

**NOVIK INC.**

Consolidated Financial Statements  
**December 31, 2010 and 2009**



To the shareholders of:

*Novik inc.*

### **Report on the Consolidated Financial Statements**

We have audited the accompanying consolidated financial statements of Novik inc, which comprise the consolidated balance sheets as at December 31, 2010 and 2009, and the consolidated statements of earnings and comprehensive income, consolidated statement of retained earnings, consolidated statement of contributed surplus and consolidated statement of cash flows and a summary of significant accounting policies and other explanatory information for the years then ended.

### ***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 audits 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 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 Novik inc. as at December 31, 2010 and 2009, and its financial performance and its cash flows for the year then ended in accordance with Canadian Generally Accepted Accounting Principles.

Yours very truly,

*Dallaire Forest Kirouac S.E.N.C.R.L.*

Quebec City (Québec) Canada

February 23, 2011

CA Auditor permit no: 11198

# Novik Inc.

## Consolidated Balance Sheets

	<b>As at December 31,</b>	
	<b>2010</b>	<b>2009</b>
	<b>\$</b>	<b>\$</b>
<b>Assets</b>		
<b>Current assets</b>		
Accounts receivable (notes 4, 9 and 11)	1,887,198	2,369,825
Inventories (notes 5, 9 and 11)	4,695,966	4,011,785
Refundable tax credits	133,692	174,168
Prepaid expenses	351,956	337,870
	<hr/>	<hr/>
	7,068,812	6,893,648
<b>Government assistance receivable</b> (note 6)	60,076	122,576
<b>Tax credits recoverable</b>	438,594	408,379
<b>Property, plant and equipment</b> (notes 7 and 11)	15,284,180	16,087,229
<b>Intangible assets</b> (note 8)	1,392,128	1,590,356
<b>Future income tax assets</b> (note 13)	62,827	212,140
	<hr/>	<hr/>
	24,306,617	25,314,328
<b>Liabilities</b>		
<b>Current liabilities</b>		
Bank loan (note 9)	1,621,972	1,794,591
Accounts payable and accrued liabilities (note 10)	2,266,095	2,251,771
Deferred income	156,010	-
Current portion of long-term debt (notes 11 and 21)	838,767	1,390,315
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	4,882,844	5,436,677
<b>Long-term debt</b> (notes 11 and 21)	8,121,660	9,059,624
<b>Future income tax liabilities</b> (note 13)	88,874	-
	<hr/>	<hr/>
	13,093,378	14,496,301
<b>Shareholders' Equity</b>		
<b>Capital stock</b> (note 12a)	9,946,318	9,946,318
<b>Stock options</b> (note 12b)	597,142	672,586
<b>Contributed surplus</b>	1,154,111	962,667
<b>Deficit</b>	(484,332)	(763,544)
	<hr/>	<hr/>
	11,213,239	10,818,027
	<hr/>	<hr/>
	24,306,617	25,314,328
<b>Commitments, Contingency and Subsequent Events</b> (notes 19, 20 and 21)		

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

**Approved on behalf of the Board of Directors**

(signed) MICHEL GAUDREAU, Director

(signed) LOUIS-ANDRÉ GAUDREAU, Director

# Novik Inc.

## Consolidated Statements of Retained Earnings (Deficit)

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	<u>Years Ended December 31,</u>	
	<b>2010</b>	<b>2009</b>
	<b>\$</b>	<b>\$</b>
<b>Balance – Beginning of year</b>	(763,544)	12,309
Net earnings (loss) for the period	<u>279,212</u>	<u>(775,853)</u>
<b>Balance – End of year</b>	<u>(484,332)</u>	<u>(763,544)</u>

## Consolidated Statements of Contributed Surplus

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	<u>Years Ended December 31,</u>	
	<b>2010</b>	<b>2009</b>
	<b>\$</b>	<b>\$</b>
<b>Balance – Beginning of year</b>	962,667	958,621
Cancelled stock options (note 12b)	<u>191,444</u>	<u>4,046</u>
<b>Balance – End of year</b>	<u>1,154,111</u>	<u>962,667</u>

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

# Novik Inc.

## Consolidated Statements of Earnings and Comprehensive Income

	<b>Years Ended December 31,</b>	
	<b>2010</b>	<b>2009</b>
	<b>\$</b>	<b>\$</b>
<b>Revenues</b>		
Gross revenue	24,429,507	15,326,627
Introduction and payment discounts	(653,839)	(265,743)
	<u>23,775,668</u>	<u>15,060,884</u>
<b>Cost of sales</b>		
Direct costs	13,504,027	7,995,176
Depreciation of property, plant and equipment	1,243,437	1,230,486
Amortization of intangible assets	56,404	73,670
Gain on disposal of property, plant and equipment	(51,829)	-
	<u>14,752,039</u>	<u>9,299,332</u>
<b>Gross margin</b>	<u>9,023,629</u>	<u>5,761,552</u>
<b>Operating expenses</b>		
Selling expenses	5,731,912	4,858,364
Administrative expenses (including stock-based compensation costs of \$ 116,000; \$ 152,000 in 2009)	1,638,233	1,795,238
Research and development costs	122,216	44,126
Depreciation of property, plant and equipment	31,082	35,184
Amortization of intangible assets	437,633	413,233
	<u>7,961,076</u>	<u>7,146,145</u>
<b>Earnings (loss) from operations</b>	<u>1,062,553</u>	<u>(1,384,593)</u>
<b>Financial expenses (revenues)</b>		
Interest and bank charges	165,944	114,098
Interest on long-term debt	650,835	690,955
Exchange gain on monetary items	(73,009)	(496,863)
Unrealized exchange gain on forward exchange contracts	(198,616)	(575,104)
	<u>545,154</u>	<u>(266,914)</u>
<b>Earnings (loss) before income taxes</b>	<u>517,399</u>	<u>(1,117,679)</u>
<b>Future income tax expense (recovery)</b> (note 13)	<u>238,187</u>	<u>(341,826)</u>
<b>Net earnings (loss) and comprehensive income for the year</b>	<u>279,212</u>	<u>(775,853)</u>
<b>Basic and diluted net earnings (loss) per share</b> (note 14)	<u>0.006</u>	<u>(0.016)</u>
<b>Weighted average number of shares considered</b> (note 14)		
Basic	<u>48,470,858</u>	<u>48,470,858</u>
Diluted	<u>48,542,396</u>	<u>48,559,482</u>

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

# Novik Inc.

## Consolidated Statements of Cash Flows

	<b>Years Ended December 31,</b>	
	<b>2010</b>	<b>2009</b>
	<b>\$</b>	<b>\$</b>
<b>Cash flows from operating activities</b>		
Net earnings (loss) for the year	279,212	(775,853)
Items not affecting cash		
Stock-based compensation	116,000	152,000
Interest capitalized on long-term debt	16,462	32,028
Unrealized exchange loss (gain)	164,362	(840,281)
Gain on disposal of property, plant and equipment	(51,829)	-
Depreciation and amortizations	1,860,469	1,830,980
Future income taxes	238,187	(341,826)
	<u>2,622,863</u>	<u>57,048</u>
Net change in non-cash working capital items (note 15a)	<u>(443,080)</u>	<u>1,575,594</u>
	<u>2,179,783</u>	<u>1,632,642</u>
<b>Cash flows from financing activities</b>		
Increase (decrease) in bank loan	(50,214)	931,548
Long-term debt contracted	114,080	1,355,157
Increase in deferred financing expenses	(84,028)	(81,030)
Repayment of long-term debt	<u>(1,503,766)</u>	<u>(1,824,941)</u>
	<u>(1,523,928)</u>	<u>380,734</u>
<b>Cash flows from investing activities</b>		
Additions to property, plant and equipment	(741,869)	(1,452,410)
Additions to intangible assets	(295,809)	(581,555)
Proceeds from disposal of property, plant and equipment	349,538	-
Increase in refundable tax credits	(30,215)	(41,911)
Government assistance	62,500	62,500
	<u>(655,855)</u>	<u>(2,013,376)</u>
<b>Net change in cash and cash equivalents</b>	-	-
<b>Cash and cash equivalents - Beginning of year</b>	-	-
<b>Cash and cash equivalents - End of year</b>	-	-
<b>Additional information</b> (notes 15b and c)		

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

# **Novik Inc.**

## Notes to Consolidated Financial Statements

At December 31, 2010 and 2009

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### **1 Statutes and nature of activities**

Novik inc. (“the company”), incorporated under Part IA of the Québec Companies Act, specializes in the design, manufacturing and marketing of new polymer siding and roofing covers and of a wide variety of exterior and utility decorative products for residential and commercial construction and the home improvement industry.

### **2 Summary of significant accounting policies**

#### **Basis of reporting**

These consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles. The company’s reporting currency is the Canadian dollar. The company’s functional currency is also the Canadian dollar except for its foreign integrated subsidiary, located in the United States of America. However, upon consolidation, the financial statements of this subsidiary are translated according to the temporal method. Accordingly, revenues, expenses and cash flows are translated at the average rate for the period. Monetary assets and liabilities are translated at the rate of exchange in effect at the end of the reporting period. All of the exchange gains and losses are current in nature and included in the statement of earnings.

#### **Consolidation policies**

These consolidated financial statements include the accounts of the company and its wholly-owned subsidiary from the date of inception. Intercompany accounts and transactions are eliminated upon consolidation.

#### **Use of estimates**

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts of assets and liabilities reported in the financial statements. Those estimates and assumptions also affect the disclosure of contingencies at the date of the financial statements and the reported amounts of revenues and expenses during the year. Actual results could differ from those estimates.

#### **Foreign currency translation**

##### Foreign currency transactions

The company follows the temporal method of accounting for translation of foreign currency transactions. Under this method, monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the exchange rate in effect at year-end. All other assets and liabilities are translated at the exchange rate in effect on each transaction date. Exchange gains or losses are accounted for in the consolidated statement of earnings. Revenues and expenses are translated at the average rate for the year.

##### Foreign currency forward exchange contracts

The company has elected not to apply hedge accounting. Consequently, the company's foreign currency forward exchange contracts, which are used to hedge anticipated US-denominated sales, are recorded at fair value. The unrealized assets or liabilities on foreign currency forward exchange contracts have been recorded under current assets or liabilities in the consolidated balance sheet as accounts receivable or accounts payable and accrued liabilities. The unrealized gain or loss has been accounted for in the consolidated statement of earnings.

# Novik Inc.

## Notes to Consolidated Financial Statements

At December 31, 2010 and 2009

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### Cash and cash equivalents

Cash and cash equivalents includes cash and highly liquid financial instruments with an original maturity term of three months or less. The bank loan is not included in cash and cash equivalents. Cash flows related to this item are reported as financing activities. The company is part of a netting agreement with its financial institution in relation with its bank loan and deposits. Therefore the balance of cash is recorded as a reduction of the bank loan balance. Any excess of cash over bank loan balance will be reported on the balance sheet as assets and as cash and cash equivalents on the cash flow statement.

### Inventories

Inventories are valued at the lower of cost and net realizable value. Cost of raw materials is determined using the weighted average cost method. Cost of finished goods is determined using the standard cost method.

The amount of inventories recognized as an expense during the period corresponds to the cost of sales presented in the statement of earnings.

### Impairment of non-monetary long-lived assets

The company tests non-monetary long-lived assets for recoverability whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. For the purposes of this evaluation, the company groups assets and liabilities for which identifiable cash flows are largely associated. A loss for impairment of non-monetary long-lived assets is accounted for when the carrying amount exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposal of the asset or group of assets (and liabilities) considered. The impairment loss accounted for in the consolidated statement of earnings is measured as the amount by which the carrying amount exceeds the fair value.

### Property, plant and equipment

Property, plant and equipment are accounted for at cost. They are depreciated from the date they are put into use over their estimated useful lives using the following methods, period and annual rates:

	Methods	Period and rates
Building	Declining balance	4%
Equipment	Declining balance	10%
Molds	Straight-line	15 years
Office furniture	Declining balance	20%
Computer equipment	Declining balance	30%

# **Novik Inc.**

## Notes to Consolidated Financial Statements

At December 31, 2010 and 2009

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### **Intangible assets**

Intangible assets, which mainly consist of Deferred development expenses, Software, Web site, Trademarks and Patents are accounted for at cost. Expenditures on research are recognized as an expense when they are incurred. Expenditures on development that do not meet certain defined conditions are also recognized as an expense when they are incurred. Expenditures on development are recognized as an intangible asset when the company can demonstrate that these conditions are met. Deferred development expenses are amortized using the straight-line method over a maximum period of five years. Software and Web site are accounted for at cost and they are amortized using the declining balance at an annual rate of 30% beginning at the date they are put into use. Trademarks and patents are amortized from the date they received authorities' acceptance into use using the straight-line method over a maximum period of fifteen years.

### **Tax credits and government assistance**

Tax credits and government assistance are accounted for in the period in which the related expenses are incurred, provided the company has reasonable assurance the amounts will be recovered. Tax credits and government assistance related to deferred development expenses or to property, plant and equipment are accounted for against the cost of these assets and are amortized at the same rate than that used for the corresponding assets. Tax credits and government assistance pertaining to current expenses are recognized in earnings as the related expenses are incurred.

Amounts comprised in "Refundable tax credits" and "Tax credits recoverable" relate to claims that are still subject to review by tax authorities. Any difference between amounts refundable accounted for by the company and tax credits granted by tax authorities shall be accounted for at this time, in the consolidated statement of earnings or as an adjustment of the cost of property, plant and equipment or intangible assets, as appropriate.

### **Provision for warranties**

The company offers on its products limited and transferable warranties that decrease proportionally to the number of years. The company's typical warranties require it to replace defective products during the warranty period at no cost to the customer. The company records a provision for warranties when products are delivered based upon its expectations of warranty costs to be incurred.

### **Long-term debt**

Long-term debt, including debt-related issue costs, is accounted for at amortized cost using the effective rate interest method.

### **Revenue recognition**

Revenue, which mainly consists of sales of goods, is recognized when the products are delivered to customers and recovery of the sale price is reasonably certain. Significant risks and benefits related to ownership are then transferred. Introduction and discount payments are presented against gross revenue. These discounts are accounted for when the products are delivered to customers if a written discount agreement exists between the company and the customer.

# **Novik Inc.**

## Notes to Consolidated Financial Statements

At December 31, 2010 and 2009

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### **Income taxes**

The company provides for income taxes using the liability method of tax allocation. Under this method, future income tax assets and liabilities are determined based on all of deductible or taxable temporary differences between carrying values and tax base values of assets and liabilities using enacted or substantively enacted income tax rates and laws expected to be in effect for the year in which the differences are expected to reverse.

The company establishes a valuation allowance against future income tax assets if, based on available information, it is more likely than not that some or all of the future income tax assets will not be realized.

### **Equity issue expenses**

Equity issue expenses are accounted for against the amount of the related equity instrument issued.

### **Earnings per share and information pertaining to the number of shares**

Basic earnings per share is determined using the weighted average number of participating shares outstanding during the year.

Diluted earnings per share is determined using the weighted average number of participating shares outstanding during the year, plus the effects of potentially dilutive participating shares outstanding during the year. The calculation of diluted earnings per share is made using the treasury stock method, as if all potentially dilutive participating shares had been exercised at the later of the beginning of the year or the date of issuance, as the case may be, and that the funds obtained thereby had been used to purchase participating shares of the company at the average market value of the participating shares during the year.

### **Stock-based compensation and other stock-based payments**

The company uses the fair value method to account for awards of stock to employees, management, directors and consultants. Any consideration paid by plan participants on the exercise of stock options or the purchase of shares is credited to capital stock together with any related stock-based compensation cost. Stock-based compensation costs are recognized over the vesting period of the options.

## **3 Changes in accounting policies**

### a) Research and other development costs

On January 1, 2009, the company has adopted Section 3064 “Goodwill and intangible assets”, which replaces Section 3062 “Goodwill and Other Intangible Assets” and Section 3450 “Research and Other Development Costs”.

The adoption of this new Section, together with the adoption of changes made to Section 1000, “Financial statement concepts”, has led the Company to change the accounting methods applied for deferred development expenses.

# Novik Inc.

## Notes to Consolidated Financial Statements

At December 31, 2010 and 2009

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However, this change had no impact on the Company's financial position and results of operations. Furthermore, the company changed the disclosure of the significant accounting policies in Note 2 and the deferred development expenses, formerly reported in the assets as a component of deferred expenses, are now reported as a component of intangible assets.

b) Future change in accounting policies

The company will adopt International financial reporting standards (IFRS) for the preparation of their interim and annual consolidated financial statements relating to fiscal years beginning on January 1, 2011. The company has developed a plan for the conversion of its financial statements to IFRS. An analysis of the differences between IFRS and the current Canadian GAAP was conducted in the last months.

As required by IFRS 1, "First-time Adoption of International Financial Reporting Standards," adjustments required upon transition to IFRS will be made retrospectively against opening consolidated retained earnings as of January 1, 2011 presented as comparative information. These adjustments will be reflected at January 1, 2010 in the Company's interim consolidated financial statements as at March 31, 2011.

#### 4 Accounts receivable

	As at December 31,	
	2010	2009
	\$	\$
Trade accounts receivable	1,313,775	1,553,685
Government assistance receivable (note 6)	62,500	62,500
Sales taxes receivable	113,825	29,906
Deposits and others	198,482	148,630
Fair value of forward exchange contracts (note 17)	198,616	575,104
	<u>1,887,198</u>	<u>2,369,825</u>

#### 5 Inventories

	As at December 31,	
	2010	2009
	\$	\$
Raw materials	1,256,752	1,044,514
Finished goods	3,439,214	2,967,271
	<u>4,695,966</u>	<u>4,011,785</u>

# Novik Inc.

## Notes to Consolidated Financial Statements

At December 31, 2010 and 2009

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### 6 Government assistance receivable

During the fiscal year ended December 31, 2008, the company has entered into an agreement whereby it could receive a financial contribution of a maximum amount of \$250,000 under the Business Assistance – Immigrant Investor Program. This government assistance was accounted for against property, plant and equipment. The amount receivable is to be cashed in annual equal instalments of \$62,500. The long-term portion receivable has been discounted to take into consideration an effective interest rate of 1.31%, which represents the one-month Treasury bill rate at the date of agreement.

	<u>As at December 31,</u>	
	<b>2010</b>	<b>2009</b>
	\$	\$
Government assistance receivable	122,576	185,076
Less current portion (note 4)	<u>62,500</u>	<u>62,500</u>
	<u>60,076</u>	<u>122,576</u>

### 7 Property, plant and equipment

	<u>As at December 31,</u>			
	<b>2010</b>		<b>2009</b>	
	<b>Cost</b>	<b>Accumulated depreciation</b>	<b>Cost</b>	<b>Accumulated depreciation</b>
	\$	\$	\$	\$
Land	476,348	-	476,348	-
Building	5,297,182	821,535	5,291,324	635,126
Equipment	8,116,189	2,718,728	8,254,810	2,351,538
Molds	7,122,427	2,408,538	6,873,863	1,936,436
Office furniture	77,492	53,472	72,759	48,353
Computer equipment	269,379	183,269	241,779	152,201
Deposits on property, plant and equipment	<u>110,705</u>	<u>-</u>	<u>-</u>	<u>-</u>
	21,469,722	<u>6,185,542</u>	21,210,883	<u>5,123,654</u>
Less:				
Accumulated depreciation	<u>6,185,542</u>		<u>5,123,654</u>	
Net amount	<u>15,284,180</u>		<u>16,087,229</u>	

# Novik Inc.

## Notes to Consolidated Financial Statements

At December 31, 2010 and 2009

### 8 Intangible assets

	As at December 31,			
	2010		2009	
	Cost \$	Accumulated amortization \$	Cost \$	Accumulated amortization \$
Deferred development expenses	2,211,804	1,186,632	1,989,563	812,671
Software	1,154,983	869,195	1,117,298	755,457
Web site	37,720	27,899	37,720	23,689
Trademarks	41,932	10,717	37,681	8,859
Patents	40,402	270	8,770	-
	3,486,841	<u>2,094,713</u>	3,191,032	<u>1,600,676</u>
Less:				
Accumulated amortization	<u>2,094,713</u>		<u>1,600,676</u>	
Net amount	<u>1,392,128</u>		<u>1,590,356</u>	

During the year ended December 31, 2010, the company applied research and development tax credits amounting to \$59,378 (\$80,389 in 2009) against deferred development expenses.

### 9 Credit facilities

The company has an available authorized line of credit of \$4,000,000 or its equivalent in US dollars that can be used in the form of letters of credit or a bank loan bearing interest at the lender's Canadian prime rate plus 1.50% and the US prime rate plus 1.50%. The line of credit is renewable annually. Accounts receivable and inventories have been pledged as collateral for the line of credit.

As at December 31, 2010, the company has outstanding letter of credit of \$USD 300,000 (\$USD 300,000 in 2009).

### 10 Accounts payable and accrued liabilities

	As at December 31,	
	2010 \$	2009 \$
Trade accounts payable	1,301,319	1,168,528
Salaries and employee benefits payable	337,911	288,117
Accrued liabilities	626,865	795,126
	<u>2,266,095</u>	<u>2,251,771</u>

# Novik Inc.

## Notes to Consolidated Financial Statements

At December 31, 2010 and 2009

### 11 Long-term debt

	As at December 31,	
	2010	2009
	\$	\$
Immoveable hypothec without delivery, bearing interest at prime rate plus 1%, payable in monthly principal instalments of \$17,170 plus interest, beginning in December 2010, maturing in May 2036	5,133,830	5,150,000
Notes payable secured by a moveable hypothec on equipment, molds and all tangible assets, bearing interest at December 31, 2010, at rates varying from prime rate plus 0.65%, at libor rate plus 8.55% and at fix rate of 4.5% to 4.87%, maturing between 2011 and 2014	2,416,541	3,503,538
Notes payable secured by a moveable hypothec on equipment and molds, bearing interest at December 31, 2010, at rates varying from prime rate plus 0.5% to 1.9%, at bank acceptance rate plus 2.7% to 2.9% and at fixe rate of 6.35%, maturing between 2011 and 2015	846,580	1,294,915
Notes payable to Canada Economic Development, non-interest bearing, payable in equal and consecutive annual instalments of \$76,440, maturing between 2011 and 2013, discounted at an effective rate of 15%*	117,958	174,812
Note payable to Canada Economic Development, non-interest bearing, payable in monthly principal instalment of \$3,000, beginning in March 2012, maturing in February 2017, discounted at an effective rate of 15%*	173,148	90,178
Note payable under a Strategic Support for Investment Program, non-interest bearing, payable in monthly principal instalments of \$9,084, starting in April 2012, maturing in March 2019, discounted at an effective rate of 15%*	390,702	362,713
Deferred financing costs	(118,332)	(126,217)
	8,960,427	10,449,939
Less: Current portion (note 21)	838,767	1,390,315
	8,121,660	9,059,624

As at December 31, 2010, the weighted average effective rate was 6.90% (6.40 % as at December 31, 2009).

The company has a long-term debt totalling \$1,463,485 which is payable in US dollars.

# Novik Inc.

## Notes to Consolidated Financial Statements

At December 31, 2010 and 2009

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The annual estimated principal instalments required over the next five years considering the new repayment terms and conditions that will apply as of February 2011 (see note 21) are as follow: \$838,767 in 2011, \$1,117,932 in 2012, \$974,378 in 2013, \$784,260 in 2014 and \$601,824 in 2015.

The company is committed to meet certain financial ratios in connection with certain of its loans. All financial ratios were met through out the period (notes 16 and 21).

\* Effective rate of 15 % represents the company's estimate of the prevailing market interest rate for a similar instrument with a similar credit rating. As at December 31, 2010, the undiscounted balance of these notes payable amount to \$1,213,587 (\$1,175,914 as at December 31, 2009).

## 12 Capital stock

- a) The company's authorized capital stock is composed of an unlimited number of common shares, without par value, voting and participating.

The following table summarizes the capital stock activity since January 1, 2009:

	2010		2009	
	Number	Stated value \$	Number	Stated value \$
<b>Balance – Beginning and End of year</b>	48,470,858	9,946,318	48,470,858	9,946,318

# Novik Inc.

## Notes to Consolidated Financial Statements

At December 31, 2010 and 2009

### b) Stock options

On September 20, 2005, the company put in place a stock option plan for employees, officers, directors and consultants. Options vest over a maximum period of ten years and are exercisable under the conditions established by the committee on the date of grant. The purchase price of the shares under the plan corresponds to the quoted market price of the shares of the company at the closing of the market, on the trading day preceding immediately the date of grant. The maximum number of shares issuable under the plan is limited to 7,435,600 shares and the maximum number that may be granted to an optionee shall not exceed 5% of all the issued and outstanding shares.

Under the plan in effect on May 28, 2009, the company granted 575,000 stock options to its directors and certain managers at an exercise price of \$0.32, maturing on May 28, 2014. A compensation expense of \$151,300 has been accounted for in the consolidated statement of earnings at the time of issue as these new stock options are exercisable immediately.

Under the plan in effect on May 27, 2010, the company granted 705,000 stock options to its directors and certain managers at an exercise price of \$0.20 maturing on May 27, 2015. A compensation expense of \$116,000 has been accounted for in the consolidated statement of earnings at the time of issue as these new stock options are exercisable immediately.

The following table summarizes information about outstanding and exercisable stock options under the plan since January 1, 2009:

	2010			2009		
	Number	Carrying value \$	Weighted average exercise price \$	Number	Carrying value \$	Weighted average exercise price \$
Outstanding - Beginning of year	2,583,500	672,586	0.39	2,024,000	524,632	0.42
Granted during the year	705,000	116,000	0.20	575,000	152,000	0.32
Cancelled during the year*	(733,500)	(191,444)	0.50	(15,500)	(4,046)	0.50
Outstanding - End of year	2,555,000	597,142	0.31	2,583,500	672,586	0.39
Exercisable - End of year	2,555,000		0.31	2,583,500		0.39

\* An amount of \$191,444 (\$4,046 in 2009) has been accounted for as an increase of the contributed surplus following cancellation of 733,500 (15,500 in 2009) exercisable stock options.

# Novik Inc.

## Notes to Consolidated Financial Statements

At December 31, 2010 and 2009

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The following table summarizes information on outstanding and exercisable stock options under the plan as at December 31, 2010:

<b>Exercise price</b>	<b>Options outstanding and exercisable</b>	
	<b>Number</b>	<b>Weighted average contractual life (years)</b>
\$0.19	330,000	1.40
\$0.32	575,000	3.41
\$0.40	425,000	2.41
\$0.45	400,000	0.40
\$0.46	120,000	0.24
\$0.20	705,000	4.41
	<b>2,555,000</b>	<b>2.64</b>

The fair value of the stock options issued was estimated using the Black-Scholes valuation model with the following assumptions:

	<b>Granted under the plan on May 27, 2010</b>	<b>Granted under the plan on May 28, 2009</b>
Risk-free interest rate	0.41%	0.44%
Expected volatility	120%	120%
Dividend yield	Nil	Nil
Expected life	60 months	60 months
Fair value on the date of grant	\$0.16	\$0.26

# Novik Inc.

## Notes to Consolidated Financial Statements

At December 31, 2010 and 2009

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### 13 Income taxes

The reconciliation of the income tax expense calculated using the statutory combined income tax rates of the federal government (Canada) and provinces concerned (Quebec), to the income tax expense per the financial statements is as follows:

	<b>Years Ended December 31,</b>	
	<b>2010</b>	<b>2009</b>
	<b>\$</b>	<b>\$</b>
Income tax expense (recovery) at the combined statutory tax rate (29.9% in 2010 and 30.9% in 2009)	154,702	(345,363)
Increase (decrease) due to:		
Non-taxable income	(8,835)	(84,177)
Stock-based compensation costs	34,684	46,968
Other non-deductible expenses	23,033	18,790
Change in valuation allowance	(9,926)	(56,904)
Change in tax rates	(18,615)	88,698
Adjustments from prior years	54,499	-
Other	8,645	(9,838)
	<u>238,187</u>	<u>(341,826)</u>

# Novik Inc.

## Notes to Consolidated Financial Statements

At December 31, 2010 and 2009

Significant components of the company's future income tax assets and liabilities are detailed as follows:

	<b>As at December 31,</b>	
	<b>2010</b>	<b>2009</b>
	<b>\$</b>	<b>\$</b>
Long-term future income tax assets		
Non-capital losses	1,207,986	1,236,051
Research and development expenses	360,854	289,618
Share issue and financing expenses	6,878	48,942
Unrealized exchange loss	-	9,926
Valuation allowance	-	(9,926)
Other	19,455	7,655
	<u>1,595,173</u>	<u>1,582,266</u>
Long-term future income tax liabilities		
Property, plant and equipment	1,463,584	1,218,187
Long term debt	143,041	151,939
Unrealized exchange gain	14,595	-
	<u>1,621,220</u>	<u>1,370,126</u>
Long-term future income tax assets (liabilities), net	<u>(26,047)</u>	<u>212,140</u>

The company accumulated federal and provincial deferred non-capital losses of \$4,254,884 and \$4,787,845 respectively and maturing at different date until 2030.

## 14 Earnings per share

The following table summarizes the basic and diluted weighted average number of common shares outstanding used in the basic and diluted net earnings per share calculations:

	<b>Years Ended December 31,</b>	
	<b>2010</b>	<b>2009</b>
Basic weighted average number of shares outstanding	48,470,858	48,470,858
Weighted average number of potentially dilutive shares	71,538	88,624
Diluted weighted average number of shares	<u>48,542,396</u>	<u>48,559,482</u>

# Novik Inc.

## Notes to Consolidated Financial Statements

At December 31, 2010 and 2009

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A number of stock options corresponding to 1,520,000 shares (2,253,500 in 2009) for the year ended December 31, 2010 has been excluded from the calculation of diluted earnings per share because the exercise prices of these stock options were greater than the average market price of the common shares.

### 15 Additional disclosures to the statements of cash flows

(a) Net change in non-cash working capital items

	<u>Years Ended December 31,</u>	
	<b>2010</b>	<b>2009</b>
	\$	\$
Accounts receivable	53,143	971,089
Inventories	(684,181)	141,027
Refundable tax credits	40,476	134,852
Prepaid expenses	(14,086)	101,595
Accounts payable and accrued liabilities	4,711	227,031
Deferred income	156,857	-
	<u>(443,080)</u>	<u>1,575,594</u>

(b) Items not affecting cash related to operating and investing activities

	<u>Years Ended December 31,</u>	
	<b>2010</b>	<b>2009</b>
	\$	\$
Acquisition of property, plant and equipment included in accounts payable and accrued liabilities	<u>27,310</u>	<u>31,832</u>

(c) Additional information

	<u>Years Ended December 31,</u>	
	<b>2010</b>	<b>2009</b>
	\$	\$
Interest paid	<u>542,460</u>	<u>662,600</u>

# Novik Inc.

## Notes to Consolidated Financial Statements

At December 31, 2010 and 2009

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### 16 Capital Disclosures

The company's objectives when managing capital are to:

1. maintain financial flexibility in order to preserve its ability to meet financial obligations;
2. deploy capital to provide an appropriate investment return to its shareholders;
3. maintain a capital structure that allows multiple financing options to the company should a financing need arise.

The company defines its capital as follows:

	<u>As at December 31,</u>	
	<b>2010</b>	<b>2009</b>
	<b>\$</b>	<b>\$</b>
Bank loan	1,621,972	1,794,591
Long-term debt, including the current portion	8,960,427	10,449,939
Shareholders' equity	11,213,239	10,818,027
	<u>21,795,638</u>	<u>23,062,557</u>

The company's financial strategy is designed and formulated to maintain a flexible capital structure consistent with the objectives stated above and to respond to changes in economic conditions and the risk characteristics of underlying assets. In order to maintain or adjust its capital structure, the company may purchase shares for cancellation pursuant to normal course issuer bids, issue new shares, raise debt (secured, unsecured, convertible and/or other types of available debt instruments) or refinance existing debt with different characteristics.

# Novik Inc.

## Notes to Consolidated Financial Statements

At December 31, 2010 and 2009

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The company periodically monitors capital using a number of financial metrics comprised of the following ratios:

1. long-term debt to net tangible value; and
2. working capital ratio.

Total long-term debt, a non-GAAP measure, is calculated as the total of the long-term debt including the current portion.

Net tangible value, a non-GAAP measure, is calculated as the sum of shareholders' equity and future income tax liabilities, less future income tax assets and intangible assets.

Working capital ratio, a non-GAAP measure, is calculated as the total of current assets over the total current liabilities.

The company's financial objectives and strategy as described above have remained substantially unchanged over the previous fiscal years. These objectives and strategy are reviewed on an annual basis. The company believes that its ratios are within reasonable limits, in light of the relative size of the company and its capital management objectives.

The company is also subject to financial covenants under its operating credit facility agreement, which compliance is measured according to certain financial ratios calculated annually as at December 31. As at December 31, 2010, the company is in compliance with all financial covenants (note 21).

# Novik Inc.

## Notes to Consolidated Financial Statements

At December 31, 2010 and 2009

The following table illustrates the financial ratios calculation for the current and prior years :

	<b>As at December 31, 2010</b>	<b>As at December 31, 2009</b>
<b>Guidelines</b>		
<b>Long-term debt, including the current portion</b>	\$8,960,427	\$10,449,939
Shareholders' equity	\$11,213,239	\$10,818,027
Less:		
Future income tax assets	\$(62,827)	\$(212,140)
Intangible assets	\$(1,392,128)	\$(1,590,356)
Plus:		
Future income tax liabilities	\$88,874	-
<b>Net tangible value</b>	<b>\$9,847,158</b>	<b>\$9,015,531</b>
Long-term debt, including the current portion	\$8,960,427	\$10,449,939
Net tangible value	\$9,847,158	\$9,015,531
<b>Long-term debt to net tangible ratio</b>	<b>1.5:1</b>	<b>0.9:1</b>
Current assets	\$7,068,812	\$6,893,648
Current liabilities	\$4,882,844	\$5,436,677
<b>Working capital ratio</b>	<b>1.3:1</b>	<b>1.4:1</b>



# Novik Inc.

## Notes to Consolidated Financial Statements

At December 31, 2010 and 2009

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### Interest rate risk

Accounts receivable and accounts payable and accrued liabilities bear no interest. The interest rates of bank loan and long-term debt are mentioned in notes 9 and 11, respectively (also see note 21).

Proportional variation of + 1% / - 1% in the prime interest rates would have an approximative impact of \$89,000 (\$83,000 in 2009) on interest expense on long-term debt.

### Credit risk

The company's credit risk is primarily attributable to its trade accounts receivable. The amounts disclosed in the balance sheet are net of allowance for bad debts, estimated by the company's management based on prior experience and their assessment of the current economic environment. The company believes that the credit risk of accounts receivable is limited for the following reasons:

- A broad client base dispersed in various sectors and geographic locations.
- Over 94% of trade accounts receivable are outstanding for less than 90 days.
- Though 40% of the company's revenue for the fiscal year 2010 comes from its top two clients, the company believes that the credit risk associated with these clients is limited. Generally, the company does not require collateral from clients for trade accounts receivable; however reasonable credit is extended to clients following an evaluation of creditworthiness. In addition, the company performs periodic credit reviews of its clients.
- The company accounts for a specific bad debt allowance when management considers that the expected recovery is less than the actual amount receivable.
- In the past three fiscal years, the company has not recorded bad debt expenses in excess of its allowance for bad debts. The allowance for bad debts as at December 31, 2010 was \$79,135 (\$67,443 as at December 31, 2009). All bad debt write-offs are charged to administrative expenses.

# Novik Inc.

## Notes to Consolidated Financial Statements

At December 31, 2010 and 2009

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### Liquidity Risk

The company actively maintains credit facilities to ensure it has sufficient available funds to meet its current and long-term financial requirements at a reasonable cost.

The following table summarizes the contractual maturities of financial liabilities as at December 31, 2010 considering the new repayment terms and conditions that will apply as of February 2011 (see note 21) :

	<b>Carrying Amount</b>	<b>Contractual Cash Flows</b>	<b>0 to 12 months</b>	<b>12 to 24 months</b>	<b>Over 24 months</b>
Bank loan	1,621,972	1,621,972	1,621,972	-	-
Accounts payable and accrued liabilities	2,266,095	2,266,095	2,266,095	-	-
Long-term debt including the current portion	9,078,759	9,610,538	1,020,968	1,227,151	7,362,419
	<u>12,966,826</u>	<u>13,498,605</u>	<u>4,909,035</u>	<u>1,227,151</u>	<u>7,362,419</u>

The company believes that future cash flows from operations and funds available under existing banking arrangements or those signed in February 2011 (see note 21) will be sufficient to adequately discharge these financial liabilities.

### Currency risk

Since a portion of the company's revenue is denominated in US dollars, the company is exposed to currency risk. This risk is partially hedged by its purchases in US dollars and by foreign currency forward exchange contracts. The company is exposed as well to currency risk on long-term debt refundable in US dollars.

Based on historical changes and volatility in the above mentioned market variable, and on management's current assessment of the financial markets, the company believes the following variation is reasonably possible over a 12-month period, net of income taxes and using an estimated effective tax rate of 31%:

- Proportional foreign exchange rate variation of -10% (depreciation of Canadian dollar (CAD)) and +10% (appreciation of CAD) against the US dollar (USD), from a period-end rate of 0.9946.

# Novik Inc.

## Notes to Consolidated Financial Statements

At December 31, 2010 and 2009

If these variations were to occur, the impact on consolidated net earnings and equity for each category of financial instruments held at the balance sheet date would be as follows:

(in thousands of dollars)	Carrying amount	Foreign exchange rate risk			
		-10%		+10%	
		Earnings	Equity	Earnings	Equity
<b>Financial assets</b>					
Accounts receivable	773	53	53	(53)	(53)
<b>Financial liabilities</b>					
Bank loan	429	(30)	(30)	30	30
Accounts payable and accrued liabilities	680	(47)	(47)	47	47
Long-term debt refundable in USD	1,463	(101)	(101)	101	101
<b>TOTAL INCREASE (DECREASE)</b>		(125)	(125)	125	125

The fair value of foreign currency forward contracts as at December 31, 2010 and 2009 is as follows:

	Purchasing currency	Selling currency	Par value in selling currency \$	Maturity	Fair value (a) \$	Average rate \$
2010	CAN\$	\$US	2,724,500	2011	198,616	1.07
2009	CAN\$	\$US	2,812,500	2010	575,104	1.26

The company has realized an exchange gain of \$41,984 on its foreign currency forward contracts in 2010 (exchange gain of \$494,828 in 2009).

- (a) Fair value of foreign currency forward contracts generally reflects the estimated amounts that the company would receive by way of settlement of favourable contracts or would be required to pay to terminate unfavourable contracts at the balance sheet date.

# Novik Inc.

## Notes to Consolidated Financial Statements

At December 31, 2010 and 2009

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### 18 Segment information

The company is organized under one single operating segment, as described in note 1. Revenue by geographic region is detailed as follows:

	<u>Years Ended December 31,</u>	
	<b>2010</b>	<b>2009</b>
	<b>\$</b>	<b>\$</b>
Canada	7,481,573	5,739,590
United States	13,922,599	6,728,044
Mexico	-	719,907
	<hr/>	<hr/>
North America	21,404,172	13,187,541
Europe and Asia-Pacific	2,371,496	1,873,343
	<hr/>	<hr/>
	23,775,668	15,060,884
	<hr/>	<hr/>

Revenue has been allocated based on the country of residence of the customer. All of the company's long-lived assets are located in Canada.

### Major customers

Customers representing 10% or more of revenues are allocated as follows:

	<u>Years Ended December 31,</u>	
	<b>2010</b>	<b>2009</b>
	<b>%</b>	<b>%</b>
Customer 1	22.79	25.53
Customer 2	17.21	10.35

### 19 Commitments

As at December 31, 2010, the company's minimum aggregate commitments under long-term equipment and vehicle lease agreements amount to \$92,656. Minimum lease payments required over the next four years amount to \$34,510 in 2011, \$34,510 in 2012, \$22,724 in 2013 and \$912 in 2014.

The company is committed to purchase an equipment of a total value of \$630,000. As at December 31, 2010, a balance of \$535,500 is payable in the first two quarters of 2011.

# **Novik Inc.**

## Notes to Consolidated Financial Statements

At December 31, 2010 and 2009

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### **20 Contingency**

A statement of claim was issued against the company from a former employee for damages. The company believes that the claim is without merit and has accrued a reasonable provision with respect to this claim. Should the actual amount be different of the amount of the recorded provision as at December 31, 2010 will be recorded in the net earnings of the period when the actual amount becomes known.

### **21 Subsequent events**

In February 2011, the company obtained a loan of \$2,625,000 bearing interest at the financial institution's prime rate plus 4%, secured by an hypothec on all chattel and real properties, payable in monthly principal instalments of \$43,000 plus interests starting in October 2011 and a final instalment of \$45,000 plus interest in September 2016. The proceeds from this loan will be used to repay notes payable maturing between 2011 and 2015 amounting to \$1,630,812.

The company also obtained a second loan of \$400,000 bearing interest at the financial institution's prime rate plus 2.75%, secured up to 70% of the loan amount by Investissement Québec and by an hypothec on all assets subordinated to the existing sureties. The loan is payable in monthly principal instalments of \$7,407 plus interests starting in October 2011 and matures in March 2016.

Finally, the company obtained a six-month capital instalment moratorium on other notes payable. Capital instalments payable after the end of the moratorium period will be adjusted so that the loans will be repaid within the initial maturity dates.

As at December 31, 2010, the current portion of long-term debt as well as the information disclosed in notes 11, 16 and 17 were established using the above terms and conditions. These allow the company to meet the working capital ratio level required by the long-term creditors.

### **22 Comparative figures**

Certain comparative figures have been reclassified to conform to the current year presentation.