

IPICO Inc.
Consolidated Financial Statements
December 31, 2009 and 2008

April 28, 2010

Auditors' Report

To the Shareholders of IPICO Inc.

We have audited the consolidated balance sheets of **IPICO Inc.** as at December 31, 2009 and 2008 and the consolidated statements of operations and comprehensive income, shareholders' equity and cash flows for each of the years in the two year period ended December 31, 2009. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and 2008 and the results of its operations and its cash flows for each of the years in the two year period ended December 31, 2009 in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants, Licensed Public Accountants

IPICO Inc.
Consolidated Balance Sheets

	December 31, 2009	December 31, 2008
Assets:		
Current assets:		
Cash and cash equivalents	\$ 1,873,268	\$ 4,371,557
Accounts receivable	1,073,501	725,968
Other receivables	21,635	126,571
Inventories (note 5)	1,893,008	3,235,670
Prepaid expense	178,023	198,032
Total current assets	5,039,435	8,657,798
Capital assets (note 6)	147,709	271,104
Intangibles (note 7)	6,952,491	8,085,089
Total assets	\$ 12,139,635	\$ 17,013,991
Liabilities and shareholders' equity:		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 1,892,149	\$ 1,352,108
Deferred revenue	124,572	480,338
Total current liabilities	2,016,721	1,832,446
Future tax liability (note 14)	416,585	483,225
Convertible debentures (note 9)	2,330,763	-
Preferred shares (note 10)	6,168,233	5,799,412
Total liabilities	10,932,302	8,115,083
Shareholders' equity:		
Convertible debentures (note 9)	625,676	-
Exchangeable shares of IPICO South Africa (note 13)	-	2,309,106
Contributed surplus	3,405,882	2,064,301
Share capital (note 13)	43,486,934	41,177,828
Deficit	(46,311,159)	(36,652,327)
Total shareholders' equity	1,207,333	8,898,908
Total liabilities and shareholders' equity	\$ 12,139,635	\$ 17,013,991

Going Concern (note 1)
 Commitments (note 11)

See accompanying Notes to Consolidated Financial Statements

Approved by the Board of Directors:

(signed) "John Gillies"

Director

(signed) "Gordon Westwater"

Director

IPICO Inc.

Consolidated Statement of Operations and Comprehensive Income

	December 31, 2009	December 31, 2008
Revenue	\$ 6,967,626	\$ 3,885,341
Cost of revenue	4,642,158	2,374,004
Gross margin	2,325,468	1,511,337
Operating expenses:		
Development	2,196,565	2,922,902
Sales and marketing	3,390,905	3,422,999
General and administrative	4,094,957	4,217,615
Foreign exchange (gain) loss	200,476	(218,429)
Depreciation (note 6)	83,427	94,247
Amortization of intangibles (note 7)	1,132,598	1,336,080
Accounts receivable impairment (note 4)	-	609,700
Impairment of intangible (note 7)	-	1,861,830
Impairment of goodwill (note 8)	-	5,307,098
Loss (gain) on disposal of capital assets	60,224	(5,052)
Total operating expenses	11,159,152	19,548,990
Loss from operations	(8,833,684)	(18,037,653)
Finance cost, net (note 16)	891,788	287,997
Loss before the provision for income taxes	(9,725,472)	(18,325,650)
Income taxes recovered (note 14)	(66,640)	(66,640)
Net loss and Comprehensive loss	\$ (9,658,832)	\$ (18,259,010)
Loss per Share – Basic and diluted	\$ (0.18)	\$ (0.35)
Weighted average shares outstanding – Basic and diluted	54,905,147	52,353,036

See accompanying Notes to Consolidated Financial Statements

IPICO Inc.
Consolidated Statement of Cash Flows

	December 31, 2009	December 31, 2008
Cash provided by (used for):		
OPERATIONS		
Loss for the year	\$ (9,658,832)	\$ (18,259,010)
Items not affecting cash		
Depreciation	83,427	94,247
Interest on preferred shares	368,821	339,803
Interest on convertible debentures	278,844	54,762
Amortization of intangibles	1,132,598	1,336,080
Impairment of goodwill	-	5,307,098
Impairment of intangibles	-	1,861,830
Impairment of accounts receivable	-	609,700
Stock-based compensation	386,304	413,708
Stock-based compensation – trust	313,960	-
Future income tax recovery	(66,640)	(66,640)
Loss (gain) on disposal of capital assets	60,224	(5,052)
Changes in non cash operating working capital (note 17)	1,304,349	(1,230,920)
Cash used for operating activities	(5,796,945)	(9,544,394)
INVESTING		
Purchase of capital assets	(20,256)	(96,283)
Cash used for investing activities	(20,256)	(96,283)
FINANCING		
Issuance of common shares and warrants	-	5,589,309
Warrant exercise	-	448,375
Issuance of convertible debentures (note 9)	3,500,000	-
Issuance cost of convertible debentures – equity portion (note 9)	(181,088)	-
Repayment of share purchase loan (note 15)	-	60,000
Cash provided by financing activities	3,318,912	6,097,684
Decrease in cash	(2,498,289)	(3,542,993)
Cash and cash equivalents, beginning of year	4,371,557	7,914,550
Cash and cash equivalents, end of year	\$ 1,873,268	\$ 4,371,557
Supplementary disclosure of cash flow information:		
Interest paid	\$ -	\$ 101,260
Income taxes paid	\$ -	\$ -
Components of cash and cash equivalents:		
Cash	\$ 1,873,268	\$ 4,371,557

See accompanying Notes to Consolidated Financial Statements

IPICO Inc.

Consolidated Statement of Shareholders' Equity

	Convertible Debentures \$	Exchangeable Shares of IPICO South Africa \$	Warrants Quantity	Stock Options Quantity	Contributed Surplus \$	IPICO Common Shares Quantity		Deficit \$	Total \$
Balances at December 31, 2007	435,950	2,873,910	13,572,042	2,815,000	944,518	41,851,561	29,563,352	(18,393,317)	15,424,413
Stock options issued, compensation charge				1,125,000	413,708				413,708
Stock options forfeited				(513,335)					-
Conversion of exchangeable shares into common shares		(564,804)				564,804	564,804		-
Conversion of convertible debentures into common shares	(435,950)					6,962,024	5,658,064		5,222,114
Common shares issued						5,212,633	4,832,255		4,832,255
Warrants issued			5,212,633		757,053				757,053
Warrants exercised			(527,500)		(30,010)	527,500	478,385		448,375
Expiry of common share warrants			(5,396,707)						-
Expiry of broker warrants			(347,835)						-
Expiry of convertible debenture warrants			(1,650,000)						-
Repayment of share purchase loan (note 15)					(20,968)		80,968		60,000
Net loss								(18,259,010)	(18,259,010)
Balances at December 31, 2008	-	2,309,106	10,862,633	3,426,665	2,064,301	55,118,522	41,177,828	(36,652,327)	8,898,908
Stock options issued, compensation charge				1,750,000	386,304				386,304
Stock options forfeited				(527,501)					-
Conversion of exchangeable shares into common shares		(2,309,106)				2,309,106	2,309,106		-
Shares returned to treasury (note 13)						(1,856,463)			-
Convertible debenture warrants issued (note 9)			14,350,000		641,317				641,317
Conversion option on the convertible debentures (note 9)	625,676								625,676
Expiry of common share warrants			(5,000,000)						-
Expiry of service warrants			(650,000)						-
Stock based compensation – Trust (note 13)					313,960				313,960
Net loss								(9,658,832)	(9,658,832)
Balances at December 31, 2009	625,676	-	19,562,633	4,649,164	3,405,882	55,571,165	43,486,934	(46,311,159)	1,207,333

See accompanying Notes to Consolidated Financial Statements

IPICO Inc.
Notes to Consolidated Financial Statements
For the years ended December 31, 2009 and 2008

1. GOING CONCERN

These financial statements have been prepared using Canadian generally accepted accounting principles applicable to a going concern, which contemplates the realization of assets and settlement of liabilities in the normal course of business as they come due.

During the year ended December 31, 2009, the Company incurred a net loss of \$9,658,832 (2008 - \$10,480,382 prior to the \$7,168,928 non cash impairment of goodwill and intangibles, and the \$609,700 impairment in accounts receivable) and used cash from operations of \$5,796,945 (2008 - \$9,544,394). To date, the Company has relied primarily upon the proceeds from private placements and public offerings of its common shares to fund its operations. The Company anticipates that it will require additional funding based on current plans and assumptions relating to its operations and current cash resources may be depleted late in the second quarter. The Company is pursuing remedial funding which could include incurring debt and/or issuing additional equity securities, which could result in substantial dilution to existing shareholders. However, there can be no assurance that the Company's plans will be successful and that additional funding will be available or, if available, that it will be available on acceptable terms.

These circumstances lend significant doubt as to the ability of the Company to meet its obligations as they come due and, accordingly, the appropriateness of the use of accounting principles applicable to a going concern.

The Company's ability to continue as a going concern is dependent upon its ability to raise additional funding to support its product development programs and to grow its business to generate positive cash flows from operations. These financial statements do not reflect the adjustments to the carrying values of assets and liabilities and the reported expenses and balance sheet classifications that would be necessary if the Company were unable to realize its assets and settle its liabilities as a going concern in the normal course of operations. Such adjustments could be material.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of consolidation

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and include the accounts of IPICO Inc. ("the Company") and its wholly owned subsidiaries. All intercompany balances and transactions have been eliminated.

Use of estimates

The preparation of financial statements in accordance with Canadian generally accepted principles requires management to make estimates, judgments and assumptions, which are evaluated on an ongoing basis, that affect the amounts reported in the financial statements. On an on-going basis, the Company evaluates its estimates including those related to revenues, bad debts, intangible assets, stock-based compensation expense and income taxes and contingencies. Management bases its estimates on historical experience and on various other assumptions that it believes are reasonable at that time, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from those estimates.

The intangible asset impairment analyses described in Note 7 required management to make certain judgments and estimates including but not limited to, future expected sales and general market conditions. These judgments and estimates which are subjective and uncertain may change over

IPICO Inc.
Notes to Consolidated Financial Statements
For the years ended December 31, 2009 and 2008

time. As a result an additional impairment charge to intangibles may be required in the future and may have a material effect on the Company's consolidated financial statements.

Cash and cash equivalents

Cash and cash equivalents includes cash on hand, balances with banks and short term investments with original maturities of three months or less, which are held for the purpose of meeting short-term cash commitments. Cash and cash equivalents are classified as held for trading. These instruments are accounted for at fair value with the change in the fair value recognized in net income during the year.

Accounts receivable

Accounts receivable are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of the receivable. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganization, and default or delinquency in payment (more than 90 days overdue) are considered indicators that the trade receivable may be impaired. The amount of the provision is the difference between the assets carrying amount and the present value of the estimated future cash flows, discounted at the original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognized in the income statement within 'general and administrative' expenses. When a trade receivable is uncollectible, it is written off against the allowance account for trade receivables. Subsequent recoveries of amounts previously written off are credited against 'general and administrative' expenses in the income statement.

Capital assets

Capital assets are recorded at cost and are depreciated on a declining basis over the estimated useful lives of the related assets. Gains and losses on asset disposals are taken into income in the year of disposition. The following represents the estimated useful lives of capital assets:

Computer equipment and software	30% declining balance
Furniture and equipment	20% declining balance
Demonstration equipment	30% declining balance
Tradeshaw equipment	30% declining balance
Leasehold improvements	30% declining balance

Intangibles with finite useful lives

The Company's intangibles represent acquired technology (patents) and licenses. These assets are considered to have a finite useful life and are being amortized over 10 year periods on a straight-line basis.

Impairment of long lived assets

The Company reviews long-lived assets for impairment whenever events and circumstances indicate that the carrying amount may not be recoverable. If the total of the expected undiscounted cash flows is less than the carrying amount of the asset, a loss is recognized for the excess of the carrying amount over the fair value of the asset.

Inventory

Inventory is stated at the lower of cost or net realizable value, cost being determined by the first-in, first-out ("FIFO") method. Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs for sale and distribution.

IPICO Inc.
Notes to Consolidated Financial Statements
For the years ended December 31, 2009 and 2008

Accounts payable and accrued liabilities

Accounts payable are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method.

Research and development

Research costs are expensed as incurred. Development costs are expensed as incurred unless they meet the criteria under Canadian generally accepted accounting principles for deferral and amortization.

Revenue recognition

Revenue is recognized when the risk of ownership of the product has been transferred to the customer, which is generally upon shipment, the value of the goods has been established and accepted by the customer in the form of an arrangement and collectability is reasonably assured. A provision for expected warranty costs is provided at the time of shipment.

Foreign currency translation

All foreign operating subsidiaries are considered integrated in that they are financially and operationally dependent on the parent. Accordingly, the temporal method of foreign currency translation is followed whereby monetary assets and liabilities are translated into Canadian dollars at the balance sheet date rate of exchange and non-monetary assets and liabilities are translated at historical rates. Revenues and expenses are translated at average monthly rates. Gains and losses on translation are included in the consolidated statement of operations.

Debt issuance costs

Transaction costs related to the issuance of debt instruments are recorded as a charge to the statement of operations in the period in which they arise.

Income taxes

The Company uses the liability method of income tax allocation. Under this method, future income tax assets and liabilities are determined based on the differences between the financial accounting and tax bases of assets and liabilities, and are measured using the substantively enacted tax rates and laws that are anticipated to be in effect when the differences are expected to reverse.

Stock-based compensation

The Company recognizes compensation expense for stock options granted in the consolidated statements of operations using the fair value based method of accounting for all options issued. Any cash paid by employees, officers and directors on the exercise of stock options along with the accumulated stock-based compensation recognized to date are credited to share capital. Consideration paid on the exercise of stock options or issuance of stock together with compensation expense recorded through contributed surplus, is credited to share capital.

Loss per share

Basic loss per share is computed by dividing the net loss by the weighted average number of common shares and common shares equivalents outstanding during the year. Diluted loss per share represents the potential dilution of securities by adding other common stock equivalents to the weighted average number of common shares outstanding during the year, if dilutive, and is calculated using the treasury stock method.

Impact of recently issued accounting pronouncements

In January 2009, the CICA issued Section 1582, Business Combinations, replacing Section 1581, Business Combinations. This section establishes the standards for the accounting for business combinations, and states that all assets and liabilities of an acquired business will be recorded at fair

IPICO Inc.
Notes to Consolidated Financial Statements
For the years ended December 31, 2009 and 2008

value at the acquisition date. The standard also states that acquisition-related costs will be expensed as incurred and that restructuring charges will be expensed in the periods after the acquisition date. This new Section will be applicable to financial statements relating to fiscal years beginning on or after January 1, 2011. Earlier adoption is permitted. The Company is currently assessing the future impact of this new standard on its financial statements.

In January 2009, the CICA issued Section 1601, Consolidated Financial Statements, which replaces the existing standard. This section establishes the standards for preparing consolidated financial statements and is effective for fiscal years beginning on or after January 1, 2011. Earlier adoption is permitted. The Company is currently assessing the future impact of this new standard on its financial statements.

In December 2009, the CICA issued EIC 175, Multiple Deliverable Revenue Arrangements, replacing EIC 142, Revenue Arrangements with Multiple Deliverables. This abstract was amended to: (1) provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and the consideration allocated; (2) require, in situations where a vendor does not have vendor-specific objective evidence (“VSOE”) or third-party evidence of selling price, that the entity allocate revenue in an arrangement using estimated selling prices of deliverables; (3) eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method; and (4) require expanded qualitative and quantitative disclosures regarding significant judgments made in applying this guidance. The accounting changes summarized in EIC 175 are effective for fiscal years beginning on or after January 1, 2011, with early adoption permitted on either a prospective basis or by retrospective application. If the Abstract is adopted early, in a reporting period that is not the first reporting period in the entity’s fiscal year, it must be applied retroactively from the beginning of the Company’s fiscal period of adoption. The Company is currently assessing the future impact of these amendments on its financial statements and has not yet determined the timing and method of its adoption.

3. CHANGE IN ACCOUNTING POLICIES

On January 1, 2009 the Company adopted the new CICA Handbook Section 3064 Goodwill and Intangible Assets. The new section establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets subsequent to their initial recognition. Standards concerning goodwill are unchanged. The adoption of this new standard had no impact on the Company’s financial statements.

4. BUSINESS COMBINATIONS

On November 19, 2008, the Company acquired a 70% interest in the assets of Mercury Sports Group, Inc. (branded “IPICO Sports”), the exclusive distributor of IPICO’s sports timekeeping technology in satisfaction of an account receivable from Mercury Sports Group, Inc. In accordance with CICA Handbook Section 1581, the acquisition has been accounted for under the purchase method as a business combination. Mercury Sports based in Peoria, Illinois is the Company’s global distributor of IPICO’s Radio Frequency Identification (“RFID”) sports timekeeping solutions.

As this transaction provided evidence surrounding the collectability of amounts that had been owing to the Company from past transactions with Mercury Sports Group, Inc., the Company recorded a \$609,700 non-cash impairment of its accounts receivable balance in the third quarter of 2008.

IPICO Inc.
Notes to Consolidated Financial Statements
For the years ended December 31, 2009 and 2008

This brought the carrying value of the Company's accounts receivable from Mercury Sports to the estimated fair value of the assets acquired as follows:

Cash	\$ 166,900
Accounts receivable	417,900
Inventory	773,600
Fixed assets	34,800
Accounts payable and accrued liabilities	<u>(309,900)</u>
	<u>\$ 1,083,300</u>

The Company assigned no value to the minority interest as Mercury Sports has accumulated losses to date and has consolidated the results of operations of Mercury Sports since the date of acquisition.

5. INVENTORIES

	2009	2008
Raw materials	\$ 1,188,512	\$ 1,354,623
Finished goods	704,496	1,881,047
	<u>\$ 1,893,008</u>	<u>\$ 3,235,670</u>

The amount of inventory recognized and included in cost of standard product sales during the year ended December 31, 2009 was \$3,616,468 (2008 - \$1,865,958). The amount charged to net income and included in the cost of standard product sales for the write-down of inventory for valuation issues during the year ended December 31, 2009 was \$206,562 (2008 - \$185,144). There have been no reversals of previous write-downs during the year.

6. CAPITAL ASSETS

	December 31, 2009			December 31, 2008		
	Cost	Accumulated Amortization	Net book value	Cost	Accumulated Amortization	Net book value
Furniture and equipment	\$ 49,341	\$ 25,478	\$ 23,863	\$ 82,959	\$ 35,431	\$ 47,528
Computer equipment and software	224,317	110,011	114,306	224,767	76,098	148,669
Demonstration equipment	-	-	-	149,241	87,262	61,979
Tradeshaw equipment	12,253	7,774	4,479	12,253	6,184	6,069
Leasehold Improvements	9,060	3,999	5,061	9,060	2,202	6,858
	<u>\$294,971</u>	<u>\$ 147,262</u>	<u>\$ 147,709</u>	<u>\$ 478,280</u>	<u>\$ 207,176</u>	<u>\$ 271,104</u>

7. INTANGIBLES

The Company's intangibles represent acquired technology (patents) and licenses. These assets are considered to have a finite useful life and are being amortized over 10 year periods on a straight-line basis.

CICA Handbook Section 3063, Impairment of Long-Lived Assets, requires the Company to evaluate its long-lived assets for impairment when events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of these assets is measured by comparison of the carrying amounts to the future estimated undiscounted cash flows expected to be

IPICO Inc.
Notes to Consolidated Financial Statements
For the years ended December 31, 2009 and 2008

derived from these assets. If these future cash flows are less than the carrying amount of the asset, then the carrying amount of the asset is written down to its fair value, based on the related estimated discounted future cash flows. During the year ended December 31, 2008, the Company determined that the business climate had changed and that such changes may impact the Company's ability to generate revenues, such that the carrying value of the Company's intangible assets may not be fully recoverable. Accordingly, the Company recorded a non-cash impairment charge in the amount of \$1,861,830 for the year ended December 31, 2008 reducing the recorded value of its patented technology to its fair value. The fair value of the patented technology was estimated through the use of a discounted cash flow model whose underlying assumptions were management's best estimate given external and internal information related to the adoption and growth of the Company's RFID products. There were no such impairments for the year ended December 31, 2009.

	December 31, 2009			December 31, 2008		
	Cost	Accumulated Amortization(1)	Net book value	Cost	Accumulated Amortization(1)	Net book value
Patented Technology	\$11,238,172	\$4,601,069	\$6,637,103	\$11,238,172	\$3,539,613	\$7,689,559
Licenses	500,000	187,500	312,500	500,000	137,500	362,500
Right to Technology	115,322	115,322	-	115,322	94,180	21,142
Incorporation costs	2,888	-	2,888	2,888	-	2,888
	\$11,856,382	\$4,903,891	\$6,952,491	\$11,856,382	\$3,771,293	\$ 8,085,089

(1) Including impairment charges

8. GOODWILL

During the year ended December 31, 2008, the Company's market capitalization decreased below the carrying value of the Company's net assets and the Company concluded this to be an indicator of goodwill impairment and, accordingly, moved to the next step in assessing impairment and determined that the fair value of the Company did not support the carrying amount of goodwill. As a result, the Company recorded a non-cash impairment charge of \$5,307,098 writing off the carrying value of goodwill.

9. CONVERTIBLE DEBENTURES

On February 26, 2008, immediately prior to the closing of the public offering described in note 13 the \$5,500,000 of outstanding convertible secured debentures were converted into 6,962,024 common shares.

On September 11, 2009, the Company completed a non-brokered private placement of convertible secured debentures (the "debentures") for gross proceeds of \$3,500,000. Each purchaser of debentures received on closing a commitment fee of 6% together with four warrants for each dollar of principal purchased. The debentures are secured by a general security agreement over assets, bear interest at a rate of 12% per annum, payable upon maturity or earlier repayment, mature on the second anniversary of closing, and are convertible at the option of the holder into common shares of IPICO at a price of \$0.25 per share. Each warrant entitles the holder to purchase one common share of IPICO for a period of 24 months from closing at a price of \$0.25 per share. In addition, a further 350,000 common share warrants with the same terms were issued to the sole holder of the Class A Preferred Shares of IPICO in consideration of certain concessions granted in support of the placement. The Company incurred debenture issuance costs of \$437,688 of which \$256,600 has been expensed in the year as per company policy. All of the securities issued in connection with the placement are restricted from resale for a period of four months and one day from closing. The debentures include various clauses which restrict the activities of the Company in some cases.

IPICO Inc.
Notes to Consolidated Financial Statements
For the years ended December 31, 2009 and 2008

Accordingly, management has included the debentures as part of its managed capital, and will adjust its management of capital process to reflect these restrictions.

As the convertible debentures include features of both debt and equity, the Company allocated the total proceeds from the convertible debentures (less a portion of the issuance costs) based upon the relative fair values of each component of the convertible debenture. The fair value of the debt was estimated by discounting the cash flows due under the convertible debenture by the fair value interest rate for a similar debt instrument without the conversion feature. Having recognized the debt initially at fair value, it is subsequently measured at amortized cost using the effective interest rate method. Interest is recorded as finance cost in the income statement. The Company valued the conversion option and the warrants issued with this convertible debenture on the date of issuance using the Black-Scholes Option Pricing Model and based upon the following assumptions: risk free rate of 1.2%, expected life of 24 months, expected volatility of 66% and expected dividends of nil. The amount allocated to the conversion option is \$625,676 net of issuance costs and the amount allocated to the warrants is \$641,317 net of issuance costs.

10. PREFERRED SHARES

The Class A Preferred shares have a fixed cumulative dividend per share at the rate of 5% per annum. The Preferred Shares have been classified as a financial liability in accordance with EIC-149. As the preferred shares are being accounted for as debt, interest expense is recorded in respect of the cumulative dividend. During the year \$295,057 (2008 - \$279,920) has been added to the value of the preferred shares in respect of this dividend.

Each Preferred Share entitles the holder thereof to one vote at all meetings of shareholders. Each Preferred Share is convertible at any time at the option of the holder without the payment of additional consideration by the holder thereof into one common share (subject to adjustment). The Company may at any time after March 30, 2008 redeem the Preferred Shares in whole or part on payment, for each Preferred Share, of \$1.00 plus any dividends accrued but not yet paid thereon. Each holder of Preferred Shares is entitled to require the Company to redeem, at a time on or after March 30, 2014 any or all of its Preferred Shares for \$1.00 per Preferred Share redeemed plus any dividends accrued but not yet paid thereon. The Preferred Shares have other preferential rights relative to other classes of shares of the Company, including the right to repayment of the stated capital thereof and all accrued and unpaid dividends thereon upon dissolution or winding-up in priority to any distribution to the holders of common shares. The holders of Preferred Shares also have certain approval rights over debt financings proposed by the Company, and pre-emptive rights upon the issuance of common shares by the Company.

11. COMMITMENTS

Operating leases

Future minimum lease payments under non-cancellable operating leases for premises and equipment at December 31, 2009 are as follows:

2010	\$ 175,628
2011	5,315
2012	2,774
2013	2,196
Thereafter	-
Total minimum lease payments	\$ 185,913

IPICO Inc.
Notes to Consolidated Financial Statements
For the years ended December 31, 2009 and 2008

12. CAPITAL MANAGEMENT

The Company considers its capital to include the following:

	2009	2008
Convertible debentures	\$ 2,330,763	\$ -
Preferred shares	6,168,233	5,799,412
Exchangeable shares	-	2,309,106
Contributed surplus	3,405,882	2,064,301
Share capital	43,486,934	41,177,828
	<u>\$ 55,391,812</u>	<u>\$ 51,350,647</u>

The Company manages its capital structure in order to ensure sufficient resources are available to meet day to day operating requirements, to meet debt obligations and to allow it to enhance existing product offerings as well as develop new ones and to have the financial ability to expand the size of its operations in support of its growth strategy. In managing its capital structure, the Company takes into consideration various factors, including the conditions of the markets in which it operates, the growth of its business and related infrastructure and the upfront cost of growing its customer base.

Although, the Company is not subject to any externally imposed capital requirements, the Company is subject to various clauses in its convertible debenture and preferred shares financial instruments which restrict the activities of the Company in some cases. The Company is also subject to certain covenants on its convertible debentures and the Company is in compliance with those covenants.

The Company's Board of Directors takes full responsibility for managing the Company's capital and does so through quarterly board meetings, reviews of financial information and regular communication with officers and senior management. Methods used by the Company to manage its capital include the issuance of new share capital and related warrants which has been done through both private placements and public offerings of its common shares along with debt financing.

13. SHARE CAPITAL

Authorized

Unlimited number of common shares, voting

Unlimited number of 5% cumulative redeemable convertible Class A preferred shares, voting

Common shares

At December 31, 2008, the common shares issued included 3,249,000 common shares held by a trust set up by the Company to provide incentives to key employees. During the year ended December 31, 2009, 1,207,537 shares were released from the trust and the Company recorded a stock based compensation expense in the amount of \$313,960 (2008 - \$0) in accordance with CICA Handbook Section 3870 – Stock Based Compensation and Other-Stock-Based Payments, while 1,856,463 were forfeited, returned to treasury and cancelled. The remaining 185,000 common shares remain in the trust and will not be voted until they are allocated and transferred to the employees.

During the year ended December 31, 2009 all of the remaining 2,309,106 of exchangeable shares were exchanged for 2,309,106 common shares of the Company.

IPICO Inc.
Notes to Consolidated Financial Statements
For the years ended December 31, 2009 and 2008

During the year the Company adopted a Shareholder Rights Plan designed to ensure that all shareholders receive equal treatment and to maximize shareholder value in the event of a take-over bid or other acquisition that could lead to the change in control of the Company. The Shareholder Rights Plan was ratified by the shareholders and will continue in effect until the earlier of the termination time, as defined in the Shareholder Rights Plan, or the date upon which the annual meeting of the shareholders of the Company terminates in 2012.

On February 26, 2008 the Company completed a public offering consisting of 5,212,633 units (“Units”) at a price of \$1.20 per Unit, for gross proceeds of \$6,255,160. Each Unit consisted of one common share of the Company (a “Common Share”) and one common share purchase warrant (a “Warrant”). Each Warrant entitled the holder to purchase one Common Share of the Company at an exercise price of \$1.35 per Common Share, and each Warrant expired without exercise on February 26, 2010. The fair value of the Warrants was estimated to be \$757,053 on the date of issuance using the Black-Scholes Option Pricing Model and based upon the following assumptions: risk free rate of 3%, expected life of 24 months, expected volatility of 35% and expected dividends of nil. The Company incurred issuance costs of \$665,851 in connection with the public offering.

All of the outstanding \$5,500,000 of convertible debentures were converted into 6,962,024 common shares effective immediately prior to the closing of the offering.

Exchangeable shares

On March 30, 2006 the Company issued 2,873,910 exchangeable non-transferable voting common shares of IPICO South Africa (Pty) Ltd. (“IPICO SA”) which shares were exchangeable, subject to South African Republic Bank approval, at the option of either the holder (at any time after the first anniversary of Closing) or IPICO SA on a share for share basis into 2,873,910 Common Shares of IPICO Inc. During the year ended December 31, 2009 the remaining 2,309,106 (2008 - 564,804) exchangeable shares of IPICO South Africa were converted into 2,309,106 (2008 - 564,804) common shares of IPICO Inc.

Warrants

The Company has the following outstanding warrants as at December 31, 2009:

	Number	Expiry Date	Exercise Price
Common share warrants issued to common shareholders – Common Warrants	5,212,633	February 26, 2010	\$ 1.35
Convertible Debenture Warrants	14,350,000	September 11, 2011	\$ 0.25
	<u>19,562,633</u>		

During the year ended December 31, 2009, there were no Common Share warrants exercised while 5,000,000 common share warrants issued to common shareholders and 650,000 compensation warrants expired without exercise. In the prior year, 527,500 Common Share warrants were exercised for proceeds of \$448,375 while 5,396,707 common share warrants issued to common shareholders and 347,835 compensation warrants along with 1,650,000 convertible debenture warrants expired without exercise.

Stock options

The Company’s stock option plan is intended to encourage ownership of the Company by directors, officers and employees of the Company and its subsidiaries. The maximum number of common shares which may be set aside for issuance under the plan is 10% of the voting shares issued and

IPICO Inc.
Notes to Consolidated Financial Statements
For the years ended December 31, 2009 and 2008

outstanding. Any option granted which, for any reason, is cancelled or terminated prior to its exercise, will again become available for grant under the plan.

Options issued under the plan vest annually over a one to three year period. In accordance with the plan, the exercise price of each option is determined based on the fair value of the Company's common shares at the date of grant. Options granted under the plan may be exercised during a period not exceeding five years from the date of grant, subject to earlier termination upon the optionee ceasing to be a director, officer or employee of the Company or any of its subsidiaries, as applicable. Options issued under the plan are non-transferable. A summary of the status of the stock options issued is as follows:

	Number of Stock Options	Weighted Average Exercise Price
Balance, December 31, 2007	2,815,000	\$ 0.99
Granted	1,125,000	\$ 1.31
Exercised	-	-
Forfeited	(513,335)	\$ 1.14
Balance, December 31, 2008	3,426,665	\$ 1.07
Granted	1,750,000	\$ 0.15
Exercised	-	-
Forfeited	(527,501)	\$ 0.70
Balance, December 31, 2009	4,649,164	\$ 0.77

The following table summarizes information regarding stock options outstanding at December 31, 2009:

Options Outstanding				Options Exercisable	
Range of exercise price	Number outstanding	Weighted average contractual life (years)	Weighted average exercise price	Number outstanding	Weighted average exercise price
\$ 0.10 – 0.49	1,675,000	4.04	\$ 0.16	508,332	\$ 0.15
\$ 0.50 – 0.74	528,332	2.48	\$ 0.66	363,329	\$ 0.65
\$ 0.75 – 0.99	100,000	2.50	\$ 0.75	66,666	\$ 0.75
\$ 1.00 – 1.24	1,497,500	1.76	\$ 1.03	1,397,500	\$ 1.01
\$ 1.25 – 2.00	848,332	2.98	\$ 1.60	344,990	\$ 1.57
\$ 0.10 – 2.00	4,649,164	2.90	\$0.77	2,680,817	\$ 0.87

The fair value of the options issued and other stock-based compensation is estimated using the Black-Scholes option pricing model. Expected volatility is based on historical volatility of the Company's common stock and other factors and the weighted average is 51.4% on options issued in 2009 (2008 – 37.4%). The weighted average risk-free interest rates on options issued in 2009 is 1.6% (2008 – 3.6%) and is based on the Government of Canada average bond yields for a period consistent with the expected life of the option in effect at the time of the grant. The expected option lives are based on the contractual lives of the options with an expected dividend yield of nil.

Total stock-based compensation expense for the year ended December 31, 2009 was \$386,304 (2008 - \$413,708).

IPICO Inc.

Notes to Consolidated Financial Statements

For the years ended December 31, 2009 and 2008

Earnings per share

As a result of the losses incurred applicable to common shares, the Common Warrants, Class A Warrants, Service Warrants, Broker Warrants, Compensation Warrants and stock options have been excluded in the diluted loss per share calculation as their inclusion would have been anti-dilutive.

14. INCOME TAXES

The provision for income taxes consists of the following:

	2009	2008
Current		
Federal	\$ -	\$ -
Provincial	-	-
Foreign	-	-
Total current taxes	-	-
Future		
Federal	-	-
Provincial	-	-
Foreign	(66,640)	(66,640)
Total future taxes	(66,640)	(66,640)
Income taxes recovered	\$ (66,640)	\$ (66,640)

The effective income tax rate differs from the statutory rate that would be obtained by applying the combined Canadian basic federal and provisional income tax rate to net loss before income taxes. These differences result from the following items:

	2009	2008
Combined Canadian basic federal and provincial income tax rate	33.0%	33.5%
Increase (decrease) in income tax rate resulting from:		
Losses not recognized for tax	(27.3)%	(31.9)%
Other permanent differences	(3.8)%	(1.4)%
Tax rate differential in foreign subsidiaries	(0.1)%	(0.5)%
Unrealized foreign exchange (gains) losses	(1.1)%	0.7%
Effective income tax rate	0.7%	0.4%

The components of the temporary differences which have created the future tax asset are:

	2009	2008
Losses carried forward	\$ 9,416,577	\$ 9,217,409
Tax depreciation less than accounting depreciation	674,887	1,028,868
Financing fees available to reduce future taxable income	419,892	608,504
Unrealized foreign exchange gains	(15,895)	(120,418)
Other	212,327	52,098
	10,707,788	10,786,461
Valuation allowance	(10,707,788)	(10,786,461)
Future tax asset	\$ -	\$ -

IPICO Inc.
Notes to Consolidated Financial Statements
For the years ended December 31, 2009 and 2008

The components of the temporary differences which have created the future tax liability are:

	2009	2008
Tax basis less than accounting basis for patented technology	\$ 416,585	\$ 483,225
Future tax liability	\$ 416,585	\$ 483,225

The Company has income tax losses available for carry forward of approximately \$34,800,000 which expire as follows:

	Canada	South Africa	Other	Total
2026	\$ 3,700,000	\$ -	\$ 240,000	\$ 3,940,000
2027	8,800,000	-	465,000	9,265,000
2028	8,430,000	-	745,000	9,175,000
2029	6,000,000	-	575,000	6,575,000
Indefinite	-	3,800,000	2,045,000	5,845,000
Total	\$ 26,930,000	\$ 3,800,000	\$ 4,070,000	\$34,800,000

15. RELATED PARTY TRANSACTIONS

The Company incurred the following fees with related parties in the normal course of operations:

	2009	2008
Legal fees to the firm of a Company director	\$ 272,597	\$ 314,080

The Company has a share purchase loan outstanding in the amount of \$240,000 to a Director of the Company secured by the shares. The loan is non-recourse and non-interest bearing. The loan is repayable as follows:

- a) \$60,000 on June 30, 2010,
- b) With the remainder due on December 31, 2011.

The terms of the share purchase loan also provide for the acceleration, in certain events, of the repayment in full of the outstanding balance of the five year term loan.

16. FINANCE COST – NET

	2009	2008
Interest expense – Convertible debentures	\$ 278,844	\$ 156,022
Interest expense – Preferred shares	368,821	339,803
Interest income	(12,477)	(207,828)
Transaction costs	256,600	-
Finance costs - Net	\$ 891,788	\$ 287,997

Cash interest paid during the year ended December 31, 2009 was \$0 (2008 - \$101,260).

IPICO Inc.
Notes to Consolidated Financial Statements
For the years ended December 31, 2009 and 2008

17. CHANGES IN NON CASH OPERATING WORKING CAPITAL

	2009	2008
Accounts receivable	\$ (347,533)	\$ (398,941)
Other receivables	104,936	3,112
Prepaid expense	20,009	(44,682)
Inventories	1,342,662	(1,065,769)
Accounts payable and accrued liabilities	540,041	(73,299)
Deferred revenue	(355,766)	348,659
Changes in non cash operating working capital	\$ 1,304,349	\$ (1,230,920)

18. FINANCIAL INSTRUMENTS

Under Canadian generally accepted accounting principles, financial instruments are classified into one of the following categories: held for trading, held-to-maturity investments, available-for-sale, loans and receivables and other financial liabilities. The following table summarizes information regarding the carrying values of the Company's financial instruments:

	2009	2008
Held for trading (1)	\$ 1,873,268	\$ 4,371,557
Loans and receivables (2)	\$ 1,095,136	\$ 852,539
Other financial liabilities (3)	\$ 10,391,145	\$ 7,151,520

(1) Cash and cash equivalents

(2) Accounts receivable and other receivables

(3) Accounts payable and accrued liabilities, convertible debentures and preferred shares

Fair Value

Cash and cash equivalents, accounts receivable, other receivables, as well as accounts payable and accrued liabilities are short term financial instruments whose fair values approximate their respective carrying amounts due to their short maturities.

Fair value measurements recognized in the balance sheet must be categorized in accordance with the following levels:

Level 1 - quoted prices in active markets for identical assets or liabilities;

Level 2 - inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices); and

Level 3 - inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Financial assets recognized in the balance sheet at fair value consist of cash and cash equivalents which have been categorized in Level 2 as they are derived from observable market inputs.

Based on current interest rates for loans with similar terms to similar companies, the fair value of the preferred shares is estimated to be \$5,112,000.

IPICO Inc.
Notes to Consolidated Financial Statements
For the years ended December 31, 2009 and 2008

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity is to ensure that it has sufficient resources to meet its liabilities when due.

The Company settles its financial obligations out of cash and cash equivalents. The ability to do this depends on the Company collecting its accounts receivable in a timely manner and maintaining sufficient cash on hand.

The following are the future contractual maturities of financial liabilities as at December 31, 2009:

Accounts payable and accrued liabilities	0 to 3 months	\$ 2,121,293
Convertible debentures – note 9	September 11, 2011	4,340,000
Preferred shares – note 10	After March 30, 2014	7,952,482
Total		\$14,413,775

During the year ended December 31, 2009, the Company incurred a net loss of \$9,658,832 (2008 - \$10,480,382 prior to the \$7,168,928 non cash impairment of goodwill and intangibles, and the \$609,700 impairment in accounts receivable) and used cash from operations of \$5,796,945 (2008 - \$9,544,394). To date, the Company has relied primarily upon the proceeds from private placements and public offerings of its common shares to fund its operations. The Company anticipates that it will require additional funding based on current plans and assumptions relating to its operations and current cash resources may be depleted late in the second quarter. The Company is pursuing remedial funding which could include incurring debt and/or issuing additional equity securities, which could result in substantial dilution to existing shareholders. However, there can be no assurance that the Company's plans will be successful and that additional funding will be available or, if available, that it will be available on acceptable terms.

Credit risk

The Company is exposed to credit risk in its cash and cash equivalents, accounts receivable and other receivables where the counterparties do not meet their obligations. The Company minimizes the credit risk of cash and cash equivalents by depositing with only reputable financial institutions and investing in short term money market investments. The Company minimizes its credit risk related to accounts receivable and other receivables through credit review and on-going monitoring of accounts and as at December 31, 2009 five customers represented approximately 68% (2008 - 75%) of the total accounts receivable. The maximum exposure to loss arising from accounts receivable is equal to the total carrying amount.

Credit risk from accounts receivable relates primarily from the potential of customers defaulting on their contractual obligations. The Company provides its services under contracts and formal purchase orders and monitors each customer's adherence to the terms and conditions of these contracts.

The Company assesses the risk of default of new customers and of current customers on an on-going basis with regular reviews of the collectability of each customer's accounts receivable including the review of the aging of accounts receivable with a focus on past due accounts. When collection is not reasonably assured the amount is written off. As at December 31, 2009, approximately 44% of accounts receivable were current with 45% being 1 to 90 days past due and 11% over 90 days past due.

IPICO Inc.
Notes to Consolidated Financial Statements
For the years ended December 31, 2009 and 2008

Foreign currency risk

The Company accounts for its foreign subsidiaries as integrated operations. The Company is funding its subsidiary operations and is exposed to foreign currency risk with the South African Rand, the United States Dollar, the Australian Dollar, the Euro and the Chinese Yuan. The Company reports in Canadian dollars and therefore is exposed to foreign exchange fluctuations in its monetary assets and liabilities, working capital and revenues and expenses. The Company does not utilize any financial instruments or cash management policies to mitigate the risks arising from changes in foreign currency rates. There is a risk to the Company's earnings that arises from fluctuations in foreign exchange rates and the degree of volatility of these rates. For the year ended December 31, 2009, the Company recorded a foreign exchange loss of \$200,476 compared to a gain in 2008 of \$218,429.

The Company's financial instruments could be exposed to foreign currency risk as follows:

	Canada %	United States %	South Africa %	Other %	Total %
Cash and cash equivalents	48	46	4	2	100
Accounts and other receivables	1	28	5	66	100
Accounts payable and accrued liabilities	35	7	35	23	100

A one-cent increase or decrease in the value of the Canadian dollar against the South African Rand, the United States Dollar, the Australian Dollar, the Euro and the Chinese Yuan on the foreign currency denominated assets and liabilities, assuming these amounts remain unchanged, results in an approximately \$14,500 foreign exchange gain or loss.

Interest rate risk

The Company is not exposed to significant interest rate risk as its cash and cash equivalents are short term investments with maturities of less than three months and the Company's interest bearing debt instruments, which include the preferred shares, have fixed interest rates.

19. SEGMENTED INFORMATION

The Company has one reportable segment. The Company's operations are substantially all related to the research, design, manufacturing and sales of RFID equipment. The Company determines the geographic area of its revenues based on the location of the customer.

Revenue:

	2009	2008
Canada	\$ 162,195	\$ 9,291
United States	2,441,586	2,463,242
South Africa	117,864	175,242
Asia Pacific	1,922,468	181,088
Europe	1,878,157	743,312
Other	445,356	313,166
Revenue	\$ 6,967,626	\$ 3,885,341

IPICO Inc.
Notes to Consolidated Financial Statements
For the years ended December 31, 2009 and 2008

In 2009, sales to the Company's largest customer accounted for 12.8% (2008 – 55.3%) of the Company's total revenue.

Intangible and capital assets:

	2009	2008
Canada	\$ 5,532,252	\$ 6,439,781
South Africa	1,495,057	1,746,652
Other	72,891	169,760
Intangible and capital assets	\$ 7,100,200	\$ 8,356,193

20. COMPARATIVE NUMBERS

Certain numbers have been restated to comply with current presentation.