

*Unaudited Consolidated Financial Statements of*

**WAVEFRONT ENERGY AND ENVIRONMENTAL SERVICES INC.**

*For the First Quarter ended November 30, 2003 and 2002*

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# WAVEFRONT ENERGY AND ENVIRONMENTAL SERVICES INC.

## Consolidated Balance Sheets

	As At 30-Nov-03 <u>(Unaudited)</u>	As At 31-Aug-03 <u>(Audited – Note 1)</u>
<b>ASSETS</b>		
<b>CURRENT</b>		
Cash	\$ 273,107	\$ 18,220
Accounts receivable	167,460	152,158
Promissory note receivable	-	20,200
Prepaid expenses	38,173	31,421
Inventory	238,309	183,431
	<b>717,049</b>	405,430
<b>CAPITAL ASSETS</b>	<b>451,869</b>	435,642
<b>INTANGIBLE ASSETS</b>	<b>227,235</b>	223,311
<b>DEPOSITS</b>	<b>13,703</b>	14,003
	<b>\$ 1,409,856</b>	<b>\$ 1,078,386</b>
<b>LIABILITIES</b>		
<b>CURRENT</b>		
Bank indebtedness	\$ 100,366	\$ 100,009
Accounts payable and accrued liabilities	727,257	720,602
Unearned revenue	208,093	208,093
Current portion of obligation under capital leases	22,841	25,400
	<b>1,058,557</b>	1,054,104
<b>OBLIGATION UNDER CAPITAL LEASES</b>	<b>24,835</b>	28,460
<b>DUE TO SHAREHOLDERS (Note 7)</b>	<b>529,704</b>	469,480
<b>FUTURE INCOME TAXES</b>	<b>73,913</b>	75,408
	<b>1,687,009</b>	1,627,452
<b>CAPITAL DEFICIENCY</b>		
Capital stock	4,134,539	4,134,539
Contributed surplus (Note 8)	1,281	-
Deficit	(4,412,973)	(4,683,605)
	<b>(277,153)</b>	<b>(549,066)</b>
	<b>\$ 1,409,856</b>	<b>\$ 1,078,386</b>

APPROVED BY THE BOARD:

“D. Brad Paterson” (signed) Director

“Brett Davidson” (signed) Director

**WAVEFRONT ENERGY AND ENVIRONMENTAL SERVICES INC.**  
**Consolidated Statements of Loss and Deficit (Unaudited)**  
**Three month period ended November 30, 2003**

	<u>2003</u>	<u>2002</u> (Note 1)
<b>REVENUE</b>		
Sales	\$ 60,051	\$ 74,147
Other income	8,003	16,212
	<b>68,054</b>	90,359
<b>COST OF GOODS SOLD</b>	<b>35,965</b>	55,103
<b>GROSS PROFIT</b>	<b>32,089</b>	35,256
<b>OPERATING EXPENSES</b>		
Wages, employee benefits, and contract employees	170,727	345,279
Professional fees	100,138	123,125
Office	73,572	88,627
Depreciation and amortization	30,786	38,353
Consultants	30,055	57,052
Listing and public company fees	19,850	-
Research and development	26,144	26,053
Travel and promotion	23,464	45,721
Vehicle	13,747	23,798
Repairs and maintenance	13,440	4,485
Interest expense	12,559	10,626
Miscellaneous	89	11
	<b>514,571</b>	763,130
<b>LOSS BEFORE UNDERNOTED</b>	<b>(482,482)</b>	(727,874)
<b>LOSS ON DISPOSAL OF CAPITAL ASSETS</b>	<b>(490)</b>	-
<b>FOREIGN EXCHANGE LOSS</b>	<b>(5,177)</b>	-
<b>IMPAIRMENT OF GOODWILL (Note 6)</b>	-	(1,280,117)
<b>IMPAIRMENT OF INTANGIBLE ASSETS (Note 6)</b>		(154,189)
<b>GAIN ON ISSUANCE OF SHARES BY SUBSIDIARY</b>	-	98,953
<b>LOSS BEFORE INCOME TAXES</b>	<b>(488,149)</b>	(2,063,227)
<b>FUTURE INCOME TAX RECOVERY</b>	<b>1,495</b>	85,916
<b>NET LOSS</b>	<b>(486,654)</b>	(1,977,311)
<b>DEFICIT, BEGINNING OF PERIOD</b>	<b>(4,683,605)</b>	(2,292,814)
<b>ACQUISITION OF PE-TECH INC. (Note 4)</b>	<b>757,286</b>	-
<b>DEFICIT, END OF PERIOD</b>	<b>\$ (4,412,973)</b>	\$ (4,270,125)
<b>LOSS PER COMMON SHARE (Note 9)</b>		
Basic and diluted	\$ (0.0266)	\$ (0.1398)

# WAVEFRONT ENERGY AND ENVIRONMENTAL SERVICES INC.

## Consolidated Statement of Cash Flow (Unaudited)

Three month period ended November 30, 2003

	<u>2003</u>	<u>2002</u> (Note 1)
<b>NET INFLOW (OUTFLOW) OF CASH RELATED TO THE FOLLOWING ACTIVITIES</b>		
<b>OPERATING</b>		
Net loss	\$ (486,654)	\$ (1,977,311)
Items not affecting cash		
Depreciation and amortization	30,786	38,353
Stock options expensed	1,281	-
Loss on sale of capital assets	490	-
Gain on issuance of shares by subsidiary	-	(98,953)
Impairment of goodwill	-	1,280,117
Impairment of intangible assets	-	154,189
Future income tax recovery	(1,495)	(85,916)
	<u>(455,592)</u>	<u>(689,521)</u>
Changes in non-cash working capital	767,733	208,738
	<u>312,141</u>	<u>(480,783)</u>
<b>FINANCING</b>		
Proceeds from notes payable	-	197,873
Repayment of obligation under capital leases	(6,184)	(4,687)
	<u>(6,184)</u>	<u>193,186</u>
<b>INVESTING</b>		
Purchase of capital assets	(42,915)	(21,967)
Proceeds on disposal of capital assets	2,300	-
Patents	(10,812)	(10,223)
	<u>(51,427)</u>	<u>(32,190)</u>
<b>NET CASH INFLOW (OUTFLOW)</b>	<b>254,530</b>	<b>(319,787)</b>
<b>CASH (BANK INDEBTEDNESS), BEGINNING OF PERIOD</b>	<b>(81,789)</b>	<b>307,090</b>
<b>CASH (BANK INDEBTEDNESS), END OF PERIOD</b>	<b>\$ 172,741</b>	<b>\$ (12,697)</b>
<b>COMPRISED OF:</b>		
Cash	\$ 273,107	\$ 87,907
Bank indebtedness	(100,366)	(100,604)
	<u>\$ 172,741</u>	<u>\$ (12,697)</u>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>		
Amount of interest paid during the period	\$ 3,707	\$ 1,705

# **WAVEFRONT ENERGY AND ENVIRONMENTAL SERVICES INC.**

Notes to the Consolidated Financial Statements (Unaudited)

Three Month Period Ended November 30, 2003

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## **1. DESCRIPTION OF BUSINESS**

Wavefront Energy and Environmental Services Inc. (the "Corporation" or "Wavefront Energy") is incorporated under the Canada Business Corporations Act. The Corporation's principal business activities are the improvement of oil recovery and environmental groundwater remediation using patented fluid flow enhancement technologies.

Effective September 30, 2003, the Corporation acquired PE-TECH Inc. (the "Acquisition"). The Acquisition constituted a reverse takeover under TSX Venture Exchange policies (Note 4). The comparative figures represent the consolidated results of PE-TECH Inc. ("PE-TECH").

These consolidated financial statements include the accounts of the Corporation for the period since the reverse take-over, and its wholly owned subsidiaries, PE-TECH Inc., Wavefront Environmental Technologies Inc., Prism Production Technologies Inc., Wavefront Energy and Environmental Services USA Inc. (formerly E2 Solutions USA Inc.), and South Mountain Resources Inc., for the entire period.

## **2. BASIS OF PRESENTATION**

These interim consolidated financial statements should be read in conjunction with the financial statements of the Corporation for the year ended August 31, 2003 and the most recently completed interim consolidated financial statements of PE-TECH for the nine month period ended August 31, 2003. These interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles, using the same accounting policies as set out in the financial statements of the Corporation for the year ended August 31, 2003 and the consolidated financial statements of PE-TECH for the nine month period ended August 31, 2003, except as reported in Note 5.

## **3. CONTINUATION OF BUSINESS**

These consolidated financial statements have been prepared on the basis of accounting principles applicable to a going concern; that is, assets can be realized and liabilities discharged in the normal course of business.

The Corporation has experienced significant losses as a result of operations and is in a significant working capital deficiency. The Corporation's continued existence is dependent on its ability to achieve operational profitability and to raise additional capital in order to finance future operations.

If the going concern assumption was not appropriate for these consolidated financial statements, then adjustments would be necessary in the carrying values of assets and liabilities, the reported net loss, and the balance sheet classifications used.

## WAVEFRONT ENERGY AND ENVIRONMENTAL SERVICES INC.

Notes to the Consolidated Financial Statements (Unaudited)

Three Month Period Ended November 30, 2003

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### 4. ACQUISITION OF PE-TECH INC.

Effective September 30, 2003, the Corporation received TSX Venture Exchange acceptance of its Acquisition of PE-TECH, a reverse take-over and acquisition by Wavefront Energy of all the issued and outstanding common shares of PE-TECH.

In consideration for the Acquisition of the PE-TECH issued and outstanding common shares, the Corporation issued 14,140,432 Wavefront Energy common shares to the shareholders of PE-TECH, and in consideration for the PE-TECH issued and outstanding share purchase warrants, Wavefront Energy issued 2,081,983 Wavefront Energy share purchase warrants, each share purchase warrant exercisable at a price of \$1 per share, on or before December 31, 2003 (Note 8).

In this transaction, Wavefront Energy, a non-operating publicly listed enterprise, acquired for accounting purposes, does not meet the definition of a business under generally accepted accounting principles, as such, this reverse takeover transaction does not constitute a business combination and is instead considered to be a capital transaction. Canadian generally accepted accounting principles requires that any net liability of the public enterprise (Wavefront Energy) should be treated as a charge to the retained earnings or deficit of the consolidated enterprise.

As at September 30, 2003, the financial position of Wavefront Energy, resulted in a charge to the deficit of the consolidated enterprise of \$757,286, as follows:

	As At September 30, 2003
Current assets (no cash)	\$ 1,059,153
<b>Total Assets</b>	<b>1,059,153</b>
Current liabilities	241,643
Due to shareholders	60,224
<b>Total liabilities</b>	<b>301,867</b>
<b>Shareholders equity</b>	<b>757,286</b>
	<b>\$ 1,059,153</b>

### 5. CHANGE IN ACCOUNTING POLICY

Effective September 1, 2003, the Corporation adopted Section 3870 of the Handbook of Canadian Institute of Chartered Accountants (CICA) with respect to the accounting and disclosure of stock-based compensation, which recommends awards to employees be valued using the fair value method of accounting.

The Corporation has elected to account for stock options by measuring expense as the excess, if any, of the quoted market value of the stock at the date of grant over the exercise price.

## WAVEFRONT ENERGY AND ENVIRONMENTAL SERVICES INC.

Notes to the Consolidated Financial Statements (Unaudited)

Three Month Period Ended November 30, 2003

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### 5. CHANGE IN ACCOUNTING POLICY (Continued)

Under CICA 3870, companies that elect a method other than the fair value method of accounting are required to disclose pro forma net income and earnings per share information, using a pricing model such as the Black-Scholes option pricing model, as if the fair value method of accounting had been used. The new rules do not apply to pre-existing awards except for those that call for settlement in cash or assets. Prior to September 30, 2003, the Corporation had no outstanding stock-based compensation instruments.

### 6. ACQUISITION OF MINORITY INTEREST OF SUBSIDIARIES

On May 31, 2002, PE-TECH acquired the outstanding minority interest positions in its subsidiaries in exchange for 3,064,390 Class A common shares and accounted for the acquisition using the purchase method. The share transaction was recorded at the estimated fair value of the PE-TECH's shares, which was determined to be the unit price of \$0.50 per share received during a PE-TECH private placement totaling \$1,532,195. PE-TECH performed a valuation to allocate the purchase price based on the fair value of the tangible and intangible assets acquired and determined the full purchase price allocation at the date of acquisition was as follows:

Assets acquired	
Pressure pulse technology licenses	\$ 378,452
Computer software	41,678
Future income tax liability	(168,052)
Goodwill	1,280,117
<hr/>	
Purchase price	\$ 1,532,195

Goodwill was tested for impairment by PE-TECH as at November 30, 2002. PE-TECH completed the impairment test by applying the prescribed method of comparing the fair value of its reporting units, PE-TECH's subsidiaries, and determined that there was goodwill impairment of \$1,280,117, which was charged directly to earnings at November 30, 2002. As at November 30, 2002, the balance of acquired intangible assets was impaired and appropriately written down to a net book value of \$205,340. Consistent with current industry-specific valuation methods and recommendations for assessment from the CICA Handbook Section 3062, PE-TECH used a combination of the discounted cash flow model and the market comparable approach for determining the fair value of its reporting units.

## WAVEFRONT ENERGY AND ENVIRONMENTAL SERVICES INC.

Notes to the Consolidated Financial Statements (Unaudited)

Three Month Period Ended November 30, 2003

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### 7. DUE TO SHAREHOLDERS

In connection with the Acquisition, certain directors and shareholders of the Corporation and a company controlled by a director of the Corporation entered into a Debt Repayment Agreement. Under the terms of the Debt Repayment Agreement, the creditors agreed to postpone their ability to demand repayment of the notes, totaling \$482,486 (2002 - \$422,262) and certain accounts payable, totaling \$47,218 (2002 - \$47,218) until September 30, 2004, after which principal repayment is restricted to twenty percent (20%) of consolidated cash flows from operations. As such, these amounts have been classified as long-term debt until such time the Corporation anticipates positive cash flows from operations.

These notes payable are unsecured, bear interest at rates ranging from nil to 8.5% per annum, and have no fixed terms of repayment. Interest expense recorded in the period totaled \$8,851 (2002 - \$6,495). Accrued interest payable at November 30, 2003, is \$33,797 (2002 - \$15,990) and is included in accounts payable and accrued liabilities.

### 8. SHARE CAPITAL

#### *Capital stock*

The Corporation's authorized and issued share capital prior to the reverse takeover (Note 4) was as follows:

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<b>Authorized</b>		
100,000,000 common shares without par value		
	<b><u>Number</u></b>	<b><u>Stated Capital</u></b>
<b>Issued</b>		
Balance, August 31, 2003	5,677,107	\$ 8,902,083
Escrow shares cancellation (a)	(624,225)	-
Share consolidation (a)	(1,010,567)	-
Private placement (b)	2,206,000	1,103,000
Balance, September 30, 2003	6,248,306	\$ 10,005,083

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## WAVEFRONT ENERGY AND ENVIRONMENTAL SERVICES INC.

Notes to the Consolidated Financial Statements (Unaudited)

Three Month Period Ended November 30, 2003

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### 8. SHARE CAPITAL (continued)

The Corporation's authorized and issued share capital subsequent to the reverse takeover is as follows:

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<b>Authorized</b>		
unlimited common shares without par value		
	<b><u>Number</u></b>	<b><u>Stated Capital</u></b>
<b>Issued</b>		
Arising on reverse takeover		
Stated capital of PE-TECH's shares	-	\$ 4,134,539
Wavefront Energy's shares outstanding	6,248,306	-
Issued shares for PE-TECH Inc. (c)	14,140,432	-
Balance, immediately subsequent to reverse takeover and November 30, 2003	20,388,738	\$ 4,134,539

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### Warrants

The Corporation's issued share purchase warrants prior to the reverse takeover (Note 4) was as follows:

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	<b><u>Number</u></b>
Balance, August 31, 2003	-
Private placement (b)	1,103,000
Balance, September 30, 2003	1,103,000

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The Corporation's issued share purchase warrants subsequent to the reverse takeover is as follows:

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	<b><u>Number</u></b>
Wavefront Energy's share purchase warrants outstanding	1,103,000
Issued in exchange for share purchase warrants of PE-TECH Inc. (c)	2,081,983
Balance, immediately subsequent to reverse takeover and November 30, 2003	3,184,983

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- (a) In connection with and prior to the Acquisition, the TSX Venture Exchange approved the Corporation's cancellation of 624,255 pre-consolidation escrow shares, and

consolidation of the Corporation's share capital at a ratio of five pre-consolidated shares for four post-consolidated shares.

## **WAVEFRONT ENERGY AND ENVIRONMENTAL SERVICES INC.**

Notes to the Consolidated Financial Statements (Unaudited)  
Three Month Period Ended November 30, 2003

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### **8. SHARE CAPITAL (continued)**

- (b) In connection with and prior to the Acquisition, the Corporation closed a non-brokered private placement of 2,206,000 units (the "Private Placement Units"), each unit comprised of one post-consolidation common share and one-half of one non-transferable share purchase warrant in the capital stock of the Corporation at a price of \$0.50 per unit to net the treasury an aggregate of \$1,103,000. Each share purchase warrant is exercisable at a price of \$1.00 per share on or before September 30, 2004.

In accordance with securities legislation, the securities that are issued in connection with the Private Placement Units will be subject to a hold period of four months plus one day expiring on January 31, 2004.

- (c) Effective September 30, 2003, the TSX Venture Exchange approved the Acquisition of all of the issued and outstanding common shares and share purchase warrants of PE-TECH Inc. In consideration of the Acquisition of the issued and outstanding PE-TECH common shares, the Corporation issued 14,140,432 Wavefront Energy common shares. In consideration of the Acquisition of the issued and outstanding PE-TECH share purchase warrants, the Corporation issued 2,081,983 (which were set to expire on various dates from May to April 2003), Wavefront Energy share purchase warrants to the shareholders of PE-TECH, each share purchase warrant exercisable at a price of \$1.00 per share, expiring on or before December 31, 2003. These 2,081,983 share purchase warrants have all since expired and none were exercised.

#### ***Stock-based compensation***

Effective September 1, 2003, the Corporation adopted the recommendations of the Canadian Institute of Chartered Accountants for accounting for stock-based compensation. As permitted under the new rules, the Corporation has elected to measure compensation expense as the difference, if any, between the quoted market value or fair value of the stock at the date of grant and the exercise price at the date of grant. The exercise price of options granted by the Corporation is not less than the market value at the date of grant, and consequently, no compensation related to employee stock options has been recorded. Compensation costs for stock options issued to non-employees were calculated using the Black-Scholes option pricing model resulting in an additional charge to consultants of \$1,281 with a corresponding increase in contributed surplus.

There were no stock options outstanding prior to September 1, 2003. During the three month period ended November 30, 2003, the Corporation issued 1,290,000 stock options on September 30, 2003 and 410,000 stock options on November 30, 2003.

If compensation costs for employee stock options issued subsequent to September 1, 2003 had been determined based on the fair market value methodology, using the Black-Scholes option pricing model, the Corporation's net loss and loss per share would have been increased to the pro forma amounts indicated below:

## WAVEFRONT ENERGY AND ENVIRONMENTAL SERVICES INC.

Notes to the Consolidated Financial Statements (Unaudited)

Three Month Period Ended November 30, 2003

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### 8. SHARE CAPITAL (continued)

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Net loss, as reported	\$ (486,654)
Pro forma net loss	\$ (497,687)
Loss per common share, as reported:	
Basic and diluted	(0.0266)
Pro forma loss per common share:	
Basic and diluted	(0.0272)

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The fair value of each option granted by the Corporation was estimated using the Black-Scholes option pricing model assuming no dividends are paid on common shares, a risk-free rate of 3.67%, an average life of 5 years, a volatility rate of 61.94%, and a marketability discount of 60%. The amounts computed according to the Black-Scholes pricing model may not be indicative of the actual values realized upon the exercise of the options by the holders.

### 9. LOSS PER SHARE

The Corporation uses the treasury stock method to calculate diluted earnings per share. Under the treasury stock method, the numerator remains unchanged from the basic earnings per share calculation, as the assumed exercise of the Corporation's share purchase warrants and stock options do not result in an adjustment to income. The denominator also remains unchanged as all dilutive securities, the outstanding share purchase warrants and stock options, are out-of-the-money and anti-dilutive. The weighted average number of common shares outstanding was 18,328,850 (2002 - 14,140,432).

### 10. RELATED PARTY TRANSACTIONS

During the three-month period ended November 30, 2003, the Corporation incurred charges for wages, employee benefits, contract employees, and consultants totaling \$68,920 (2002 - \$73,200) that were paid to directors, significant shareholders, or a corporation controlled by a shareholder of the Corporation. As at the November 30, 2003, no amounts (2002 - \$9,321) were included in accounts payable and accrued liabilities. These transactions are in the normal course of business and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

### 11. SEGMENTED INFORMATION

The Corporation is managed using two operating segments, which have been determined based on the nature of products produced and services provided: Wavefront Environmental Technologies Inc. (Wavefront) and Prism Production Technologies Inc. (Prism). Wavefront provides a unique solution for environmental groundwater remediation to increase the rate of removal of potentially

harmful subsurface substances known in the industry as non-aqueous phase liquids (NAPLs). Prism provides downhole monitoring and improved oil recovery technologies for the monitoring, analysis, stimulation, and production optimization of reservoirs to the global oil and gas industry.

Period ended November 30, 2003 (3 months)	Revenue	Goodwill Impairment	Intangible Asset Impairment	Segment Loss	Depreciation and Amortization	Capital Expenditures	Assets
Prism	\$ 60,098	\$ -	\$ -	\$ (452,233)	\$ 22,384	\$ 42,965	\$ 1,183,523
Wavefront	7,956	-	-	(30,249)	8,402	10,762	226,333
	<b>\$ 68,054</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ (482,482)</b>	<b>\$ 30,786</b>	<b>\$ 53,727</b>	<b>\$ 1,409,856</b>

Period ended November 30, 2002 (3 months)	Revenue	Goodwill Impairment	Intangible Asset Impairment	Segment Loss	Depreciation and Amortization	Capital Expenditures	Assets
Prism	\$ 74,380	\$ 998,920	\$ 102,998	\$ (551,513)	\$ 32,916	\$ 32,190	\$ 1,018,770
Wavefront	15,979	281,197	51,191	(176,361)	5,437	-	250,372
	<b>\$ 90,359</b>	<b>\$ 1,280,117</b>	<b>\$ 154,189</b>	<b>\$ (727,874)</b>	<b>\$ 38,353</b>	<b>\$ 32,190</b>	<b>\$ 1,269,142</b>

In the three-month period ended November 30, 2003, the Corporation recorded revenue from two customers in the amount of \$45,601 and \$12,450, which represents 67.0%, and 18.3% of total revenue respectively. In 2002, the Corporation recorded revenue from two customers of \$44,563 and \$29,583, which represents 49.3% and 32.7% of total revenue respectively.

The Corporation has generated revenue from products sold and services provided within Canada of \$60,098 and to the United States of \$7,956.

## 12. SUBSEQUENT EVENT

Subsequent to the reporting period, the Corporation entered into an agreement with Leede Financial Markets Inc. ("Leede") to act as its Agent to raise up to \$2,000,000 by way of a short form offering document and a concurrent brokered private placement with accredited investors. The Corporation will offer up to 4,761,905 million units at a price of \$0.42 per unit. Each unit will consist of one Common Share and one-half of one non-transferable share purchase warrant (the "Warrant"). Each whole Warrant will entitle the holder thereof to acquire one additional Common Share for a period of one (1) year at a price of \$0.60 or such price as will be determined in accordance with TSX Venture Exchange. The Corporation estimates that net proceeds from the offering will approximate \$1,785,000 after estimated commissions, corporate finance fees, and estimated legal, accounting and administrative fees are deducted.