



## Dynetek Reports 2010 Fourth Quarter and Year-End Results

**Calgary, Alberta, Canada – March 30, 2011** – Dynetek Industries Ltd. (“Dynetek”) reported today its results for the three months and year ended December 31, 2010. The full audited consolidated financial statements and MD&A have been filed on SEDAR at [www.sedar.com](http://www.sedar.com) and on Dynetek’s website at [www.dynetek.com](http://www.dynetek.com).

### FOURTH QUARTER OPERATIONAL HIGHLIGHTS

- Delivered 18 hydrogen systems to India to be used in 3-wheeled vehicles during the Commonwealth Games
- Developed and certified a new hydrogen cylinder to be used in pre-production hydrogen passenger vehicles for an Asian based Original Equipment Manufacturer (“OEM”)
- Received an order to develop and certify a new hydrogen cylinder to be used in pre-production passenger vehicles for a European based OEM

### Financial Highlights

(tabular amounts in thousands of Canadian dollars, except share capital and per share data)  
(unaudited)

	December 31			
	Three months ended		Year ended	
	2010	2009	2010	2009
Cylinder and system sales	4,256	4,893	22,272	26,380
Research and development income	1,279	912	3,060	3,811
Investment and other income	1,489	61	1,495	68
Total revenue	<b>7,024</b>	5,866	<b>26,827</b>	30,259
EBITDA <sup>(1)</sup>	47	(580)	478	127
Net loss	<b>(1,067)</b>	(2,025)	<b>(2,965)</b>	(3,422)
Net loss per common share (basic and fully diluted)	<b>(0.05)</b>	(0.09)	<b>(0.14)</b>	(0.16)
Cash	1,370	1,448	1,370	1,448
Non-cash working capital <sup>(1)</sup>	9,743	12,278	9,743	12,278
Working capital <sup>(1)</sup>	11,113	13,726	11,113	13,726
Total assets	33,267	36,380	33,267	36,380
Long-term debt and capital lease	5,078	6,491	5,078	6,491
Capital and intangible expenditures	(117)	163	706	915
Cash flow (deficiency) from operations	(119)	1,695	388	(1,404)
Weighted average common shares outstanding	<b>20,959,500</b>	20,940,062	<b>20,958,686</b>	20,940,062

<sup>(1)</sup> EBITDA, non-cash working capital and working capital are non-GAAP financial measures (“the non-GAAP Measures”). Dynetek defines EBITDA as earnings before interest, taxes, stock based compensation, foreign exchange gain or loss, loss on equipment disposal, 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. Dynetek believes the non-GAAP Measures provide investors and analysts with useful information so that they can better understand the financial results and perform a better analysis of Dynetek’s growth and profitability potential.

Cylinder and system sales for the year ended December 31, 2010 were \$22.3 million, a decrease of 16% from \$26.4 million in 2009. The decrease in 2010 sales reflects the appreciation of the Canadian dollar against the US dollar and Euro. Dynetek’s North American sales are primarily transacted in US dollars and European sales are primarily transacted in Euros. The Canadian dollar appreciated 11% against the US dollar and 16% against the Euro, comparing 2010 year-to-date foreign exchange rates against 2009.

(thousands of Canadian dollars)  
(unaudited)

	<b>December 31</b>			
	<b>Three months ended</b>		<b>Year ended</b>	
	<b>2010</b>	2009	<b>2010</b>	2009
<b>Cylinder and system sales</b>				
European operations	<b>1,897</b>	3,681	<b>14,151</b>	20,233
North American operations	<b>2,359</b>	1,212	<b>8,121</b>	6,147
	<b>4,256</b>	4,893	<b>22,272</b>	26,380

Cylinder and system sales for the three months ended December 31, 2010 were \$4.3 million, a decrease of \$0.6 million or 13% from the same period in 2009. Dynetek's North American operations increased its cylinder and system sales by \$1.1 million to \$2.3 million during the fourth quarter of 2010 versus the same quarter of 2009 due to a revised focus on North American sales. The European operations experienced a quarter-over-quarter decrease in cylinder sales of \$1.7 million as a greater percentage of European annual sales were delivered in the second quarter of 2010.

North American 2010 cylinder revenue increased 32% from \$6.1 million in 2009 to \$8.1 million due to Dynetek's revised North American sales focus. European 2010 cylinder revenue decreased 30% from \$20.2 million in 2009 to \$14.1 million due in part to lower than anticipated natural gas bus system tenders and in part to the 16% depreciation of the Euro against the Canadian dollar.

Research and development income for the three months ended December 31, 2010 was \$1.3 million, an increase of 40% or \$0.4 million from \$0.9 million in the same period of 2009. During the first nine months of 2010, research and development income was lower due to delays in start-up of major hydrogen contracts. Major deliverables under the hydrogen contracts began in the fourth quarter of 2010 and will continue into 2011. As a result of the delay in start-up, Research and development income for 2010 was \$3.1 million, down 20% or \$0.7 million from \$3.8 million in 2009.

Investment and other income for the three months ended December 31, 2010 was \$1.5 million, an increase of \$1.5 million from the same period of 2009. The increase was the result of the settlement and expiration of government contribution agreements. The contribution agreements were originally recorded as long-term debt. Certain conditions were met in the fourth quarter resulting in a conversion of the debt into income.

Gross margin on product sales for 2010 decreased to \$5.0 million from \$5.2 million in 2009 but as a percentage of sales increased to 20% in 2010 from 17%. The increase in gross margin percentage is a combination of improved input pricing and the shift in product sales mix from systems to cylinders.

Greater efficiencies on product sales and the conversion of the government contribution agreements in 2010 translated into improved EBITDA and net loss. 2010 EBITDA was \$0.5 million compared to \$0.1 million in 2009 and the 2010 net loss was \$3.0 million or net loss of \$0.14 per share compared to the 2009 net loss of \$3.4 million or net loss of \$0.16 per share.

Dynetek continues to maintain sufficient levels of working capital. At December 31, 2010, working capital was \$11.1 million compared to \$13.7 million at December 31, 2009.

## OUTLOOK

Dynetek is focused on generating increased worldwide sales from its commercialized compressed natural gas ("CNG") products and continuing to develop opportunities in the long-term hydrogen market through research and development activities with the global OEMs. Dynetek also continues to develop applications for its cylinders in the bulk transportation and stationary storage segments.

Geographic expansion will be the main driver of worldwide sales growth. While Europe and North America continue to provide the majority of near-term sales, Dynetek is actively expanding its presence in the Asia-Pacific market through its expanding joint venture relationships.

The Asia-Pacific market represents significant opportunity for revenue growth. Demand for CNG cylinders in the Asia-Pacific market is expected to increase materially over the next 5 years. The International Gas Union issued its report, "Report on Study Group 5.3 – Natural Gas Vehicles" at the IGU World Gas Conference in October 2009, which estimated that by 2015, there will be an additional 7.9 million natural gas vehicle equivalents in Asia-Pacific compared to only 0.8 million additional in Europe and 0.2 million additional in North America.

The Korean joint venture with Sejung Co. Ltd. represents significant progress in accessing this important market. In addition to Korea, Dynetek cylinders are now fully certified by the Chief Controller of Explosives ("CCoE") in India and a letter of intent with a potential joint venture partner in India has been executed. Dynetek expects to have the Indian joint venture finalized in the first half of 2011 with initial sales coming in the second half of 2011.

Discussions are underway with a potential Chinese joint venture partner and it remains the Company's intent to establish a Chinese joint venture by the end of 2011. For additional information on the Asia-Pacific market, please refer to the Chairman's Remarks at the Company's June 16<sup>th</sup>, 2010 Annual and Special Meeting as posted on the Company's web site, [www.dynetek.com](http://www.dynetek.com).

## **ABOUT DYNETEK**

Dynetek Industries Ltd. is a world-leading participant in the global clean technology space and a leader in the design and manufacture of proprietary fuel storage systems. Dynetek designs, produces and markets one of the lightest and most advanced fuel storage and refueling systems for compressed natural gas, low emission vehicles and compressed hydrogen, zero-emission fuel cell vehicles. Dynetek is recognized around the world for its solutions-of-choice to the alternate fuel vehicle sector, evidenced by strategic relationships with major manufacturers around the globe. Dynetek is listed on the Toronto Stock Exchange, symbol: DNK.

## **FORWARD LOOKING STATEMENTS AND non-GAAP MEASURES**

*In addition to historical information, this news release contains forward-looking statements and should be read in conjunction with the financial statements and related notes for the year ended December 31, 2010 and quarterly interim financial statements for 2010. Readers are encouraged to review the section in the annual 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.*

*Certain information set forth in this document contains forward-looking statements or information ("forward-looking statements"). Forward-looking statements are not based on historical facts, but rather reflect management's expectations regarding future plans and intentions, growth, results of operations, performance and business prospects and opportunities. The use of any of the words "plan", "expect", "project", "intend", "believe", "should", "anticipate", "estimate" or other similar words, or statements that certain events or conditions "may" or "will" occur are typically intended to identify forward-looking statements. Forward-looking statements contained in this document include, without limitation, expectations as to 2011 revenue and cylinder unit sales compared to 2010, timing of major deliverables under hydrogen contract, timing of finalization of Indian joint venture, timing of establishment of Chinese joint venture and commencement of sales and expected increase in demand for cylinders.*

*Forward-looking statements are based on a number of factors and assumptions which have been used to develop such statements but which may prove to be incorrect. Although Dynetek believes that the expectations and assumptions reflected in such forward-looking statements are reasonable, undue reliance should not be placed on forward-looking statements because Dynetek can give no assurance that such expectations and assumptions will prove to be correct. With respect to the forward-looking statements contained in this document assumptions have been made regarding, among other things: (i) industry demand; (ii) expectations regarding technology adoption rates for certain countries; (iii) the impact of governmental regulatory regimes and tax, environmental and other laws; (iv) prices of commodities; and the economic condition in certain countries. Forward-looking statements are based on current expectations, estimates and projections that involve a number of risks and uncertainties, which could cause actual results to differ materially from those anticipated and described in the forward looking statements. Such statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements including, without limitation: (i) changes in general economic, market and business conditions of certain countries; (ii) volatility in commodity prices and exchange rates; (iii) access to capital; (iv) competition for, among other things, capital and skilled personnel; and, (v) actions by governmental or regulatory authorities including changes in environmental legislation. The Company cautions that the foregoing list of assumptions, risks and uncertainties is not exhaustive. Additional information on these and other factors that could affect operations or financial results can be found in the Company's Annual Information Form available on SEDAR at [www.sedar.com](http://www.sedar.com). The Company does not undertake any obligation to publicly update or revise any forward-looking statements except as expressly required by applicable securities law.*

*Dynetek's method of calculating the non-GAAP Measures may differ from methods used by other issuers. Therefore, Dynetek's use of the non-GAAP Measures may not be comparable to similar measures used by other issuers. These non-GAAP Measures should be read in conjunction with the financial statements or other financial information of Dynetek.*

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**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)

	<b>2010</b>	<b>2009</b>
<b>ASSETS</b>		
<b>Current assets</b>		
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
	<b>16,387</b>	17,911
<b>Intangible assets</b> (note 6)	<b>3,610</b>	4,452
<b>Capital assets</b> (note 7)	<b>13,270</b>	14,017
	<b>33,267</b>	36,380
<b>LIABILITIES</b>		
<b>Current liabilities</b>		
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
	<b>5,274</b>	4,185
<b>Long-term debt and capital lease</b> (note 9)	<b>5,078</b>	6,491
<b>Commitments</b> (note 14)		
<b>Shareholders' equity</b>		
Share capital (note 11)	52,423	52,422
Contributed surplus (note 13)	3,005	2,830
Deficit	(32,513)	(29,548)
	<b>22,915</b>	25,704
	<b>33,267</b>	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)

	<b>2010</b>	<b>2009</b>
<b>Revenue and other income</b>		
Sales	22,272	26,380
Research and development	3,060	3,811
Investment and other income (note 15)	1,495	68
	<b>26,827</b>	30,259
<b>Expenses</b>		
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
	<b>29,792</b>	33,681
<b>Loss before taxes</b>	<b>(2,965)</b>	(3,422)
<b>Provision for income taxes</b> (note 10)	-	-
<b>NET LOSS AND COMPREHENSIVE LOSS</b>	<b>(2,965)</b>	(3,422)
Deficit, beginning of year	<b>(29,548)</b>	(26,126)
<b>Deficit, end of year</b>	<b>(32,513)</b>	(29,548)
<b>Per Share Information</b>		
Loss per share (basic and diluted) (note 11(d))	<b>(0.14)</b>	(0.16)
Weighted average number of common shares outstanding	<b>20,958,686</b>	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)

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

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**

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

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

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

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.

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**5. Inventory**

	<b>2010</b>	2009
Raw materials	<b>2,814</b>	2,126
Work-in-progress	<b>4,424</b>	4,815
Finished goods	<b>3,355</b>	3,452
	<b>10,593</b>	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**

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

**7. Capital assets**

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

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**8. Bank indebtedness**

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

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**

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

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**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	<b>284</b>
2012	<b>438</b>
2013	<b>385</b>
2014	<b>334</b>
2015	<b>334</b>
Thereafter	<b>3,050</b>
<b>Total repayment obligation</b>	<b>4,825</b>

**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:

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

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

	<b>2010</b>	2009
Research and development costs	<b>2,093</b>	1,861
Capital assets	<b>1,909</b>	1,738
Non-capital losses	<b>1,407</b>	1,861
Cumulative eligible capital and other	<b>278</b>	45
Valuation allowance	<b>(5,687)</b>	(5,505)
Future income tax asset	<b>-</b>	-

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.

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**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
<b>Balance December 31, 2010</b>	<b>20,959,500</b>	<b>52,423</b>

(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".

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**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)
<b>Balance December 31, 2010</b>	<b>2,889,880</b>	<b>\$0.41</b>

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
	<b>2,889,880</b>	<b>4.2</b>	<b>\$0.41</b>	<b>787,012</b>	<b>\$0.69</b>

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:

	<b>2010</b>	2009
Weighted average risk-free interest rate	<b>0.82%</b>	0.49%
Weighted average expected life	<b>5 years</b>	5 years
Estimated volatility in the market price of the common shares	<b>112%</b>	108%
Expected dividend yield	<b>0%</b>	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
<b>Balance December 31, 2010</b>	<b>3,005</b>

**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**

	<b>2010</b>	2009
Interest received	<b>7</b>	7
Interest paid	<b>309</b>	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.

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

**(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
<b>Assets held for Trading</b>				
Cash and restricted cash	1,370	1,370	1,448	1,448
<b>Loans and Receivables</b>				
Accounts receivables	3,737	3,737	5,628	5,628
<b>Other Liabilities</b>				
Accounts payable and accrued liabilities	3,651	3,651	2,915	2,915
Bank indebtedness	856	856	–	–
Contribution agreement <sup>(a)</sup>	537	509	2,014	1,967
Mortgage	4,554	4,554	4,888	4,888
Capital lease <sup>(b)</sup>	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)
<b>Total Capital</b>	<b>27,315</b>	<b>31,996</b>

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
<b>Cylinder and system revenue:</b>		
North America	6,920	5,532
European Union <sup>(a)</sup>	14,273	20,147
Other	1,079	701
	<b>22,272</b>	<b>26,380</b>

(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.

**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)

**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.



## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

The following sets out management's discussion and analysis ("MD&A") of the financial position and results of operations for Dynetek Industries Ltd. ("Dynetek" or "Company") for the years ended December 31, 2010 and 2009 and is based on information available as at March 28, 2011. All financial information is presented in Canadian dollars. Dynetek's consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles ("GAAP").

### **Non-GAAP Financial Measures**

Dynetek reports its financial results in accordance with generally accepted accounting principles. 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, loss on equipment disposal, 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 measures from the Consolidated Balance Sheets and Consolidated Statements of Operations, Comprehensive Loss and Deficit is provided in the section Reconciliation of non-GAAP Financial Measures.

### **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 bus 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. In addition, Dynetek continues to pursue the industrial compressed gas market for bulk hauling trailer applications, having received both Transport Canada and United States Department of Transportation certification in prior years.

Dynetek remains committed to continuing to grow its CNG and hydrogen revenue streams globally through targeted marketing initiatives with a stronger short-term focus on CNG activities. Dynetek believes that the market for compressed hydrogen enabling technologies will continue to develop over the next 5 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. Dynetek's plan is to continue the development of its enabling technologies to meet these market opportunities. Dynetek plans to focus its marketing efforts in regions where the majority of Dynetek's original equipment manufacturer ("OEM") and other CNG and hydrogen related technology partners are today.

Dynetek's products are designed primarily for fuel storage and fuel delivery of alternative compressed gas in vehicles, fuel cell applications and hydrogen refueling and stationary storage products. The Company 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 2010**

- On February 5, 2010, Dynetek announced the appointment of Douglas Pigot to the position of Executive Chairman and announced that Darren Sentner had been appointed to the position of Chief Financial Officer of the Corporation.
- On June 2, 2010, Dynetek announced the formation of Dynetek Korea Co. Ltd. ("DNK Korea"), a Korean joint venture 51% owned by Sejung Co. Ltd. ("Sejung") of Seoul, Korea and 49% owned by Dynetek.
- On September 21, 2010, Dynetek announced the execution of a letter of intent to form "Dynetek Cylinders India Pvt. Ltd." ("DNK India"), an Indian joint venture to be 49% owned by Dynetek and 51% owned by S.V. Energy, an Indian partnership.
- On October 25, 2010, Dynetek executed a supply agreement with Timberloch CNG Partners to be their exclusive cylinder supplier to a large bus fleet operator in Istanbul, Turkey.
- During the third quarter of 2010, Dynetek commenced discussions with a potential Chinese joint venture partner to access the Chinese market.
- North American revenue increased 32% from 2009 due to increased CNG activity with a major North American school bus manufacture and a North American waste management company.
- During the third quarter of 2010, Dynetek received orders for 29 hydrogen fuel storage systems from a major European bus manufacturer.
- During the third quarter of 2010, Dynetek commenced delivery of hydrogen valves for pre-production hydrogen vehicles for one European based and two Asian based OEMs.
- During the fourth quarter of 2010, Dynetek delivered 18 hydrogen systems to India to be used in 3-wheeled vehicles during the Commonwealth Games.
- During the fourth quarter of 2010, Dynetek developed and certified a new hydrogen cylinder to be used in pre-production hydrogen passenger vehicles for an Asian based OEM.
- Improved EBITDA by \$0.35 million compared to 2009 and increased the number of cylinder unit sales by 19% in 2010 compared to 2009.
- Maintained a strong working capital surplus of \$11.1 million at December 31, 2010.

**Selected Consolidated Financial Information**
**December 31**

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

	<b>2010</b>	2009	2008
<b>Revenue and other income</b>			
Cylinder and system sales	<b>22,272</b>	26,380	19,014
Research and development	<b>3,060</b>	3,811	5,315
Investment and other income	<b>1,495</b>	68	257
	<b>26,827</b>	30,259	24,586
Net Loss	<b>(2,965)</b>	(3,422)	(2,942)
Net Loss per common share (basic and fully diluted)	<b>(0.14)</b>	(0.16)	(0.14)
EBITDA <sup>(1)</sup>	<b>478</b>	127	(553)
Cash flow (deficiency) from operations	<b>388</b>	(1,404)	(2,364)
Capital and intangible expenditures	<b>706</b>	915	782
Cash and restricted cash	<b>1,370</b>	1,448	3,797
Non-cash working capital <sup>(1)</sup>	<b>9,743</b>	12,278	11,565
Working capital <sup>1</sup>	<b>11,113</b>	13,726	15,770
Total assets	<b>33,267</b>	36,380	44,122
Operating bank line utilization	<b>1,750</b>	245	–
Long-term debt and capital lease	<b>5,078</b>	6,491	7,096
Common shares outstanding	<b>20,959,500</b>	20,956,500	20,936,500
Weighted average common shares outstanding	<b>20,958,686</b>	20,940,062	20,936,500

(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)

	<b>2010</b>	<b>% of</b>	2009	<b>% of</b>
	<b>\$</b>	<b>revenues</b>	<b>\$</b>	<b>revenues</b>
North American cylinder and system sales	<b>8,121</b>		6,147	
European cylinder and system sales	<b>14,151</b>		20,233	
Total Cylinder and system sales	<b>22,272</b>	<b>83%</b>	26,380	87%
Research and development income	<b>3,060</b>	<b>11%</b>	3,811	13%
Investment and other income	<b>1,495</b>	<b>6%</b>	68	–%
	<b>26,827</b>	<b>100%</b>	30,259	100%

**Cylinder and system sales** for the year ended December 31, 2010 were \$22.3 million, a decrease of 16% from \$26.4 million for 2009. The decrease was the result of the appreciation of the Canadian dollar against the US dollar and Euro. Dynetek's North American sales are primarily transacted in US dollars and virtually all European sales are transacted in Euros. The Canadian dollar appreciated 11% against the US dollar and 16% against the Euro, comparing 2010 foreign exchange rates against 2009 rates.

Dynetek's revised North American sales focus resulted in 2010 cylinder sales increasing by \$2.0 million, from \$6.1 million in 2009 to \$8.1 million. Fiscal 2010 saw a switch in product mix with a greater focus on cylinder sales versus system sales in North America. Major North American customers include bus manufacturers and customers involved in the heavy-duty truck industry.

Dynetek's European cylinder and system revenues decreased to \$14.1 million in 2010 from \$20.2 million in 2009, representing a decrease of 30%. The decrease in 2010 was due in part to lower than anticipated natural gas bus system activity and in part to the 16% depreciation of the Euro against the Canadian dollar. Bus manufacturers continue to be the major customers for the European operations.

**Research and development income** for the year ended December 31, 2010 was \$3.1 million compared to \$3.8 million in 2009. The decrease of \$0.7 million was the result of delays in the start-up of major hydrogen contracts. Major deliverables under the hydrogen contracts began during the fourth quarter of 2010 and will continue into 2011. Revenues received from these projects are recorded on billing milestones outlined in the contracts and timing differences will occur between when costs are incurred and funding is received.

The decrease in 2010 research and development income was partially offset by higher hydrogen valve sales. 2010 hydrogen valve sales increased 129% compared to 2009, as demand for hydrogen valves increased due to increased activity in OEM projects.

During 2010, Dynetek continued to be involved with various hydrogen and research and development projects with different OEMs. Research and development income is dependent development contracts with OEMs. 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)

	<b>2010</b>	2009
Investment and other income	<b>1,495</b>	68

**Investment and other income** for the year ended December 31, 2010 was \$1.5 million compared to less than \$0.1 million in 2009. This increase was the result of the settlement and expiration of government contribution agreements during the fourth quarter of 2010. The Company originally recorded the contribution agreements as long-term debt as the contribution amounts were non-interest bearing and repayable annually based on 3% - 5% of related product sales. Certain conditions were met by the Company, constituting settlement of long-term debt, which was then recognized as other income.

When the Company has excess cash, the Company will invest its excess cash in triple A rated securities and earns interest at these associated rates.

#### **Costs of Goods Sold and Contribution Margin**

(thousands of Canadian dollars)

	<b>2010</b>	2009
Cost of goods sold	<b>20,342</b>	25,011
Contribution Margin	<b>4,990</b>	5,180
Percentage of Sales	<b>20%</b>	17%

**Cost of goods sold** was \$20.3 million for the year ended December 31, 2010 compared to \$25.0 million for the same period in 2009. Corresponding contribution margins for 2010 were \$5.0 million, or 20% of cylinder and system sales and research and development income, compared to contribution margin of \$5.2 million or 17% in 2009. The margin percentage increase for 2010 compared to 2009 was the result of the shift in product mix from fuel storage systems to cylinders and the Company being successful in negotiating better pricing for its raw materials.

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

Research and development expense is dependent on OEM projects. 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.

**General and Administrative**

(thousands of Canadian dollars)

	<b>2010</b>	2009
General and administrative expense	<b>4,624</b>	3,525

**General and administrative expense** was \$4.6 million in 2010 compared to \$3.5 million for 2009, an increase of \$1.1 million. 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 increase in 2010 general and administrative expense related to additional management to assist in the penetration of new Asia-Pacific markets and expand the Company's strategic and financial expertise. General and administration costs as a percentage of revenue was 17% in 2010 compared to 12% in 2009, reflecting a larger portion of General and administration costs being fixed costs.

**Marketing**

(thousands of Canadian dollars)

	<b>2010</b>	2009
Marketing expense	<b>1,383</b>	1,596

**Marketing expense** was \$1.4 million in 2010, a decrease of \$0.2 million when compared to 2009. Marketing expense relates to labour and benefits of sales personnel, travel, attendance at tradeshow, agents commissions and promotional collateral. The decrease in 2010 marketing expense reflected lower European commissions and greater efficiencies in marketing Dynetek products in North America. Overall, marketing expense as a percentage of revenue was 5% in 2010 which was comparable to 2009.

**Interest**

(thousands of Canadian dollars)

	<b>2010</b>	2009
Interest expense	<b>350</b>	335

**Interest expense** was \$0.3 million in 2010 which was comparable to 2009. The minor increase was due to a higher prime lending rate on the Corporation's floating interest rate debt in 2010 offset by lower principal balances from long-term debt in 2010.

The Company currently has a \$2.75 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 2.0% per annum. The Company also has a \$4.6 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 2.0% per annum.

**Depreciation**

(thousands of Canadian dollars)

	<b>2010</b>	2009
Depreciation expense	<b>1,194</b>	1,324

**Depreciation expense** was \$1.2 million in 2010, compared to \$1.3 million in 2009. The decrease in 2010 depreciation expense continues a trend for lower depreciation expense since the Company's last major capital expenditures were incurred in 2007.

### Amortization

(thousands of Canadian dollars)

	<b>2010</b>	2009
Amortization	<b>1,099</b>	1,266

**Amortization** was \$1.1 million in 2010, compared to \$1.3 million in 2009. Items included in amortization relate to certification costs and patents. The 2009 amortization expense reflects recognizing additional German amortization expense from minor intangible assets that were considered fully amortized in that year.

### Loss on equipment disposal

(thousands of Canadian dollars)

	<b>2010</b>	2009
Loss on equipment disposal	<b>2</b>	299

**Loss on equipment disposal** was \$0.3 million in 2009, compared to an insignificant amount in 2010. There were no major equipment sales or disposals in 2010. In 2009, the Company disposed of a winding machine and related production equipment.

### Foreign Exchange

(thousands of Canadian dollars)

	<b>2010</b>	2009
Foreign exchange loss	<b>623</b>	222

**Foreign exchange** for the year ended December 31, 2010 was a loss of 0.6 million, compared to a loss of \$0.2 million in 2009. The North American 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 and Euros. The foreign exchange loss in 2010 was due to a weakening of the US dollar and Euro against the Canadian dollar resulting in a negative impact on the US and Euro denominated accounts receivable and cash when translating into Canadian dollars and settlement of accounts receivable transactions during the period.

At December 31, 2010 the exchange rates for 1 Euro was \$1.33 Canadian and for 1 US dollar was \$0.99 Canadian, compared to exchange rates at December 31, 2009 of 1 Euro worth \$1.50 Canadian and 1 US dollar worth \$1.05 Canadian respectively.

At December 31, 2010 the Company held the following amounts in foreign currencies:

(thousands)	<b>US Dollars</b>	<b>Euros</b>
Cash	864	759
Accounts receivable	1,256	2,173
Accounts payable	351	1,286

**Stock based Compensation**

(thousands of Canadian dollars)

	<b>2010</b>	2009
Stock based compensation expense	<b>175</b>	103

**Stock based compensation** for the year ended December 31, 2010 was \$0.2 million compared to \$0.1 million in 2009. The increase was due to the Company granting 1.74 million stock options in 2010 compared to issuing 0.15 million stock options in 2009.

**Income Taxes**

(thousands of Canadian dollars)

	<b>2010</b>	2009
Future income taxes	-	-

**Income taxes** were in \$nil in 2010 and 2009. During the second quarter of 2007, the Company considered the future income tax assets impaired and reduced the future income tax asset value to \$nil. Since 2007, the Company continues to view the future income tax assets having a value of \$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 accounting purposes.

**Net Loss**

(thousands of Canadian dollars)

	<b>2010</b>	2009
Net loss	<b>(2,965)</b>	(3,422)

**Net loss** for the year ended December 31, 2010 was (\$3.0) million or (\$0.14) per common share, compared to a loss of (\$3.4) million or (\$0.16) per share in 2009. The decrease in Net loss of (\$0.4) million in 2010, is a result of recognizing income from the settlement of long-term debt of \$1.5 million which was offset by an increase in foreign exchange loss of \$0.4 million and increased G&A expense related to additional management to assist in the penetration of new Asia-Pacific markets and expand the Company's strategic and financial expertise.

**Summary of Quarterly Results**

The following tables show selected unaudited financial information for the past eight quarters ending December 31, 2010. 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.

**2010 Quarter Ended** (unaudited)

(thousands of Canadian dollars – except per share amounts)

	<b>Three months ended</b>				
	<b>March 31</b>	<b>June 30</b>	<b>September 30</b>	<b>December 31</b>	<b>Year Ended</b>
<b>Revenue and other income</b>					
Cylinder and system sales	3,949	9,242	4,825	4,256	22,272
Research and development	380	696	705	1,279	3,060
Investment & other income	1	–	5	1,489	1,495
	<u>4,330</u>	<u>9,938</u>	<u>5,535</u>	<u>7,024</u>	<u>26,827</u>
<b>Operating expenses</b>					
Cost of goods sold	3,477	7,770	4,141	4,954	20,342
Marketing & G&A	1,295	1,277	1,412	2,023	6,007
	<u>4,772</u>	<u>9,047</u>	<u>5,553</u>	<u>6,977</u>	<u>26,349</u>
<b>EBITDA<sup>(1)</sup></b>	<u>(442)</u>	<u>891</u>	<u>(18)</u>	<u>47</u>	<u>478</u>
Interest	74	99	93	84	350
Foreign exchange loss (gain)	314	83	(193)	419	623
Depreciation & amortization	553	555	619	566	2,293
Stock based compensation	36	37	59	43	175
Loss on equipment disposal	–	–	–	2	2
	<u>977</u>	<u>774</u>	<u>578</u>	<u>1,114</u>	<u>3,443</u>
<b>Net Income (Loss)</b>	<u>(1,419)</u>	<u>117</u>	<u>(596)</u>	<u>(1,067)</u>	<u>(2,965)</u>
<b>Income (Loss) per share</b>					
Basic and fully diluted	<u>(0.07)</u>	<u>0.01</u>	<u>(0.03)</u>	<u>(0.05)</u>	<u>(0.14)</u>

(1) EBITDA is defined in the Reconciliation of non-GAAP Financial Measures section of the 2010 MD&A.

**2009 Quarter Ended** (unaudited)

(thousands of Canadian dollars – except  
per share amounts)

	<b>Three months ended</b>				<b>Year Ended</b>
	<b>March</b>	<b>June</b>	<b>September</b>	<b>December</b>	
	<b>31</b>	<b>30</b>	<b>30</b>	<b>31</b>	
<b>Revenue and other income</b>					
Cylinder and system sales	5,796	8,258	7,433	4,893	26,380
Research and development	1,057	922	920	912	3,811
Investment & other income	3	3	1	61	68
	<u>6,856</u>	<u>9,183</u>	<u>8,354</u>	<u>5,866</u>	<u>30,259</u>
<b>Operating expenses</b>					
Cost of goods sold	5,542	7,358	6,707	5,404	25,011
Marketing & G&A	1,313	1,418	1,348	1,042	5,121
	<u>6,855</u>	<u>8,776</u>	<u>8,055</u>	<u>6,446</u>	<u>30,132</u>
<b>EBITDA<sup>(1)</sup></b>	<u>1</u>	<u>407</u>	<u>299</u>	<u>(580)</u>	<u>127</u>
Interest	69	74	94	98	335
Foreign exchange loss (gain)	228	(62)	(143)	199	222
Depreciation & amortization	588	584	595	823	2,590
Stock based compensation	25	25	27	26	103
Loss on equipment disposal	–	–	–	299	299
	<u>910</u>	<u>621</u>	<u>573</u>	<u>1,445</u>	<u>3,549</u>
<b>Net Loss</b>	<u>(909)</u>	<u>(214)</u>	<u>(274)</u>	<u>(2,025)</u>	<u>(3,422)</u>
<b>Loss per share</b>					
Basic and fully diluted	<u>(0.04)</u>	<u>(0.01)</u>	<u>(0.02)</u>	<u>(0.09)</u>	<u>(0.16)</u>

(1) EBITDA is defined in the Reconciliation of non-GAAP Financial Measures section of the 2010 MD&amp;A.

**Seasonality and Cycles**

Dynetek will normally experience an increase in cylinder and system sales in the second and third quarters of the calendar year. This demand pattern is principally a result of when municipalities require products from OEMs such as bus manufacturers.



## **Fourth Quarter Results**

**Cylinder and system sales** for the three months ended December 31, 2010 were \$4.3 million, a decrease from \$0.6 million or 13% for the same period in 2009. The North American operations generated an increase in cylinder sales of \$1.1 million in the fourth quarter of 2010 compared to the same quarter of 2009 due to our increased North American sales focus. European operations experienced a quarter over quarter decrease in cylinder sales of \$1.7 million as a greater percentage of annual sales were delivered in the second quarter of 2010.

**Research and development income** increased to \$1.3 million from \$0.9 million in the fourth quarter of 2009, an increase of \$0.4 million. The increase is the result of the start-up of major hydrogen contracts and increased hydrogen valve sales. In the fourth quarter of 2009, the Company completed the third and final milestone under the Magna Steyr contract.

**Investment and other income** increased by \$1.4 million in the fourth quarter of 2010 as a result of the settlement and expiration of certain government contribution agreements. The contribution agreements had been recorded as long-term debt and after certain conditions were determined as concluded by the Company and the government agency, settlement of the long-term debt balance was recorded as other income.

**Cost of goods sold** was \$5.0 million for the three months ended December 31, 2010 compared to \$5.4 million for the same period in 2009. Corresponding contribution margin for the three months ended December 31, 2010 was \$0.6 million or 10% of cylinder and research and development sales, compared to \$0.4 million or 7% for the same period of 2009. The increase in contribution margin in the fourth quarter of 2010 was due to more efficient production runs and continuing to negotiate for lower raw material prices.

**General and administrative expense** was \$1.6 million for the three months ended December 31, 2010 compared to \$0.9 million for the same period of 2009. The \$0.7 million increase was due to higher levels of business development activities in the new Asia-Pacific markets, additional management resources and the accrual of annual incentive compensation.

**Marketing expense** was \$0.4 million for the quarter ended December 31, 2010, an increase of \$0.2 million from the same quarter of 2009. Marketing expenses increased in conjunction with increased business development activity in new Asian markets. The European operations incurred more third party agent commission expenses in the fourth quarter of 2010 compared to amounts paid in the same quarter of 2009.

**Depreciation expense** was \$0.3 million for the quarter ended December 31, 2010, comparable to \$0.3 million for the same period of 2009.

**Amortization expense** was \$0.3 million for the quarter ended December 31, 2010, compared to \$0.5 million for the same period of 2009. The decrease is due to the Company recognizing German amortization expense on a quarterly basis starting in the third quarter of 2010.

**Loss on equipment disposal expense** was \$0.3 million for the fourth quarter of 2009 compared to an insignificant amount for the same period of 2010. The Company disposed of a winding machine and related production equipment during the fourth quarter of 2009.

**Foreign exchange** for the fourth quarter of 2010 was a loss of \$0.4 million compared to a loss of \$0.2 million for the same period of 2009. The increase in foreign exchange loss was due to a greater level of weakening of the US dollar and Euro against the Canadian dollar in the fourth quarter of 2010, compared to the same quarter of 2009.

**Net loss** for the quarter ended December 31, 2010 was \$1.1 million or (\$0.05) per common share compared to a loss of \$2.0 million or (\$0.09) per common share for the same period of 2009. The reduction in the 2010 fourth quarter net loss of \$0.9 million over the same quarter of 2009, was a result of the settlement of long-term debt of \$1.5 million netted against increased general and administrative, marketing and foreign exchange costs.

### Intangible Assets and Project Costs

(thousands of Canadian dollars)

	<b>2010</b>	2009
Patents	–	2
Project Costs	<b>56</b>	13
Certification Costs	<b>201</b>	735
	<b>257</b>	750

Intangible asset expenditures for the year ended December 31, 2010 were \$0.3 million compared to \$0.8 million in 2009. The variance was related to the Company initiating more funding on new product certifications at its North American and European operations and certification costs in obtaining certification of Dynetek products in new Asian countries in 2009. New costs in 2010 included the development of the Korean and Indian joint venture opportunities and expenditures related to improving Dynetek's hydrogen products.

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.

### Capital Expenditures

(thousands of Canadian dollars)

	<b>2010</b>	2009
Building and leaseholds	<b>9</b>	–
Manufacturing equipment	<b>227</b>	123
Office furniture and other equipment	<b>45</b>	3
Computer hardware and software	<b>25</b>	20
Manufacturing equipment under construction	<b>143</b>	19
	<b>449</b>	165

Capital expenditures for the year ended December 31, 2010 were \$0.5 million compared to \$0.2 million for 2009. The Company's capital resource requirements in 2010 consisted of capital expenditures to improve the existing production line and increase the cylinder output capabilities from its North American production facilities.

### 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 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.

As at December 31, 2010 Dynetek had cash of \$1.4 million, compared to \$1.5 million at December 31, 2009 and cash flow from operations of \$0.4 million compared to a cash flow deficiency of \$1.4 million for the year ended December 31, 2009.

At December 31, 2010, the Company has a \$2.75 million operating line of credit with major chartered bank and the ability to fund liquidity requirements through its line of credit facility. For a period of approximately four months in 2010, the Company was granted an additional \$0.85 million line of credit facility from the same lender. The additional line of credit facility was not utilized during its availability. In future years, the Company may request additional credit facilities, which may be made available on a temporary basis. As of December 31, 2010, \$1.75 million was drawn down on this credit facility compared to \$245 thousand at December 31, 2009. All financial covenants under the credit agreement were in compliance at December 31, 2010 and 2009.

The following table provides additional information on working capital balances at December 31, 2010 as compared to December 31, 2009.

(thousands of Canadian dollars)	<b>December 31, 2010</b>	December 31, 2009	Change
Cash	<b>1,370</b>	1,448	(78)
Accounts receivable	<b>3,737</b>	5,628	(1,891)
Inventory	<b>10,593</b>	10,393	200
Prepaid expenses and other	<b>687</b>	442	245
Bank indebtedness	<b>(856)</b>	–	(856)
Accounts payable and accrued liabilities	<b>(3,651)</b>	(2,915)	(736)
Deferred revenue	<b>(483)</b>	(429)	(54)
Current portion of long-term debt and capital lease	<b>(284)</b>	(841)	557
	<b>13,318</b>	15,362	(2,613)

At December 31, 2010 accounts receivable were \$3.8 million representing a decrease of \$1.9 million compared to December 31, 2009. This decrease is representative of the decrease in cylinder and system sales and research and development sales in the fourth quarter of 2010 compared to 2009.

The Company's investment in inventory resulted in an increase of \$0.2 million to \$10.6 million at December 31, 2010 from \$10.4 million at December 31, 2009. This increase was reflective of a customer request in Germany to defer a substantial order from the fourth quarter into 2011. North American operations inventory levels remained at consistent levels at year-end 2010 and 2009. Inventory levels can widely fluctuate during the fiscal years depending on levels of volume and timeliness of customer orders.

The following table summarizes the inventory balance at December 31, 2010 compared to December 31, 2009.

(thousands of Canadian dollars)	<b>December 31 2010</b>	December 31 2009	Change
Raw materials	<b>2,814</b>	2,126	688
Work-in-progress	<b>4,424</b>	4,815	(391)
Finished goods	<b>3,355</b>	3,452	(97)
	<b>10,593</b>	10,393	200

Inventory at December 31, 2010 of \$10.6 million was relatively unchanged compared to \$10.4 million as at December 31, 2009. Work-in-progress is substantially represented by confirmed orders. Fluctuations between raw materials and work-in-progress is driven by the expected delivery dates of future orders. The Company strives to carry raw materials on a "just in time" basis rather than making cash expenditures to keep excess raw materials on hand.

Accounts payable at December 31, 2010 were \$3.7 million, compared to \$2.9 million as at December 31, 2009. This increase is representative of the increases in cylinder production and the start-up of major hydrogen projects, including the start-up to deliver 29 hydrogen fuel storage systems to a European bus manufacturer.

Long-term debt and capital lease relates to one research and development government contribution supplied by NRCan, the capital lease obligation and a mortgage with the Business Development Bank of Canada ("BDC").

The remaining NRCan debt is interest free and repayable only in the form of royalties based on specific related commercial product sales. The Company did not receive funding from NRCan in the form of government contribution in 2010 or 2009. In the fourth quarter of 2010, Dynetek and NRCan did agree to settle three government contribution agreements which Dynetek included as other income.

The Company will repay \$0.2 million against the BDC mortgage principal over the next twelve months. In January 2011, the Company exercised its option to extend repayment of principal for six months beginning February 2011. Another option to extend repayment of principal for an additional six months is available under the mortgage agreement.

## Contractual Obligations and Commitments

The following table provides Dynetek's contractual obligations at December 31, 2010 for each of the next five years and after 2015. The table also includes interest from the Company's long-term debt and capital lease obligation repayments.

(thousands of Canadian dollars)	Total	2011	2012	2013	2014	2015	Thereafter
Operating lease obligations	924	307	286	284	47	–	–
Capital lease obligation	297	133	111	53	–	–	–
Mortgage obligation	6,228	392	546	529	512	496	3,753
Total contractual obligations	7,449	832	943	866	559	496	3,753

## Transactions with Related Parties

There were two transactions with related parties and each related party transaction was completed in the normal course of business.

For the first related party transaction, the Company purchased under normal terms and conditions, \$1.7 million in 2010 and \$4.3 million in 2009, of material used in the production of lightweight fuel storage systems from Mitsubishi Rayon Co. Ltd., a shareholder of the Company.

For the second related party transaction, the Company's Board of Directors agreed to contract the services of its Chairman to provide financial consulting and strategic planning services. The agreement for the services was effective for the period August 2009 through January 2010. Under this contract, the Company paid \$29 thousand to a company controlled by the chairman during the first quarter of 2010 and \$28 thousand to the same company in 2009. Beginning February 5, 2010, the Company has employed its Chairman as Executive Chairman.

## 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.

The increase to the operating line of credit is required to fund additional working capital associated with a greater percentage of fiscal 2011 sales currently anticipated in the third and fourth quarter of 2011 than in previous years.

## Outstanding Share Data

(thousands of Canadian dollars except share amounts)

### Issued and outstanding:

	Number of Shares	Amount
<b>Balance at December 31, 2008</b>	<b>20,936,500</b>	<b>52,418</b>
Stock options exercised	20,000	4
<b>Balance at December 31, 2009</b>	<b>20,956,500</b>	<b>52,422</b>
Stock options exercised	3,000	1
<b>Balance at December 31, 2010</b>	<b>20,959,500</b>	<b>52,423</b>

	2010	2009
<b>Securities convertible into common shares:</b>		
Stock options	2,889,880	1,214,500
Warrants	39,879	108,035

Common shares and securities convertible into common shares as at March 15, 2011 were as follows: common shares outstanding 20,959,500, options of 2,889,880 and warrants of 39,879.

## 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, net realizable value of inventory, intercompany profits (losses) unrealized in inventory, fixed asset useful lives, determination of impairment and recoverability of long-lived assets, stock-based compensation and valuation allowance of future 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. The Company provided for a write-down of \$0.1 million of inventory to net realizable value in each of 2010 and 2009. In 2010, there was a reversal of less than \$0.1 million of write-downs previously taken.

## 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.

Trade accounts receivable are normally from OEMs, the majority being bus manufacturers. At December 31, 2010 and 2009, the Company has trade receivables outstanding from three customers each greater than 10% of the Company's outstanding trade receivable balance. 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.

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 \$14 thousand recognized as an allowance for doubtful accounts at December 31, 2010.

#### **(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 and 2009, the Company has a \$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 compared to \$245 thousand at December 31, 2009. 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.

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 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.

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 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 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 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.

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.

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

**(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 and 2009 are disclosed below by financial instrument category.

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

(1) 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.

(2) 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



## Principal Risks and Uncertainties

**Development of the Alternate Fuel Industry and Infrastructure:** Dynetek's 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 endeavor 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 two major suppliers of carbon fibre at its North American and three major suppliers of carbon fibre at its European production facilities. 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 certain sizes of 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 increased from 17% in 2009 to 20% in 2010. 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 inability to enforce 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 laborers 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. 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 North American 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, 2010. 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, 2010 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.

No material changes in the Company's internal controls and procedures have occurred during which has 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, 2010. 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 will 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 ("IFRS")**

IFRS will become Canadian GAAP for publicly accountable enterprises in Canada on January 1, 2011. The Company will be required to adopt IFRS for interim and annual financial statements beginning January 1, 2011 including comparative financial statements for 2010.

The Company is progressing in its IFRS transition project in preparation of the first IFRS interim financial report in the first quarter of 2011. The impact assessment of IFRS accounting policies chosen by the Company has been completed for the January 1, 2010 balance sheets and will be completed for the December 31, 2010 balance sheets and 2010 year-end results based on the accounting standards and interpretations in effect as at December 31, 2010.

While IFRS uses concepts similar to Canadian GAAP and has many similarities to Canadian GAAP, there are several significant differences in accounting policies that have been addressed as part of the conversion to IFRS. As part of the Company's IFRS conversion project, the Company has analyzed IFRS accounting standards and accounting policy alternatives.

Dynetek would be considered a smaller public entity compared to other companies adopting IFRS, therefore, has fewer alternatives and exemptions to consider under IFRS. However, the Company has considered the exemptions within IFRS 1. Under IFRS 1 "First-Time Adoption of International Financial Reporting Standards", this standard provides entities adopting IFRS for the first time with a number of optional exemptions and mandatory exemptions, in certain areas, to the general requirement for full retrospective application of IFRS. Dynetek has analyzed the choices available under IFRS 1 and listed the key exemptions elected or rejected that will impact the opening IFRS balance sheet at January 1, 2010 and prospective IFRS accounting policies.

- Cumulative currency translation differences for the European operations are deemed to be nil at January 1, 2010. Accordingly, all cumulative foreign exchange gains and losses in the Company's cumulative foreign currency translation account will be recognized in retained earnings at January 1, 2010.
- The Company has not reassessed any arrangements to determine whether they contain a lease if they have already been assessed under Canadian GAAP. Any arrangements that have not been assessed under Canadian GAAP have been assessed under IFRIC 4, "Determining Whether an Arrangement Contains a Lease" based on terms and conditions existing at January 1, 2010. In the process of assessing, the Company does not anticipate recognizing any new leases.
- IFRS 2, "Share-based Payment" has not been applied to equity instruments related to stock-based compensation arrangements that were granted on or before November 7, 2002, nor has it been applied to equity instruments granted after November 7, 2002 that vested before January 1, 2010.
- The Company has made the decision to continue to apply the historical cost model to its property, plant and equipment and not to use fair value measurement of its property, plant and equipment for its production facilities in Calgary and Germany.

### **Significant Accounting Policy Changes**

#### **a) Impairment of property, plant and equipment**

Under IFRS, the Company will be required to recognize an impairment loss if the carrying value of property, plant and equipment exceeds its estimated future discounted cash flows. Under existing Canadian GAAP, estimated future cash flows used to assess impairments are not discounted. As such, impairment losses may be recognized earlier under IFRS than under Canadian GAAP. The Company has not calculated any impairment of property, plant and equipment as at January 1, 2010 as a result of adopting IFRS and is not anticipating any impairment under IFRS at December 31, 2010.

#### **b) Effects of Changes in Foreign Exchange Rates**

The functional currency of an entity is determined by focusing on the primary economic environment in which it operates and less precedence is placed on factors regarding the financing from and operational involvement of the reporting entity which consolidates the entity in its financial statements. Under Canadian GAAP, equal precedence is placed on all factors. The effect of this change to IFRS impacts the translation of the European operations. The translation of the results and balance sheet of the European operations requires a translation of all assets and liabilities at the closing rate at each reporting date with all resulting foreign exchange gains or losses recognized in other comprehensive income. Revenues and expenses of the European operations are translated using average monthly foreign exchange rates, which approximate the foreign exchange rates on the dates of the transactions with foreign exchange differences recognized into other comprehensive income. Prior to the conversion to IFRS, the Company used the temporal method under existing Canadian GAAP to translate its European operations. The retrospective application of IAS 21 resulted in a cumulative foreign currency exchange loss on revaluation of approximately \$100 thousand as at January 1, 2010 which was recognized in cumulative translation account prior to applying the IFRS 1 exemption.

As at January 1, 2010, the Company elected to utilize the IFRS 1 exemption to deem all foreign currency translation differences that arose prior to this date with respect to its European operations to be nil. The Company will reverse the balance of exchange differences on translation of the European operations within other reserves and record a decrease to opening retained earnings of approximately \$100 thousand as at January 1, 2010.

#### **c) Fair value of Long-Term Debt**



The Company will apply fair value to its long-term debt commencing at January 1, 2010 which will impact its long-term debt related to government contribution agreements. The long-term debt associated from the government contribution agreements is non-interest bearing, unsecured amounts which are repayable based on sales of related products. The contribution agreements will be revalued using the effective interest rate method. The carrying value of the contribution agreements will be reduced by approximately \$600 thousand and opening retained earnings will be adjusted by the same amount. The amount of \$600 thousand will be amortized over the remaining life of the contribution agreements with the annual amortized amount being recorded as interest expense each year.

### **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**

Dynetek is focused on generating increased worldwide sales from its commercialized CNG products and continuing to develop opportunities in the long-term hydrogen market through research and development activities with the global OEMs. Dynetek also continues to develop applications for its cylinders in the bulk transportation and stationary storage segments.

Geographic expansion will be the main driver of worldwide sales growth. While Europe and North America continue to provide the majority of near term sales, Dynetek is actively expanding its presence in the Asia-Pacific market through its expanding joint venture relationships.

The Asia-Pacific market represents significant opportunity for revenue growth. Demand for CNG cylinders in Asia-Pacific market is expected to increase materially over the next 5 years. The International Gas Union issued its report, "Report on Study Group 5.3 – Natural Gas Vehicles" at the IGU World Gas Conference in October 2009, which estimated that by 2015, there will be an additional 7.9 million natural gas vehicle equivalents in Asia-Pacific compared to only 0.8 million additional in Europe and 0.2 million additional in North America.

The Korean joint venture with Sejung Co. Ltd. represents significant progress in accessing this important market. In addition to Korea, Dynetek cylinders are now fully certified in India and a letter of intent with a potential joint venture partner in India has been executed. The Company expects to have the joint venture finalized in the first half of 2011 with initial sales coming in the second half of 2011.

Discussions are underway with a potential Chinese joint venture partner and it remains the Company's intent to establish a Chinese joint venture by the end of the second half of 2011. Additional information on the Asia-Pacific market was supplied by the Executive Chairman at Dynetek's June 16<sup>th</sup>, 2010 Annual and Special Meeting and is also posted on the Company's web site, [www.dynetek.com](http://www.dynetek.com).

**Reconciliation of non-GAAP Financial Measures**
**EBITDA**

GAAP Measures from Consolidated Statements of Operations, Comprehensive Loss and Deficit	Three months ended December 31		Year ended December 31	
(thousands of Canadian dollars – unaudited)	2010	2009	2010	2009
Net Loss and Comprehensive Loss	(1,067)	(2,025)	(2,965)	(3,422)
Stock based compensation	43	26	175	103
Loss on equipment disposal	2	299	2	299
Foreign exchange loss	419	199	623	222
Depreciation and Amortization	566	823	2,293	2,590
Interest	84	98	350	335
<b>Non-GAAP measure - EBITDA</b>	<b>47</b>	<b>(580)</b>	<b>478</b>	<b>127</b>

**Working Capital and Non-Cash Working Capital**

GAAP Measures from Consolidated Balance Sheets	December 31, 2010	December 31, 2009
(thousands of Canadian dollars – unaudited)		
Accounts receivable	3,737	5,628
Inventory	10,593	10,393
Prepays expenses and other	687	442
Bank indebtedness	(856)	–
Accounts payable and accrued liabilities	(3,651)	(2,915)
Deferred revenue	(483)	(429)
Current portion of long-term debt and capital lease	(284)	(841)
<b>Non-GAAP measure – Non-Cash Working Capital</b>	<b>9,743</b>	<b>12,278</b>
Add: Cash and Restricted cash	1,370	1,448
<b>Non-GAAP measure - Working Capital</b>	<b>11,113</b>	<b>13,726</b>

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 the Company's Annual Information Form, is available on SEDAR at [www.sedar.com](http://www.sedar.com) under Dynetek Industries Ltd. and the Company's website [www.dynetek.com](http://www.dynetek.com).



## **FORWARD LOOKING STATEMENTS**

In addition to historical information, this MD&A contains forward-looking statements and should be read in conjunction with the financial statements and related notes for the year ended December 31, 2010 and 2009. Readers are encouraged to review the section in the annual 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.

Certain information set forth in this document contains forward-looking statements or information ("forward-looking statements"). Forward-looking statements are not based on historical facts, but rather reflect management's expectations regarding future plans and intentions, growth, results of operations, performance and business prospects and opportunities. The use of any of the words "plan", "expect", "project", "intend", "believe", "should", "anticipate", "estimate" or other similar words, or statements that certain events or conditions "may" or "will" occur are typically intended to identify forward-looking statements. Forward-looking statements contained in this document include, without limitation, statements regarding: management's growth and development strategies; the number of compressed natural gas ("CNG") buses operated in foreign markets; the number of CNG buses manufactured; incentives relating to CNG applications implemented by foreign governments; foreign market trends; and demand for, and sales of, CNG and hydrogen cylinders.

Forward-looking statements are based on a number of factors and assumptions which have been used to develop such statements but which may prove to be incorrect. Although Dynetek believes that the expectations and assumptions reflected in such forward-looking statements are reasonable, undue reliance should not be placed on forward-looking statements because Dynetek can give no assurance that such expectations and assumptions will prove to be correct. With respect to the forward-looking statements contained in this document, assumptions have been made regarding, among other things: (i) industry demand; (ii) expectations regarding technology adoption rates for certain countries; (iii) the impact of governmental regulatory regimes and tax, environmental and other laws; (iv) prices of commodities; and the economic condition in certain countries. Forward-looking statements are based on current expectations, estimates and projections that involve a number of risks and uncertainties, which could cause actual results to differ materially from those anticipated and described in the forward looking statements. Such statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements including, without limitation: (i) changes in general economic, market and business conditions of certain countries; (ii) volatility in commodity prices and exchange rates; (iii) access to capital; (iv) competition for, among other things, capital and skilled personnel; and, (v) actions by governmental or regulatory authorities including changes in environmental legislation. The Company cautions that the foregoing list of assumptions, risks and uncertainties is not exhaustive. Additional information on these and other factors that could affect operations or financial results can be found in the Company's Annual Information Form available on SEDAR at [www.sedar.com](http://www.sedar.com). The Company does not undertake any obligation to publicly update or revise any forward-looking statements except as expressly required by applicable securities law.