

**Seair Inc.**  
**Consolidated Financial Statements**  
**Year Ended August 31, 2006 and 2005**

**Index to Consolidated Financial Statements**

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**SEAIR INC.**

Years Ended August 31, 2006 and 2005

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An independent member firm



November 17, 2006  
Edmonton, Alberta

**Auditors' Report**

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To the shareholders of Seair Inc.:

We have audited the consolidated balance sheets of Seair Inc. as at August 31, 2006 and August 31, 2005 and the consolidated statements of loss and deficit and cash flow for the years then ended. These consolidated financial statements are the responsibility of the Company's management. 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 plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the 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 August 31, 2006 and August 31, 2005 and the results of its operations and the changes in its cash flow for the years then ended in accordance with Canadian generally accepted accounting principles.

A handwritten signature in cursive script that reads 'Kingston Ross Pasnak LLP'.

**Kingston Ross Pasnak LLP**  
Chartered Accountants

**Consolidated Statements of Loss and Deficit**

**SEAIR INC.**

Years Ended August 31, 2006 and 2005

|  | 2006                  | 2005                  |
|--|-----------------------|-----------------------|
| <b>REVENUE</b>                                     | <b>\$ 723,235</b>     | <b>\$ 77,042</b>      |
| <b>COST OF SALES</b>                               | <b>107,983</b>        | <b>45,046</b>         |
| <b>GROSS PROFIT</b>                                | <b>615,252</b>        | <b>31,996</b>         |
| <b>EXPENSES</b>                                    |                       |                       |
| Salaries and benefits                              | 263,981               | 292,454               |
| Bad debts  | 70,987                | 26,950                |
| Professional fees                                  | 65,790                | 46,935                |
| Amortization                                       | 54,847                | 17,485                |
| Stock-based compensation                           | 35,418                | 38,200                |
| Travel and trade shows                             | 35,301                | 56,492                |
| Advertising and promotion                          | 35,206                | 26,100                |
| Repairs and maintenance                            | 33,800                | -                     |
| Rent   | 32,234                | 30,064                |
| Contract services                                  | 20,200                | 28,757                |
| Office and shop                                    | 19,142                | 18,484                |
| Telephone  | 18,374                | 14,107                |
| Compliance and investor relations                  | 17,991                | 21,456                |
| Interest and bank charges                          | 12,546                | 21,643                |
| Shop and yard maintenance                          | 11,972                | -                     |
| Fees and licenses                                  | 8,956                 | 5,722                 |
|  | <b>736,745</b>        | <b>644,849</b>        |
| <b>LOSS FROM OPERATIONS</b>                        | <b>(121,493)</b>      | <b>(612,853)</b>      |
| <b>OTHER INCOME (LOSS)</b>                         |                       |                       |
| Gain on settlement of management fees payable      | 56,000                | -                     |
| Loss on disposal of property and equipment         | (6,089)               | -                     |
|  | <b>49,911</b>         | <b>-</b>              |
| <b>NET LOSS</b>                                    | <b>(71,582)</b>       | <b>(612,853)</b>      |
| <b>DEFICIT, BEGINNING OF YEAR</b>                  | <b>(3,011,348)</b>    | <b>(2,398,495)</b>    |
| <b>DEFICIT, END OF YEAR</b>                        | <b>\$ (3,082,930)</b> | <b>\$ (3,011,348)</b> |
| <b>BASIC LOSS PER SHARE (Note 14)</b>              | <b>\$ -</b>           | <b>\$ (0.04)</b>      |
| <b>WEIGHTED AVERAGE NUMBER OF SHARES (Note 14)</b> | <b>18,043,660</b>     | <b>16,664,523</b>     |

Consolidated Balance Sheets

**SEAIR INC.**

August 31, 2006 and 2005

**ASSETS**

|  | 2006                | 2005              |
|--|---------------------|-------------------|
| <b>CURRENT ASSETS</b>                  |                     |                   |
| Cash                                   | \$ 14,831           | \$ -              |
| Accounts receivable                    | 523,139             | 74,806            |
| Inventory (Note 5)                     | 562,221             | 248,580           |
| Equipment held for rental or resale    | 289,000             | -                 |
| Prepaid expenses                       | 1,481               | 11,702            |
|  | 1,390,672           | 335,088           |
| <b>PROPERTY AND EQUIPMENT (Note 6)</b> | 977,135             | 36,091            |
| <b>INTANGIBLES (Note 7)</b>            | 47,221              | 36,174            |
| <b>GOODWILL</b>                        | 1,165,000           | -                 |
|  | <b>\$ 3,580,028</b> | <b>\$ 407,353</b> |

**LIABILITIES AND  
SHAREHOLDERS'  
EQUITY**

|   |                     |                   |
|---|---------------------|-------------------|
| <b>CURRENT LIABILITIES</b>                                |                     |                   |
| Bank indebtedness   | \$ -                | \$ 4,679          |
| Accounts payable and accrued liabilities (Note 8)         | 949,387             | 293,651           |
| Advances from affiliates (Note 10)                        | 178,127             | 21,118            |
|   | 1,127,514           | 319,448           |
| <b>CONVERTIBLE DEBENTURE - LIABILITY PORTION (Note 9)</b> | -                   | 82,000            |
|   | 1,127,514           | 401,448           |
| <b>NON-CONTROLLING INTEREST</b>                           | 1,008,824           | -                 |
| <b>COMMITMENTS (Note 11)</b>                              |                     |                   |
| <b>CONTRIBUTED SURPLUS (Note 13)</b>                      | 433,135             | 397,717           |
| <b>SHARE CAPITAL (Note 12)</b>                            | 4,093,485           | 2,619,536         |
| <b>DEFICIT</b>  | (3,082,930)         | (3,011,348)       |
|   | 1,443,690           | 5,905             |
|   | <b>\$ 3,580,028</b> | <b>\$ 407,353</b> |

APPROVED BY THE BOARD

*"John L. Yannitsos"*

Director

*"Barbara F. Fraser"*

Director

Consolidated Statements of Cash Flow

**SEAIR INC.**

Years Ended August 31, 2006 and 2005

|   | 2006             | 2005              |
|---|------------------|-------------------|
| <b>CASH FLOW FROM OPERATING ACTIVITIES</b>          |                  |                   |
| Cash received from customers                        | \$ 203,915       | \$ 266,762        |
| Cash paid to suppliers and contractors              | (523,504)        | (449,345)         |
| Interest received                                   | -                | 18                |
| Interest paid                                       | (12,546)         | -                 |
|   | (332,135)        | (182,565)         |
| <b>CASH FLOW FROM INVESTING ACTIVITY</b>            |                  |                   |
| Expenditures in development costs                   | (25,810)         | -                 |
| Purchase of property and equipment                  | (96,893)         | (11,813)          |
| Proceeds on sale of property and equipment          | 3,500            | -                 |
|   | (119,203)        | (11,813)          |
| <b>CASH FLOW FROM FINANCING ACTIVITIES</b>          |                  |                   |
| Advances from affiliates                            | 157,009          | (7,030)           |
| Share issue costs paid                              | (5,956)          | (11,155)          |
| Issuance of equity on private placements            | 195,020          | 7,000             |
| Stock options exercised                             | 124,775          | 101,378           |
| Repayment of convertible debentures                 | -                | (3,000)           |
|   | 470,848          | 87,193            |
| <b>NET INCREASE (DECREASE) IN CASH</b>              | <b>19,510</b>    | <b>(107,185)</b>  |
| <b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b> | <b>(4,679)</b>   | <b>102,506</b>    |
| <b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>       | <b>\$ 14,831</b> | <b>\$ (4,679)</b> |

## Notes to the Consolidated Financial Statements

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### SEAIR INC.

Years Ended August 31, 2006 and 2005

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#### Note 1

##### Going Concern Assumption

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These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles applicable to a going concern, which assumes that Seair Inc. (the "Company") will be able to realize its assets and discharge its liabilities in the normal course of business or achieve profitable operations. The use of such principles may not be appropriate as the Company has been unable to generate a profit from operations. The Company's current operations and credit facilities are not sufficient to fund working capital and other cash requirements for the next fiscal year. The Company's ability to continue as a going concern is dependent on accessing additional funding or achievement of profitable operations.

Management believes that the going concern basis is appropriate. Accordingly, these financial statements do not reflect adjustments to the carrying value of assets and liabilities, the reported revenues and expenses and balance sheet classifications used that would be necessary if the going concern assumption was not appropriate. Such adjustments could be significant.

#### Note 2

##### General

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The Company was incorporated under the Alberta Business Corporations Act on April 12, 2001. The Company is a technology corporation which is based in Edmonton, Alberta. It is developing proprietary diffusion technology that may have global applications in several industry sectors.

The Company is engaged in the business of developing two primary product lines: a water diffuser and a water sterilization device. Since inception, the efforts of the Company have been devoted to the development of these two product lines and establishing a market. To date, the Company has begun earning revenues but is still considered to be in the development stage.

The Company has completed product testing on both the water diffuser and the water sterilizer.

#### Note 3

##### Significant Accounting Policies

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These financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada. Because the precise determination of many assets, liabilities, revenues and expenses are dependent on future events, the preparation of financial statements for a period necessarily includes the use of estimates and approximations which have been made using careful judgment. Actual results could differ from those estimates. These financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the significant accounting policies summarized below.

## Notes to the Financial Statements

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### SEAIR INC.

Years Ended August 31, 2006 and 2005

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**Note 3**  
Significant Accounting  
Policies  
Continued...

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#### **Basis of Consolidation**

The consolidated financial statements include the accounts of the Company and its subsidiaries, Seair Diffusion Systems Inc. for the entire year and Seair Septic Inc. since its acquisition date of April 1, 2006. All significant intercompany balances and transactions have been eliminated.

#### **Revenue Recognition**

Revenue is recognized when the product is shipped or delivered and collection is reasonably assured.

#### **Inventory**

Inventory consists of raw materials and finished goods, which is composed of water diffusion systems. Inventory is valued at the lower of cost and net realizable value, with cost being determined on an average cost basis.

#### **Equipment held for rental or resale**

Equipment held for rental or resale consists of portable waste water treatment units. Equipment held for rental or resale is valued at the lower of cost and net realizable value.

The Company evaluates the carrying value of equipment held for rental or resale whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

#### **Property and equipment**

Property and equipment are recorded at cost less accumulated amortization. The Company provides amortization on its property and equipment using the following methods and rates:

|                               | <u>Method</u>       | <u>Rate</u> |
|-------------------------------|---------------------|-------------|
| Sewage and storage equipment  | Diminishing balance | 4 to 8 %    |
| Office Complex                | Diminishing balance | 4 %         |
| Machinery                     | Diminishing balance | 15 to 20%   |
| Vehicles                      | Diminishing balance | 30 %        |
| Diffuser equipment            | Diminishing balance | 20 %        |
| Office and computer equipment | Diminishing balance | 20 to 30%   |

The Company regularly reviews its property and equipment to eliminate obsolete items. The Company records half the normal amortization in the year of addition, and no amortization in the year of disposal. No amortization is taken unless the assets are available for use.

#### **Goodwill**

Goodwill represents the excess of the purchase price paid for Seair Septic Inc. over the fair value of the net assets acquired. Management annually reviews the valuation of this goodwill based on the estimated future cash flows of Seair Septic Inc., taking into account any events and circumstances which might have impaired the fair value. There were no events between the acquisition date and the year end date that would indicate an impairment exists in the value of the goodwill at August 31, 2006.

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**SEAIR INC.**

Years Ended August 31, 2006 and 2005

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**Note 3**  
Significant Accounting  
Policies  
*Continued...*

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**Intangibles**

Research and development and patent related expenditures are expensed as incurred with the exception of costs, which meet criteria whereby the product is clearly defined and its costs are identifiable, the product is technically feasible, management has indicated their intention to produce and market the product, the future market for the product is clearly defined and adequate resources exist to complete the project. If, at any time, it appears unlikely that capitalized development costs will be recovered through related future revenues from commercialization, then the unamortized balance is written off as a charge to income in the year in which such a determination is made.

Development costs relate to some of the initial product development completed by the Company. Development costs are amortized on a straight-line basis over five years.

**Investment Tax Credits**

The Company claims investment tax credits as a result of incurring scientific research and experimental development expenditures. Investment tax credits are recognized when the related expenditures are incurred, and there is reasonable assurance of their realization. Management has made a number of estimates and assumptions in determining the expenditures eligible for the investment tax credit claim. It is possible that the allowed amount of the investment tax credit claim could be materially different from the recorded amount upon assessment by Canada Revenue Agency.

**Future Income Taxes**

The Company follows the asset and liability method of accounting for income taxes. Under the asset and liability method, the change in the net future tax asset or liability is to be included in income. Future tax assets and liabilities are measured using enacted rates expected to apply to taxable income in the years in which the temporary differences are expected to be removed or settled. A valuation allowance is provided to the extent that it is more likely than not that a future tax asset will not be realized in the near term.

**Leases**

Leases are classified as capital or operating leases. A lease that transfers substantially all of the benefits and risks incidental to the ownership of property is classified as a capital lease. All other leases are accounted for as operating leases, wherein rental payments are expensed as incurred.

**Stock based compensation**

The Company has a stock option plan that provides for the issuance of stock options to key employees, directors and officers as described in Note 12. On July 1, 2002, the Company adopted the requirements of CICA Handbook Section 3870, Stock-Based Compensation and Other Stock Based Payments. The Company adopted the fair value based method to account for stock based transactions with non-employee directors. The value is recognized over the applicable vesting period as an increase to compensation expense and contributed surplus. When the options are exercised, the proceeds received by the Company, together with the amount in contributed surplus, would be credited to share capital.

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**SEAIR INC.**

Years Ended August 31, 2006 and 2005

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**Note 3**  
Significant Accounting  
Policies  
Continued...

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**Translation of Foreign Currency Transactions**

Accounts in foreign currencies have been translated into Canadian dollars using the temporal method. Under this method monetary assets and liabilities have been translated at the year end exchange rate. Non-monetary assets have been translated at the rate of exchange prevailing at the date of transaction. Revenues and expenses have been translated at the rates of exchange during the year.

Foreign exchange gains and losses on monetary assets and liabilities are included in the determination of earnings.

**Financial Instruments**

a) Fair Value

The carrying values of cash, accounts receivable, accounts payable and accrued liabilities approximate their fair values due to the short-term maturity of these instruments. Financial instruments also include advances from affiliates. Management considers that no events have occurred subsequent to the inception of these financing arrangements that would indicate that fair value differs substantially from carrying value.

b) Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily within accounts receivable. In the normal course of business, the Company evaluates the financial condition of its customers on a continuing basis and reviews the credit worthiness of all new customers. Management assesses the need for allowances for potential credit losses by considering the credit risk of specific customers, historical trends, and other information.

c) Foreign Currency Risk

The Company is exposed to currency risk with regards to its U.S. denominated accounts receivable. The Company has not engaged in any hedging activity to mitigate this risk.

**Statement of Cash Flow**

The Company is using the direct method in its presentation of the Statement of Cash Flow.

**Measurement Uncertainty**

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The significant estimates pertain to inventory obsolescence, the physical and economic lives of property and equipment and intangibles, and the volatility applied in the calculation of stock-based compensation.

Notes to the Financial Statements

**SEAIR INC.**

Years Ended August 31, 2006 and 2005

**Note 4**  
Business Acquisitions

Effective March 31, 2006, the Company acquired 51% of the outstanding shares of Sear Septic Inc. for \$1,050,000 of share consideration from an unrelated party. Sear Septic Inc. owns several portable waste water treatment units.

The purchase price was allocated to the estimated fair value of the assets acquired as follows:

|                         |                     |
|-------------------------|---------------------|
| Property and equipment  | \$ 893,825          |
| Goodwill                | 1,165,000           |
|                         | <u>\$ 2,058,825</u> |
| Proportion acquired     | 51%                 |
| Net assets acquired     | <u>\$ 1,050,000</u> |
| Consideration:          |                     |
| 3,000,000 common shares | <u>\$ 1,050,000</u> |

**Note 5**  
Inventory

|  | <u>2006</u>       | <u>2005</u>       |
|--|-------------------|-------------------|
| Inventory is comprised of the following: |                   |                   |
| Finished goods                           | \$ 232,733        | \$ 153,385        |
| Raw materials and parts                  | 329,488           | 95,195            |
|  | <u>\$ 562,221</u> | <u>\$ 248,580</u> |

**Note 6**  
Property and Equipment

|                               |                     |                             | <u>2006</u>       | <u>2005</u>       |
|-------------------------------|---------------------|-----------------------------|-------------------|-------------------|
|                               | Cost                | Accumulated<br>Amortization | Net Book<br>Value | Net Book<br>Value |
| Sewage and storage equipment  | \$ 800,439          | \$ 20,982                   | \$ 779,457        | \$ -              |
| Office complex                | 95,000              | 3,000                       | 92,000            | -                 |
| Machinery                     | 59,644              | 10,204                      | 49,440            | 8,419             |
| Vehicles                      | 49,500              | 7,425                       | 42,075            | -                 |
| Diffuser equipment            | 41,394              | 32,602                      | 8,792             | 10,990            |
| Office and computer equipment | 12,239              | 6,868                       | 5,371             | 16,682            |
|                               | <u>\$ 1,058,216</u> | <u>\$ 81,081</u>            | <u>\$ 977,135</u> | <u>\$ 36,091</u>  |

Amortization provided for in the current year totaled \$40,081; (2005 - \$8,990).

Notes to the Financial Statements

**SEAIR INC.**

Years Ended August 31, 2006 and 2005

**Note 7**  
Intangibles

|                   |                  |                             | 2006              | 2005              |
|-------------------|------------------|-----------------------------|-------------------|-------------------|
|                   | Cost             | Accumulated<br>Amortization | Net Book<br>Value | Net Book<br>Value |
| Development costs | \$ 68,287        | \$ 37,546                   | \$ 30,741         | \$ 15,574         |
| Patent costs      | 20,600           | 4,120                       | 16,480            | 20,600            |
|                   | <u>\$ 88,887</u> | <u>\$ 41,666</u>            | <u>\$ 47,221</u>  | <u>\$ 36,174</u>  |

Amortization provided for in the current year totaled \$14,766; (2005 - \$8,495).

**Note 8**  
Accounts payable and  
accrued liabilities

|                                 | 2006              | 2005              |
|---------------------------------|-------------------|-------------------|
| Trade payables                  | \$ 855,637        | \$ 226,451        |
| Management compensation payable | 93,750            | 67,200            |
|                                 | <u>\$ 949,387</u> | <u>\$ 293,651</u> |

**Note 9**  
Convertible Debentures

|   | 2006        | 2005             |
|---|-------------|------------------|
| Opening balance                                     | \$ 82,000   | \$ 85,000        |
| Convertible debentures issued                       | -           | -                |
| Convertible debentures repaid                       | -           | (3,000)          |
| Convertible debentures converted into common shares | (82,000)    | -                |
|   | <u>\$ -</u> | <u>\$ 82,000</u> |

The equity and debt components is comprised as follows:

|  |             |                  |
|--|-------------|------------------|
| Current liability portion of convertible debenture   | \$ -        | \$ -             |
| Long term liability portion of convertible debenture | -           | 82,000           |
| Equity portion of convertible debenture              | -           | -                |
|  | <u>\$ -</u> | <u>\$ 82,000</u> |

Notes to the Financial Statements

**SEAIR INC.**

Years Ended August 31, 2006 and 2005

**Note 10**  
Advances from  
Affiliates

The advances are due on demand, are unsecured and have no specific terms of repayment. All advances bear no interest. The affiliated parties have indicated that they do not intend to materially reduce the loan balance within the next fiscal year. However, because the parties do not have a written contract or other postponements, the amount has been presented as a current liability. All affiliated parties are either controlling shareholders or companies controlled by these same shareholders.

**Note 11**  
Commitments

The Company has obligations under two leases for its office premises. The lease commitments are exclusive of operating costs. Minimum lease payments in future years are as follows:

2007 \$ 18,000

**Note 12**  
Share Capital

Authorized:  
Unlimited number of Common, voting shares  
Unlimited number of Preferred shares

Issued Common shares:

|                                       | <u>2006</u>         |                     | <u>2005</u>         |                     |
|---------------------------------------|---------------------|---------------------|---------------------|---------------------|
|                                       | Number of<br>Shares | Stated<br>Capital   | Number of<br>Shares | Stated<br>Capital   |
| Opening                               | 16,893,692          | \$ 2,619,536        | 16,584,042          | \$ 2,522,313        |
| Shares issued on business acquisition | 3,000,000           | 1,050,000           | -                   | -                   |
| Private placement                     | 557,200             | 195,020             | 20,000              | 7,000               |
| Options exercised                     | 356,500             | 124,775             | 289,650             | 101,378             |
| Shares issued as settlement of debt   | 260,000             | 110,110             | -                   | -                   |
| Share issue costs                     | -                   | (5,956)             | -                   | (11,155)            |
|                                       | <u>21,067,392</u>   | <u>\$ 4,093,485</u> | <u>16,893,692</u>   | <u>\$ 2,619,536</u> |

During the year ended August 31, 2006, 356,500 options to purchase shares were exercised for \$124,775 of cash proceeds. Also during the year ended August 31, 2006, the Company issued 3,000,000 shares at \$0.35 in an acquisition of Sear Septic Inc., 557,200 shares at \$0.35 in private placements for proceeds totaling \$195,020, and 260,000 shares upon the conversion of convertible debentures by a shareholder.

Notes to the Financial Statements

**SEAIR INC.**

Years Ended August 31, 2006 and 2005

**Note 12**  
Share Capital  
Continued...

During the year ended August 31, 2005, 289,650 options to purchase shares were exercised for \$101,378 of cash proceeds. Also during the year ended August 31, 2005, the Company issued 20,000 shares at \$0.35 in a private placement for proceeds totaling \$7,000.

Warrants:

At August 31, 2006, there were 307,200 (2005 - 20,000) warrants outstanding. The warrants have an exercise price of \$0.45 per share and expire on January 31, 2007. The fair value of these warrants was determined to be Nil. The assumptions used in determining the fair value were a risk-free rate of 4.84%, a volatility of 22.94% and a maturity period of 0.46 years.

Escrow:

At August 31, 2006, the following shares were held in escrow with CIBC Mellon Trust Company pursuant to the Company's Escrow Agreements. The Escrow Agreement provides that these items be released from escrow as follows:

|                 | Common<br>Shares | Convertible<br>Debentures |
|-----------------|------------------|---------------------------|
| October 1, 2006 | 1,200,000        | -                         |
| April 1, 2007   | 1,200,000        | -                         |
|                 | <u>2,400,000</u> | <u>-</u>                  |

During the year ended August 31, 2006, the following shares were released from escrow:

|                  | Common<br>Shares | October 19,<br>2001 Options | October 31,<br>2002 Options | Convertible<br>Debentures |
|------------------|------------------|-----------------------------|-----------------------------|---------------------------|
| February 5, 2005 | 1,243,889        | -                           | -                           | 42,750                    |
| August 5, 2005   | 1,243,889        | -                           | -                           | 42,750                    |
|                  | <u>2,487,778</u> | <u>-</u>                    | <u>-</u>                    | <u>85,500</u>             |

Notes to the Financial Statements

**SEAIR INC.**

Years Ended August 31, 2006 and 2005

**Note 12**  
Share Capital  
Continued...

Stock options outstanding:

The Company has 1,692,000; (2005 - 1,640,400) outstanding stock options all of which are distributed to directors, officers and employees under the terms of its stock option plan.

The Company has reserved 414,739 of additional shares in Treasury to meet stock options not yet issued.

A summary of the status of the plan as at August 31, 2006 and 2005 and changes during the years then ended is presented below:

|  | <u>2006</u>      |  | <u>2005</u>      |  |
|--|------------------|--|------------------|--|
|  | <u>Options</u>   | <u>Weighted Average Exercise Price</u> | <u>Options</u>   | <u>Weighted Average Exercise Price</u> |
| Options outstanding, beginning of year           | 1,640,400        | \$ 0.357                               | 2,395,210        | \$ 0.393                               |
| Granted  | 590,300          | 0.680                                  | 450,000          | 0.376                                  |
| Exercised  | (356,500)        | 0.350                                  | (289,650)        | 0.350                                  |
| Expired  | (182,200)        | 0.350                                  | (915,160)        | 0.350                                  |
| Options outstanding and exercisable, end of year | <u>1,692,000</u> | <u>\$ 0.472</u>                        | <u>1,640,400</u> | <u>\$ 0.357</u>                        |

The option prices and expiry dates of the 1,874,200 stock options outstanding as at August 31, 2006 are as follows:

| <u>Expiry Date</u> | <u>Options</u>   | <u>Option Price Per Share</u> |
|--------------------|------------------|-------------------------------|
| July 14, 2008      | 681,700          | 0.35                          |
| September 28, 2009 | 200,000          | 0.40                          |
| August 26, 2010    | 220,000          | 0.35                          |
| May 30, 2011       | 590,300          | 0.68                          |
|                    | <u>1,692,000</u> |                               |

Notes to the Financial Statements

**SEAIR INC.**

Years Ended August 31, 2006 and 2005

**Note 12**  
Share Capital  
Continued...

Stock-based compensation:

*Options granted during the year:*

During the year ended August 31, 2006, the Company granted options for a total of 590,300, of which 550,300 were to certain directors and officers. Under the terms of the stock based compensation agreement the options expire on May 30, 2011.

| Grant Date   | Expiry Date  | Options | Option Price Per Share |
|--------------|--------------|---------|------------------------|
| May 30, 2006 | May 30, 2011 | 590,300 | \$ 0.68                |

| Expiry Date  | Estimated Fair Value Per Option | Spot Rate | Strike Price | Aggregate Fair Value |
|--------------|---------------------------------|-----------|--------------|----------------------|
| May 30, 2011 | \$ 0.06                         | \$ 0.45   | \$ 0.68      | \$ 35,418            |
|              |                                 |           |              | <u>\$ 35,418</u>     |

The common assumptions utilized in determining the fair values were a risk-free rate of 4.84%, volatility of 22.94% and a maturity period of 5.0 years.

*Options granted during the prior year:*

During the year ended August 31, 2005, the Company granted options for a total of 230,000 and 220,000 common shares to certain directors and officers. Under the terms of the stock based compensation agreement the options expire on September 28, 2009 and August 26, 2010 respectively.

| Grant Date      | Expiry Date     | Options | Option Price Per Share |
|-----------------|-----------------|---------|------------------------|
| Sept. 28, 2004  | Sept. 28, 2009  | 230,000 | \$ 0.40                |
| August 26, 2005 | August 26, 2010 | 220,000 | 0.35                   |

  

| Expiry Date        | Estimated Fair Value Per Share | Spot Rate | Strike Price | Aggregate Fair Value |
|--------------------|--------------------------------|-----------|--------------|----------------------|
| September 28, 2009 | \$ 0.08                        | \$ 0.36   | \$ 0.40      | \$ 18,400            |
| August 26, 2010    | 0.09                           | 0.33      | 0.35         | 19,800               |
|                    |                                |           |              | <u>\$ 38,200</u>     |

Notes to the Financial Statements

**SEAIR INC.**

Years Ended August 31, 2006 and 2005

**Note 12**  
Share Capital  
Continued...

The common assumptions utilized in determining the fair values were a risk-free rate of 4.0%, volatility of 23.04% and a maturity period of 5.0 years for the options expiring on September 28, 2009 and a risk free rate of 4.0%, volatility of 23.04% and a maturity period of 5 years for the options expiring on August 26, 2010.

**Note 13**  
Contributed Surplus

|  | <u>2006</u>       | <u>2005</u>       |
|--|-------------------|-------------------|
| Contributed surplus, opening               | \$ 397,717        | \$ -              |
| Change in accounting policy                | -                 | 359,517           |
| Stock-based compensation expense (Note 12) | 35,418            | 38,200            |
| Contributed surplus, ending                | <u>\$ 433,135</u> | <u>\$ 397,717</u> |

**Note 14**  
Loss Per Share

Basic

Basic net loss per share is determined by dividing net loss available to common shareholders as reported in the Statement of Loss by the average daily number of common shares outstanding for the period.

|   | <u>2006</u> | <u>2005</u>      |
|---|-------------|------------------|
| Net Income (Loss)   | (71,582)    | (612,853)        |
| Weighted average number of shares outstanding<br>for purposes of calculating basic loss per share | 18,043,660  | 16,664,523       |
| Basic loss per share  | <u>\$ -</u> | <u>\$ (0.04)</u> |

Diluted

The effects of all outstanding stock options, warrants and all convertible debentures were excluded from the loss per share calculation as the results would be anti-dilutive.

Notes to the Financial Statements

**SEAIR INC.**

Years Ended August 31, 2006 and 2005

**Note 15**

Income Taxes

As at August 31, 2006, the Company had income tax losses carried forward for tax purposes aggregating \$2,021,692 that are available for the reduction of future year's taxable income. No recognition has been given in these financial statements to any potential tax savings arising from application of these losses. The losses expire as follows:

|      |                     |
|------|---------------------|
| 2009 | \$ 153,393          |
| 2010 | 507,864             |
| 2011 | 624,353             |
| 2012 | 659,308             |
| 2013 | 76,774              |
|      | <u>\$ 2,021,692</u> |

The Company has investment tax credits carried forward arising from expenditures in Scientific Research and Experimental Development of \$124,493. These credits will be applied directly against taxes incurred. No future tax benefit has been recognized in these financial statements for any potential tax savings arising from these credits. The Company has \$552,501 (net of investment tax credits carried forward) of deductible Scientific Research and Experimental Development expenditures available for the reduction of future years' taxable income.

Future income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's future income tax assets and liabilities as of August 31, 2006 are as follows:

|                                     | <u>2006</u> | <u>2005</u> |
|-------------------------------------|-------------|-------------|
| Future income tax assets:           |             |             |
| Property and equipment              | \$ 71,149   | \$ 13,467   |
| Non-capital losses                  | 680,340     | 771,687     |
| Capital losses                      | -           | -           |
| Valuation allowance                 | (751,489)   | (779,703)   |
|                                     | -           | 5,451       |
| Future income tax liabilities:      |             |             |
| Deferred development costs          | -           | 5,451       |
|                                     | -           | 5,451       |
| Net future tax assets (liabilities) | <u>\$ -</u> | <u>\$ -</u> |

Notes to the Financial Statements

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**SEAIR INC.**

Years Ended August 31, 2006 and 2005

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**Note 16**  
Income Taxes  
continued ...

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The components of the income tax expense are as follows:

|  | <u>2006</u> | <u>2005</u>  |
|--|-------------|--------------|
| Tax recovery at the statutory rate of 33.6% (2004 - 35%) | \$ (24,051) | \$ (214,499) |
| Capital cost allowance in excess of amortization         | (12,689)    | 6,119        |
| Non-deductible meals and entertainment expense           | 587         | 800          |
| Share issue costs  | (25,230)    | (26,281)     |
| Non-capital losses carried forward                       | 61,409      | 230,758      |
| Other  | (26)        | 3,103        |
|  | <u>\$ -</u> | <u>\$ -</u>  |

**Note 17**  
Subsequent Events

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Subsequent to year end, the Company purchased the remaining 49% of the shares of Seair Septic Inc. As consideration, the Company issued 2,750,000 shares at \$0.50 per share.

**Seair Inc.**  
**Management Discussion and Analysis**  
**Year and Quarter Ending August 31, 2006**

**Forward-looking statements**

Management's discussion and analysis contains certain forward-looking statements that are subject to risks and uncertainties that may cause actual results or events to differ materially from the results or events predicted in this discussion. In addition to the risks outlined in the Risk Management section at the end of the discussion, factors which could cause actual results or events to differ could include, but are not limited to: the impact of competition; consumer confidence and spending levels; general economic conditions; interest and currency exchange rates; the cost and availability of capital; and the ability of Seair to attract and retain quality employees. No assurances can be given that results, performance or achievement expressed in, or implied by, forward-looking statements within this disclosure will occur, or if they do, that any benefits may be derived from them.

This document should be read in conjunction with the audited consolidated financial statements for the years ending August 31, 2006 and 2005 and the notes contained therein. This document was prepared as of December 12, 2006.

**Corporate Overview**

Seair is a leading developer of proprietary diffusion and sterilization technologies. Seair's patent-pending technologies allow for the efficient diffusion of gases into a liquid, thereby facilitating numerous applications in a wide variety of industries, including waste water treatment, pulp and paper, aquaculture, agriculture/horticulture, sterilization, golf course irrigation and pond treatment, animal enhancement and oil and gas.

Seair's primary focus is developing and selling equipment that diffuses gases, such as oxygen, ozone or carbon dioxide, into a liquid, resulting in a supersaturate solution. The major difference between Seair and other diffusion technologies is Seair's ability to achieve extremely small gas bubble size, which in turn allows for the mass transfer of gas to fluid. The result is a stable condition where the gases remain in solution for extended periods of time, leading to increased productivity and lower operating costs.

In May 2006 Seair acquired a 51% interest in Seair Septic. For purposes of this document "Seair" shall refer to the consolidated entity comprised of Seair Diffusion and Seair Septic (hereinafter referred to as "Septic"). Septic supplies and leases sewage treatment systems to various remote campsites, primarily in the oilfield industry. In connection with the May 2006 transaction, Septic now has an exclusive sub-license to incorporate Seair's diffusion technology into the portable sewage treatment plants. These newly designed units will provide a waste treatment system that Septic feels far exceeds the discharge guidelines established by Government regulations and environmental agencies.

## **Key Business Drivers**

Seair is continuing the transition from a research and development orientation to a sales and customer support orientation. The core Seair technology is proven and the current business development phase is to integrate that core technology into industry specific solutions. The versatility of Seair's technology prompted the Company to explore numerous end-applications in order to determine where the optimal initial market impact and penetration could be achieved, which is dependent upon being able to promise and deliver a full customer service and support capability. To date Seair has frequently worked with third parties to address and service specific industry and geographic markets. Seair expects to continue to use this partnering model even though it means that Seair cannot always directly control the pace at which target markets are pursued. However, by virtue of the May 2006 acquisition of Septic, Seair has moved to a direct business model in the portable sewage treatment industry, as this was determined to be an ideal situation to supply Seair-enhanced systems directly to end-customers.

While Seair will continue to support its many partners and distributors outside the portable sewage treatment industry, the bulk of the Company's near-term resources will be applied to the sewage application. Septic's business, which involves recurring revenue from rental/leasing of portable units, is seasonal as it relates to oilfield campsites. Most western Canadian oilfield campsites are idle during the summer months. Nevertheless, Seair expects to be able to expand the sewage application into other industries that are not subject to the seasonality inherent in oil and gas exploration and development. For example, municipal waste water treatment is a year-round end-use application well suited to the Septic units.

Seair has only recently commenced commercial sales of its diffusion-based solutions. Considerable financial resources were consumed in the research and development phase and since Septic is presently rapidly expanding the number of Septic units available for rental, Seair is left with limited cash and working capital. Additional working capital, along with continued emphasis on prudent cash management and cost containment, will accelerate growth and, ultimately, increase profits.

Seair provides reasonable equipment financing terms, either directly or via third parties, in order to resolve this obstacle to completed sales. Seair has now successfully linked customers to external financing, both for lease situations and with Canada's Export Development Corporation ("EDC") for international sales.

## Results of Operations

Seair's consolidated sales and financial performance is summarized as follows:

|                      | Quarter Ending |            |        | Year Ending |           |        |
|----------------------|----------------|------------|--------|-------------|-----------|--------|
|                      | 31-Aug-06      | 31-Aug-05  | Change | 31-Aug-06   | 31-Aug-05 | Change |
| Revenue              | \$ 333,779     | \$ (7,803) | 4378%  | \$ 723,235  | \$ 77,042 | 839%   |
| Gross profit         | 329,851        | 5,637      | 5752%  | 615,252     | 31,996    | 1823%  |
| Net loss             | (32,440)       | (216,726)  | -85%   | (71,582)    | (612,853) | -88%   |
| Basic loss per share | (0.00)         | (0.01)     |        | (0.00)      | (0.04)    |        |

### *Fiscal Year Ending August 31, 2006*

Fiscal 2006 revenue of \$723,235 was 839% higher than fiscal 2005. This increase is directly attributable to waste water treatment growth originating with Seair's March 2006 acquisition of a 51% interest in Septic. As a result of this acquisition Seair is a direct participant in the waste water treatment industry. Revenue is derived primarily from rentals of portable water treatment systems that utilize Seair's proprietary diffusion technology.

Prior to fiscal 2005 Seair was essentially a technology development company. Initial efforts were made to bring Seair's technology to market, but gaining a foothold in target sectors proved to be challenging. The versatility of Seair's technology means it can be applied in a wide variety of end applications, but Seair lacked the resources to build market presence from the ground up. Accordingly, in fiscal 2005 Seair shifted to a partnering model whereby third parties, acting as distributors, partners or similar forms of arrangement, assumed responsibility for end sales and first line customer support. The partnering model exposed Seair's technology to a number of end-use applications and markets. As a result of this exposure it was determined that the waste water treatment industry had particular potential in both the near and long-term. The Septic acquisition gives Seair an immediate presence in this high potential industry.

The partnering model continues to be used in a wide variety industries. However, by shifting responsibility for sales to third parties significantly reduces Seair's ability to influence the pace at which specific opportunities are pursued. Although distributor agreements generally include minimum sales targets that must be achieved to maintain the distributor status, by necessity these targets are spread over relatively long time frames in order to permit the distributor adequate time to develop the market. The Company expects distributor-based sales to increase as Seair's partners complete their initial market development.

Gross margin for the year ending August 31, 2006 was \$615,252 compared to \$31,996 in the preceding year (an increase of 1823%). Seair retrofitted existing Septic rental units with Seair technology, rather than building complete new units from scratch. By retrofitting Seair was able to minimize the cost of fusing the Seair technology into the Septic assets, which in turn leads to extremely high gross margins on rentals of the current units. The 85% gross

margin rate realized in fiscal 2006 is expected to decrease slightly as Seair expands the number of available rental units.

Total operating expenses increased by \$91,896 from fiscal 2005 to fiscal 2006. This 14% increase compares to an 839% increase in revenue. Seair continues to focus intently on cost control even though revenue and cash flow have dramatically increased.

Professional fees increased \$18,855 (40%) as a direct result of work required to complete the Septic acquisition. Repairs and maintenance and shop yard/maintenance totaled \$45,772 versus \$0 for fiscal 2005. These activities are directly linked to maintaining Septic's rental assets. Amortization increased by \$37,362 to \$54,847 (an increase of 214%) as a result of the much larger capital asset base acquired in the Septic transaction. Seair also cleaned up a number of customer accounts, which resulted in a \$44,037 increase in bad debts expense.

Increased revenues and gross margins, coupled with continued cost control, served to significantly reduce Seair's operating loss. Net loss improved by 88% on a year-over-year basis (loss decreased by \$541,271 to \$71,582).

#### *Quarter Ending August 31, 2006*

Seair's revenue for the quarter ending August 31, 2006 was \$333,779, or \$341,582 higher than the equivalent quarter in fiscal 2005. In the quarter ending August 31, 2005 Seair reversed a sale booked previously in the year in the amount of \$39,403. As a result of this adjustment, revenue for the fourth quarter was negative \$7,803. If not for this adjustment from a prior quarter, the fourth quarter revenue would have been \$31,600, which in turn reduces the fiscal 2006 increase to \$302,179. Nonetheless, Seair's revenues have increased substantially on a year-over-year basis as a result of the Septic acquisition.

Sequentially, Seair's revenues increased \$164,085 (or 97%) from the quarter ending May 31, 2006. Seair had the full benefit of the Septic business in the quarter ending August 31, 2006 whereas there was only partial inclusion in the quarter ending May 31, 2006.

Gross profit was \$329,851 for the quarter ending August 31, 2006 compared to \$5,637 for the quarter ending August 31, 2005. This 6060% increase (\$341,582) is a direct result of the Septic acquisition. Sequential gross margin increased by 109% (\$168,754) from May 31, 2006.

Operating expenditures totaled \$412,202 for the quarter ending August 31, 2006 versus \$222,363 for the quarter ending August 31, 2005. This \$189,839 increase in operating expenditures, an 85% increase, reflects the increased scope of activity since the Septic acquisition. The increase in operating costs is overshadowed by the increase in gross profits (gross profit was up \$341,582 versus operating costs up \$189,839).

Total personnel related costs, excluding stock-based compensation, in the quarter were \$122,809 (versus \$60,312 for the quarter ending May 31, 2006 and \$69,163 for the quarter

ending August 31, 2005) as Seair has expanded its workforce to meet the demands of the post-Septic acquisition business.

The year over year quarterly loss decreased \$184,286, or 85%..

Seair's summarized results for the most recent eight quarters are as follows:

| Quarter<br>Ending | Revenue    | Gross<br>Profit | Net<br>Income/(Loss) | Basic<br>Income/(Loss)<br>per Share |
|-------------------|------------|-----------------|----------------------|-------------------------------------|
| 31-Aug-06         | \$ 333,779 | \$ 329,851      | \$ (32,440)          | \$ (0.00)                           |
| 31-May-06         | 169,694    | 154,266         | (7,196)              | (0.00)                              |
| 28-Feb-06         | 128,083    | 57,863          | (43,830)             | (0.00)                              |
| 30-Nov-05         | 91,679     | 73,272          | 11,884               | 0.00                                |
| 31-Aug-05         | (7,803)    | 5,637           | (216,726)            | (0.01)                              |
| 31-May-05         | 17,413     | 12,619          | (116,758)            | (0.01)                              |
| 28-Feb-05         | 46,085     | 10,348          | (127,643)            | (0.01)                              |
| 30-Nov-04         | 21,374     | 3,392           | (151,726)            | (0.01)                              |

Quarterly results vary significantly because Seair has only recently commenced building sales channels. The Septic acquisition in May 2006 gives Seair a foundation for sales and gross profit that did not previously exist with the Company. This has led to increasing stability and improved operating results.

Revenue for the quarter ending November 30, 2004 includes an \$11,000 credit granted to a greenhouse industry customer for equipment returned to Seair. This credit reduced the revenue that would otherwise have been reported for the six months ending February 28, 2005.

### **New Business Development**

Seair has strategically determined that emphasis on the western Canadian portable sewage treatment market is the preferred route to commercialization of Seair's proprietary diffusion technologies. The Septic acquisition in May 2006 was a key step in implementing this strategy. Septic has an established customer base that will benefit from the diffusion-enhanced units beginning in the fall of 2006. Seair expects to leverage this position into a significant presence in the market, which in turn will serve as Seair's showpiece for moving into other geographic and application markets.

Seair will place less emphasis on direct involvement in other industries and sectors. Rather, business development in these areas will be assigned to Seair's network of partners and distributors.

## Liquidity and Capital Structure

Working capital at August 31, 2006 was \$263,158 up from \$15,640 at August 31, 2005 and up \$359,859 from working capital of negative \$96,702 at May 31, 2006. Current liabilities at May 31, 2006 include \$82,000 with respect to a convertible debenture due to a former director, whereas at August 31, 2005 this item was included as a non-current liability. This debenture has now been retired.

Sear continues to operate at a loss while the sales channel is being developed. Accordingly, additional working capital will be required until such time profitable operations are achieved. Strengthened working capital will enable Sear to systematically build market position in selected industries, optimize margins and terms of business and aggressively pursue new opportunities when warranted. Moreover, increased working capital will allow Sear to accelerate both the retrofit of existing Septic portable sewage treatment units as well as facilitate adding new customers in the market sector on momentum created by the melding of Sear's diffusion technology into portable sewage treatment systems.

At August 31, 2006 Sear had 21,067,392 shares outstanding at a book value of \$4,093,485, or \$0.194 per share. A total of 356,500 shares were issued in connection with stock options exercised during the year ending August 31, 2006 for gross proceeds of \$124,775 (\$0.35 per share). Of these options, 100,000 were exercised during the quarter ending August 31, 2006 for gross proceeds of \$35,000 (\$0.35 per share).

Sear had 1,692,000 issued and outstanding stock options at August 31, 2006 exercisable at prices ranging from \$0.35 to \$0.68 per share. The average exercise price for outstanding options is \$0.472 per share. All of these options, which constitute 7.4% of the combined shares and options outstanding at August 31, 2006, have been issued to Sear officers, employees and directors.

Sear has recorded contributed surplus of \$433,135 as the estimated fair value of stock options issued since inception. Of this amount, \$35,418 was expensed in the year ending August 31, 2006 in conjunction with the 590,300 stock options issued during that period. No stock options were granted during the quarter ending August 31, 2006.

In 2002 Sear issued \$135,000 of prime + 4% convertible debentures to a director. At August 31, 2005 \$82,000 of this debenture remained outstanding, down from \$85,000 at August 31, 2004. The debenture was retired in the quarter ending August 31, 2006 by issued the debenture holder 260,000 common shares for deemed proceeds of \$110,100.

Sear intends to build working capital through achieving profitable operations. Until then it may be necessary to raise additional capital.

Sear has obligations under several long-term leases for its premises. The lease commitments are exclusive of operating costs. Minimum lease payments in future years are as follows:

|      |          |
|------|----------|
| 2007 | \$18,000 |
|------|----------|

Searir has no other contractual obligations for convertible debt and operating leases.

### **Capital Expenditures**

Total capital expenditures for the year ending August 31, 2006 were \$96,893 (compared to \$11,813 for the year ending August 31, 2005) in addition to the equipment acquired as part of the Septic acquisition. Searir intends to increase the number of portable waste water treatment plants available for rent/lease and, accordingly, capital expenditures are expected to rise.

The Company has no off-balance sheet arrangements that have, or are likely to have, a current or future effect on the results of operations or financial condition of the Company.

### **Subsequent Event**

On October 23, 2006 the Company announced that it had acquired the balance of the outstanding shares of Septic in exchange for 2,750,000 Searir shares. Searir, with 100% ownership of Septic, has accelerated the pace of expanding the portable waste water treatment fleet. Searir expects to soon have approximately 100 units in the waste water treatment rental fleet.

### **Risk Management**

Searir is exposed to a number of risks in the normal course of its business that have the potential to affect its operating performance.

#### Technology Risk

Searir's core asset is its patented diffusion technology. Although Searir has completed its core research and development work and has market ready products, the technology and resulting products require continual refinement. Moreover, the versatility of Searir's products leads to use in many industries and many differing end applications. In many cases Searir must customize the integration of its equipment into these varying end applications. Failure to properly integrate and operate the equipment can lead to reduced performance or even failure. Searir intends to improve and document its equipment installation and operation process. Investment in trained technical personnel will ensure proper installation. Improved customer support is required to ensure customers optimize the results from Searir equipment without requiring frequent field visits by Searir personnel.

#### Financial Risk

Apart from technology, Searir also faces considerable financial risk. Additional working capital will need to be accessed to carry Searir through to profitable operations.

Searir has a considerable investment in accounts receivable (\$523,139 at August 31, 2006, up from \$74,806 at August 31, 2005). Tighter credit granting controls and increased emphasis

on account collection will continue to be required to reduce accounts receivable exposure and shorten the cash flow cycle. In addition, Seair is has now successfully facilitated a financing transaction between the Export Development Corporation (“EDC”) and a customer residing outside of Canada and the United States. The use of EDC can significantly reduce the time and risk associated with collecting on overseas sales.

At as August 31, 2006, the Company reviewed, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of the design and operation of its disclosure controls and procedures. There are limitation to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and of individuals overriding the controls and procedures. These limitations are particularly significant when a company, like Seair, has a limited number of personnel which reduces the capacity to segregate duties. As a result, even effective disclosure controls and procedures can fail to achieve the desired results. Based on our evaluation and as of August 31, 2006, the Chief Executive Officer and the Chief Financial Officer concluded that the disclosure controls and procedures provide the Company with reasonable assurances that the information required to be disclosed in the Company’s reports that are filed and submitted to the securities regulatory authorities are recorded, processed, summarized and reported as and when required. Nevertheless, Seair will implement further segregation of duties as additional personnel are added in connection with ongoing Company growth.