levels of the fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value are described below:

Level 1: Values based on unadjusted quoted prices in active markets that are accessible at the measurement date for identical assets or liabilities.

Level 2: Values based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full term of the asset or liability.

Level 3: Values based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement.

The following table presents the Company's fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of December 31, 2010.

	Level 1	Level 2	Level 3	Total
Held for trading:				
Cash and restricted cash	1,370	-	-	1,370

The Company's fair value hierarchy for those assets and liabilities measured at fair value on a recurring basis as of December 31, 2009.

	Level 1	Level 2	Level 3	Total
Held for trading:				
Cash and restricted cash	1,448	-	-	1,448

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18. Financial risk management and financial instruments (continued)

(e) Supplier risk

The Company currently relies on one supplier for certain sizes of aluminum pipe. Suppliers are chosen carefully and the Company prefers entering into strategic alliances with suppliers who provide the raw materials. The loss of any supplier, including an inability to supply raw materials, and pricing structure could have a material adverse effect on the operations and financial position of the Company.

19. 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, long-term debt and capital lease less cash and is summarized in the table below:

	2010	2009
Shareholders' equity	22,915	25,704
Long-term debt and capital lease, including current portion	5,362	7,332
Cash	(962)	(1,040)
Total Capital	27,315	31,996

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 financial covenant ratios in the operating line of credit agreement, which requires the Company to meet three financial covenants (see note 8). The Company's overall strategy with respect to capital risk management for the year ended December 31, 2010 remained unchanged from the year ended December 31, 2009.

20. 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, 2010 and 2009. Revenues attributed to foreign countries are based on the location of the customer.

	2010	2009
Cylinder and system revenue:		
North America	6,920	5,532
European Union ^(a)	14,273	20,147
Other	1,079	701
	22,272	26,380

(a) 2010 revenue includes three customers who each comprises 10% or more (2009- three customers) of revenue from the European Union. In aggregate, the three customers comprise 71% (2009 – 63%) of European Union revenue.

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21. Subsequent event

On March 28, 2011, the Company finalized its negotiations of a revised credit agreement to its operating line of credit. The Company's lender agreed to increase the Company's operating line of credit from \$2.75 million to \$4.25 million, reducing to \$3.5 million on September 30, 2011. Amounts drawn on the operating line are repayable on demand and bear interest at the bank's prime rate plus 2.00% per annum. The operating bank line is secured by a general security agreement, a guarantee from Dynetek Europe GmbH, a guarantee from Export Development Canada in the amount of \$1.5 million and a collateral mortgage. The Company will be required to maintain a working capital ratio above 2.0:1.0, a debt to tangible net worth not to exceed 1.50:1.00 and shareholders' equity in excess of \$19.0 million.