

MANAGEMENT'S RESPONSIBILITY TO THE SHAREHOLDERS

The accompanying consolidated financial statements of Garneau Inc. and its subsidiaries and all the information in Management's Discussion and Analysis are the responsibility of management and have been approved by the Board of Directors.

The consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. The consolidated financial statements include certain amounts that are based on the best estimates and judgments of management and in their opinion present fairly, in all material respects, Garneau Inc.'s financial position, results of operations and cash flows. Management has prepared the financial information presented elsewhere in Management's Discussion and Analysis and has ensured that it is consistent with the consolidated financial statements.

Management of Garneau Inc. in furtherance of the integrity of the consolidated financial statements has developed and maintains a system of the internal controls. Management believes the internal controls provide reasonable assurance that transactions are properly authorized and recorded, financial records are reliable and form a proper basis for the preparation of consolidated financial statements and that Garneau Inc.'s assets are properly accounted for and safeguarded. The internal controls processes include management's communication to employees of policies that govern ethical business conduct.

The Board of Directors is responsible for overseeing management's responsibility for financial reporting and is ultimately responsible for reviewing and approving the consolidated financial statements. The Board carries out this responsibility through its Audit Committee.

The Audit Committee meets periodically with management, as well as the external auditors, to discuss internal controls over the financial reporting process, auditing matters and financial reporting issues; to satisfy itself that each party is properly discharging its responsibilities; and to review Management's Discussion and Analysis, the consolidated financial statements and the external auditors' report. The Audit Committee reports its findings to the Board of Directors for consideration when approving the consolidated financial statements for issuance to the shareholders. The Audit Committee also considers, for review by the Board of Directors and approval by the shareholders, the engagement or re-appointment of the external auditors.

The consolidated financial statements have been audited by KPMG LLP, the external auditors, in accordance with Canadian generally accepted auditing standards on behalf of the shareholders. KPMG LLP has full and free access to the Audit Committee.

Sincerely,



Glen R. Garneau
President, CEO



Richard N. Hughes
Chief Financial Officer

Edmonton, Canada
March 31, 2009



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AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of Garneau Inc. as at December 31, 2008 and 2007 and the consolidated statements of operations and comprehensive income (loss) and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatements. 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 Corporation as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

A handwritten signature in black ink that reads 'KPMG LLP'. The signature is written in a cursive, slightly slanted style. Below the signature is a long, horizontal, slightly curved line that tapers at both ends, serving as a decorative underline.

Chartered Accountants

Edmonton, Canada
March 31, 2009

CONSOLIDATED BALANCE SHEETS

<i>(In thousands of Canadian dollars)</i>	at December 31, 2008	at December 31, 2007
Assets		
Current Assets:		
Accounts receivable	\$ 1,811	\$ 4,719
Unbilled revenue	1,146	166
Inventories (note 4)	3,203	3,427
Prepaid expenses and deposits	103	331
	6,263	8,643
Other assets	66	60
Property, plant and equipment (note 5)	20,229	21,182
	\$ 26,558	29,885
Liabilities and Shareholders' Equity		
Current Liabilities:		
Operating loan (note 2)	\$ 3,095	\$ 3,141
Accounts payable and accrued liabilities	3,366	1,854
Customer deposits	478	112
Deferred revenue	1,775	-
Billings in excess of costs incurred on bill-and-hold arrangements	370	-
Demand loans (note 2)	7,601	8,209
Current portion of capital lease obligations	236	265
	16,921	13,581
Capital lease obligations (note 6)	-	118
	16,921	13,699
Shareholders' Equity:		
Share capital (note 7 (b))	21,460	21,438
Contributed surplus (note 7 (e))	350	260
Deficit	(12,173)	(5,512)
	9,637	16,186
Basis of presentation – going concern (note 1)		
Commitments (note 8)		
Contingencies (note 9)		
Subsequent event (notes 1, 2, 5, 11, 12 (c))		
	\$ 26,558	\$ 29,885

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

On behalf of the Board:



Dan Motyka
Director



John Carruthers
Director

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS) AND DEFICIT

<i>(In thousands of Canadian dollars, except per share data)</i>	Year Ended December 31, 2008	Year Ended December 31, 2007
Revenue	\$ 17,287	\$ 20,161
Operating costs	13,615	16,445
	3,672	3,716
Other operating expenses (income):		
Selling, general and administrative	6,133	6,015
Amortization	2,442	2,188
Impairment of long-lived assets (note 5)	425	-
Research and development	297	192
Bad debts	190	94
Foreign exchange loss (gains)	30	(18)
Gain on disposal of property, plant and equipment	(15)	(4)
	9,502	8,467
	(5,830)	(4,751)
Financing:		
Interest on operating loan	200	122
Interest on demand loans	537	385
Other	102	117
Other income	(8)	(41)
Loss before income taxes	(6,661)	(5,334)
Income taxes (note 10):		
Future (recovery)	-	(606)
	-	(606)
Net loss and comprehensive income (loss)	(6,661)	(4,728)
Deficit, beginning of year	(5,512)	(784)
Deficit, end of year	\$ (12,173)	\$ (5,512)
Earnings (loss) per share (note 7 (f)):		
Basic	\$ (0.55)	\$ (0.39)
Diluted	\$ (0.55)	\$ (0.39)
Weighted average number of shares outstanding:		
Basic	12,116,402	12,063,933
Diluted	12,116,402	12,063,933

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands of Canadian dollars)

	Year ended December 31, 2008	Year ended December 31, 2007
Cash provided by (used in):		
Operations:		
Net loss	\$ (6,661)	\$ (4,728)
Items not involving cash:		
Amortization	2,442	2,188
Impairment of long-lived assets	425	-
Stock-based compensation expense (note 7 (c))	96	171
Gain on disposal of property, plant and equipment	(15)	(4)
Future income taxes	-	(606)
	(3,713)	(2,979)
Changes in non-cash operating working capital (note 14)	6,403	4,338
	2,690	1,359
Financing:		
Proceeds from exercise of share purchase options	16	27
Repayment of operating loan	(46)	(2,083)
Repayment of demand loans	(1,408)	(1,709)
Advances under demand loans	800	5,000
Repayment of capital lease obligations	(147)	(365)
	(785)	870
Investments:		
Other assets	(6)	(4)
Proceeds from disposal of property, plant and equipment	18	27
Additions to property, plant and equipment	(1,917)	(2,252)
	(1,905)	(2,229)
Change in cash	-	-
Cash, beginning of year	-	-
Cash, end of year	\$ -	\$ -

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

Garneau Inc.
Notes to the Consolidated Financial Statements
For the years ended December 31, 2008 and 2007

(Amounts in thousands of Canadian dollars, except per share amounts or unless otherwise specified)

Garneau Inc. (the “Corporation”) is incorporated under the Business Corporations Act of Alberta. Its principal business activities are the coating of pipe and the manufacturing of equipment for use in the oil and gas industry.

1. BASIS OF PRESENTATION – GOING CONCERN:

These consolidated financial statements have been prepared on a going concern basis in accordance with Canadian GAAP. The going concern basis of presentation assumes that the Corporation will continue in operation for the foreseeable future and be able to realize its assets and discharge its liabilities and commitments in the normal course of business.

There is significant doubt about the appropriateness of the use of the “going concern” assumption. The Corporation:

- experienced a loss of \$6,661 in 2008 (2007: a loss of \$4,728);
- has an accumulated deficit of \$12,173 (2007: an accumulated deficit of \$5,512);
- had negative cash flows from operations before adjusting for changes in working capital of \$3,713 in 2008 (2007: negative cash flows of \$2,979);
- has a working capital deficiency as at December 31, 2008 of \$10,658 (2007: a deficiency of \$4,938); and
- has received notice from its primary lender demanding repayment of all amounts owing to it.

The Corporation is in breach of its debt service and working capital covenants under its loan agreement (including certain capital leases); the breaches have not been waived by the Corporation’s primary lender. Based on the Corporation’s current projections, the Corporation believes it is unlikely that it will be in compliance with the existing loan agreement financial covenants during fiscal 2009.

Subsequent to year end, the Corporation’s primary lender demanded repayment of all amounts owing to it be paid no later than April 15, 2009, and stated that it will exercise such rights as it considers necessary to collect all amounts owing. The Corporation is in receipt of the statutory Notice of Intention to Enforce Security from the lender pursuant to section 244 of the Bankruptcy and Insolvency Act (Canada) and the ten day notice period required pursuant thereto has expired. The Corporation has waived its right to any other notice or demand from the lender.

The Corporation is assessing its business strategy. Alternatives being evaluated include, but are not limited to:

- attempting to secure financing from existing and alternate sources;
- attempting to obtain additional working capital from investors or from the partial sale of its business or the sale of certain assets, including potential sale-lease back arrangements;
- reorganizing the Corporation to allow its shares to be vended to a purchaser;
- identifying opportunities to generate sustainable profits in the foreseeable future from operations; and
- voluntarily filing an application with the Court of Queens Bench of Alberta (the “Court”) for creditor protection under the Companies’ Creditors Arrangement Act.

The Corporation has engaged an agent to solicit interest from parties in participating in certain of these strategic alternatives. Management is of the opinion that viable strategic alternatives exist to enable the Corporation to continue as a going concern. No agreements with lenders, investors or other counterparties have been reached and there can be no assurance that any such agreements will be reached. In addition, pursuance of any such strategic alternative could be subject to the approval

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of the Corporation's primary lender. There can be no assurance that any such plan would be confirmed or approved by the Corporation's primary lender, or that any such plan could be implemented successfully. Furthermore, there can be no assurance that future operations will generate sustainable profits.

The ability of the Corporation to continue as a going concern and to realize the carrying value of its assets and discharge its liabilities when due is dependent upon the successful completion of the actions taken or planned by Management, some of which are described above, which Management believes can mitigate the adverse conditions and events which raise significant doubt about the validity of the "going concern" assumption used in preparing these financial statements. There is no certainty that these and other strategies, including but not limited to strategies that are contingent upon actions of third parties as well as improved market acceptance and revenues for the Corporation's products and services, will be sufficient to permit the Corporation to continue as a going concern.

These financial statements do not reflect adjustments that would be necessary if the "going concern" assumption were not appropriate, including if the Corporation was to dispose, whether voluntarily or involuntarily, of a significant portion of or all of its assets used in operations. The potential range of outcomes that may or may not be achieved materially affect the degree of uncertainty associated with the measurement of many amounts in these consolidated financial statements. If the "going concern" basis was not appropriate for these financial statements, then adjustments would be necessary to the carrying value of assets and liabilities, the reported revenues and expenses, and the balance sheet classifications used and those adjustments could be material. Furthermore, the audited financial statements do not purport to reflect or to provide for the consequences of any creditor protection proceedings, wind-up of the Corporation, or the results if the Corporation's primary lender makes an application to the Court to place the Corporation into bankruptcy. In particular, these consolidated financial statements do not purport to show: (a) as to assets, the realizable value on a liquidation basis or their availability to satisfy liabilities; (b) as to pre-bankruptcy application liabilities, if such application or similar action were to occur, the amounts that may be allowed for claims or contingencies, or the status and priority thereof; (c) as to shareholder accounts, the effect of any changes that may be made in the Corporation's capitalization; or (d) as to operations, the effect of any changes that may be made in the Corporation's business.

2. DEMAND DEBT FACILITY

Subsequent to year end, the Corporation's primary lender demanded repayment of all amounts owing to it be paid no later than April 15, 2009, and stated that it will exercise such rights as it considers necessary to collect all amounts owing. The Corporation is in receipt of the statutory Notice of Intention to Enforce Security from the lender pursuant to section 244 of the Bankruptcy and Insolvency Act (Canada) and the ten day notice period required pursuant thereto has expired. The Corporation has waived its right to any other notice or demand from the lender.

On June 27, 2007 the Corporation entered into a new credit facility with its existing lender. Under this facility the Corporation is required to meet certain financial debt covenants with respect to debt to tangible net worth, the ratio of current assets to current liabilities, and debt service coverage.

The maximum amount available under the demand revolving operating loan at December 31, 2008 was \$6,250 (2007 - \$18,000) subject to a borrowing based formula on the level of eligible accounts receivable and inventories. Canadian dollar advances under the operating loan bear interest at the lender's prime rate plus 1.5% (2007 - 0.375%). US dollar advances under the operating loan bear interest at the lenders US Dollar prime rate plus 1.5% (2007 - 0.375%). On July 29, 2008, the

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Corporation's lender eliminated the option to pay LIBOR plus 1.975% on US Dollar advances. At December 31, 2008 and 2007, no funds were advanced under the US dollar arrangement. Letters of guarantee and credit for performance and bid guarantees when issued, reduce the amount available for borrowing under the facility.

Under the demand debt facility, the Corporation also had available at December 31, 2008:

- A demand revolving evergreen loan available to a maximum of \$2,300 (2007 – \$5,000) to finance the cost of capital upgrades, limited to the lesser of the total cost of upgrades and the maximum available limit, bearing interest at the lender's prime rate plus 2.0% (2007 – 0.875%).
- A demand bank loan available to a maximum of \$6,500 (2007 – \$9,000) repayable in monthly installments of principal and interest based upon an amortization period of 20 years, bearing interest at the lender's prime rate plus 2.0% (2007 – 0.875%).
- An import line of credit available to a maximum of \$2,500 (2007 – \$5,000) repayable in monthly installments of principal and interest based upon an amortization period of 20 years, bearing interest at the lender's prime rate plus 2.0% (2007 - 0.50% to 0.75%). No funds were outstanding under this facility at December 31, 2008 and 2007.
- A finance lease facility available to a maximum of \$200 (2007 – \$1,800), bearing interest at the lender's prime rate plus 0.875% (note 6).

The demand loan amounts outstanding at December 31 are as follows:

	2008	2007
Demand revolving evergreen bank loan, payable in monthly principal installments of \$52. Interest is charged at the rate of bank prime plus 2.0%.	\$ 1,621	\$ 1,599
Demand non-revolving bank loan, payable in monthly principal installments of \$55. Interest is charged at the rate of bank prime plus 2.0%.	5,980	6,610
	\$ 7,601	\$ 8,209

As collateral for the demand debt facility, the Corporation has provided a general security agreement creating a first priority charge over all assets, a floating charge over all present and after acquired real property, and assignment of all insurance.

As at December 31, 2008 the Corporation was not in compliance with its debt service ratio or its working capital coverage ratio covenants under its demand debt facility, which have not been waived by the Corporation's lender. Based on the Corporation's current projections, the Corporation believes it is unlikely that it will be in compliance with the existing loan agreement financial covenants during 2009. The debt service covenant under its loan agreement (including certain capital leases) is determined quarterly based on the trailing four quarters of net earnings (loss) plus depreciation plus interest expense ending on each determination date. The working capital coverage ratio under its loan agreement is determined quarterly and is based on the total current assets divided by the total current liabilities.

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Provided the lender does not exercise its rights under the demand feature of the demand debt facility, the contractual repayments of principal, classified as a current liability, are as follows:

2009	\$	1,300
2010		1,148
2011		982
2012		820
2013		820
And subsequent years		<u>2,531</u>
Total scheduled repayments	\$	<u>7,601</u>

On January 1, 2009, the Corporation and its lender executed an amended credit extension agreement, which included (but not limited to) the following amendments:

- An increase in the rate of interest on the revolving operating loan to the lender's prime rate plus 2.5%;
- An increase in the rate of interest on the demand revolving evergreen loan to the lender's prime rate plus 3.0%;
- An increase in the rate of interest on the US Dollar balances to the lender's US Dollar prime rate plus 2.5%;
- An increase in the rate of interest on the demand non-revolving bank loan to the lender's prime rate plus 3.0%;
- The fee for issuance of any letter of guarantee under the Import Facility is increased to 3.0% on all items; and
- An extension of the agreement to February 2, 2009.

On February 12, 2009, the Corporation's lender completed a review of the loans as set out in the Facility Letter and the Credit Extension Agreement and related amendments issued to the Corporation. The lender issued a notice demanding all amounts owing to be repaid on or before close of business on March 12, 2009.

On March 13, 2009, the Corporation entered into a second Credit Extension Agreement effective February 3, 2009. Under the amended terms of the agreement, the Operating Line is not to exceed \$5.0 million, and the remaining facilities are not to exceed the outstanding principal amounts as at March 13, 2009, as follows: the line on the Evergreen Loan – \$1.516 million; the Demand Loan – \$5.841 million; and, the Lease Line – \$100 thousand. Further, the Import Line has been cancelled. The agreement also included the following amendments effective March 15, 2009:

- An increase in the rate of interest on the revolving operating loan to the lender's prime rate plus 3.5%;
- An increase in the rate of interest on the demand revolving evergreen loan to the lender's prime rate plus 4.0%;
- An increase in the rate of interest on the US Dollar balances to the lender's US Dollar prime rate plus 3.5%;
- An increase in the rate of interest on the demand non-revolving bank loan to the lender's prime rate plus 4.0%;
- The letter of guarantee under the Import Facility is no longer available; and
- An extension of the agreement to April 15, 2009.

Garneau Inc.

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3. SIGNIFICANT ACCOUNTING POLICIES:

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”) and include the accounts of the Corporation and its subsidiaries. All significant inter-company balances and transactions have been eliminated in consolidation. The following is a summary of the significant accounting policies used in the preparation of the consolidated financial statements.

(a) 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 disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses for the year. Significant items subject to such estimates and assumptions include the estimated useful life and carrying amount of property, plant and equipment, valuation of accounts receivable, inventory and future income taxes, and the assessment of the percentage of completion on lump-sum contracts (including estimated costs and provision for estimated losses). The Corporation relies on assumptions regarding applicable industry performance and prospects, as well as general business and economic conditions that prevail and are expected to prevail (note 1). Assumptions underlying asset valuations are limited by the uncertainty of predictions concerning future events. By nature, asset valuations are subjective and do not necessarily result in precise determinations. Actual results could differ from those estimates.

(b) Recognition of revenue:

Revenue from product sales is recognized when products are shipped and the customer takes ownership and assumes the risk of loss, collection is probable, persuasive evidence of an arrangement exists and the sales price is fixed and determinable. For arrangements where the criteria for revenue recognition have not been met because legal title or risk of loss on products does not transfer to the customer until final payment has been received or where delivery has not occurred, revenue is deferred to a later period when the outstanding criteria have been met. For arrangements where the customer agrees to purchase products but the Corporation retains physical possession until the customer requests delivery (“bill and hold arrangements”), revenue is not recognized until delivery to the customer has occurred and all other revenue recognition criteria have been met.

Revenue related to the coating of pipe is recognized as the services are provided and the collection of the relevant receivable is probable, persuasive evidence of an arrangement exists, and the sales price is fixed and determinable.

The Corporation performs the majority of its equipment fabrication activities under lump-sum contracts. Revenue on lump-sum contracts is recognized using the percentage-of-completion method, measured by the ratio of costs incurred to date to estimated total costs. Excluded from costs incurred to date, particularly in the early stages of the contract, are the costs of items that do not relate to performance of contracted work. Contract project costs include all direct labour, material, subcontract, and equipment costs and those indirect costs related to contract performance such as indirect labour, supplies, and tools. General and administrative costs are charged to expense as incurred. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined. Changes in project performance, project conditions, and estimated profitability, including those arising from contract penalty provisions and final contract settlements, may result in revisions to costs and income that are recognized in the period in which such adjustments are determined. Revenue from contract change orders, which

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occur in most large projects, is recognized when the owner has agreed to the change order in writing. The asset entitled “unbilled revenue” represents revenue recognized in advance of amounts invoiced.

For some contracts, using the cost-to-cost method in estimating percentage-of-completion may overstate the progress on the project. For instance, in a project where a large amount of materials are purchased, including the costs of these materials in calculating the percentage-to-completion may overstate the actual progress on the project. For projects where the cost-to-cost method does not appropriately reflect the progress on the project, an alternative method for measuring progress on the project is utilized and revenue is recognized accordingly.

(c) Inventories:

Inventories are valued at the lower of cost and net realizable value. Inventories of raw materials and finished goods held for resale are recorded at cost on a first-in, first-out basis. The cost of work in progress and finished products are comprised of direct product costs, direct labour and an allocation of variable and fixed manufacturing overhead including amortization and are recorded at cost based upon weighted average cost. Net realizable value represents the estimated selling price for inventories in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale

(d) Foreign currency translation:

Foreign currency transactions are translated to Canadian dollars by applying exchange rates in effect at the transaction date. At each reporting period end, monetary assets and liabilities denominated in foreign currencies are converted to Canadian dollars at rates of exchange prevailing at that date. Realized and unrealized exchange gains and losses are included in earnings.

The operations of a wholly owned subsidiary are translated using the temporal method. Under this method, transactions originating in foreign currencies are translated to Canadian dollars by applying exchange rates in effect at the transaction date. Monetary items denominated in foreign currencies are translated to Canadian dollars at exchange rates in effect at the balance sheet dates and non-monetary items are translated at rates of exchange in effect when the assets were acquired or obligations incurred. Foreign exchange gains and losses are included in the determination of earnings.

(e) Stock-based compensation plan:

The Corporation has a stock-based compensation plan, which is described in note 7(c). The Corporation accounts for stock options granted to employees, officers and directors in accordance with the fair value based method of accounting. Under this method, compensation cost is measured at the grant date using the Black-Scholes model and amortized to expense over the vesting period of the options, with a corresponding increase in contributed surplus. When the options are exercised, the proceeds received by the Corporation along with the amount in contributed surplus associated with the exercised options, will be credited to share capital.

(f) Property, plant and equipment:

Property, plant and equipment are stated at cost. Equipment under capital lease is initially recorded at the present value of minimum lease payments at the inception of the lease. Amortization is provided using the straight-line method at the following annual rates:

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Asset	Rate
Land improvements	5 %
Buildings	5 %
Machinery, equipment and extrusion plant	6.25 % to 33 %

Equipment under construction is not amortized until it is available for use.

Equipment under capital lease is amortized over the shorter of the lease term and the estimated useful life of the asset.

(g) Income taxes:

The Corporation uses the asset and liability method of accounting for income taxes. Under this method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of enactment or substantive enactment. A valuation allowance is recorded against any future income tax asset if it is more likely than not that all, or some part, of the asset will not be realized.

(h) Impairment of long-lived assets:

Long-lived assets (comprised of property, plant and equipment) are reviewed for impairment annually, or more frequently if events or changes in circumstances indicate that the carrying amount may not be recoverable. If the sum of the undiscounted future cash flows expected to result from the use and eventual disposition of a group of assets is less than its carrying amount, it is considered to be impaired. The Corporation measures an impairment loss as the amount by which the carrying amount exceeds its fair value, determined using prices for similar items or the results of discounted cash flows when quoted market prices are not available. The Corporation made assumptions about the future cash flows expected from the use of its long-lived assets, such as: applicable industry performance and prospects; general business and economic conditions that prevail and are expected to prevail; expected growth; maintaining its customer base; and, achieving cost reductions. There can be no assurance that expected future cash flows will be realized, or will be sufficient to recover the carrying amount of long-lived assets. Furthermore, the process of determining fair values is subjective and requires management to exercise judgment in making assumptions about future results, including revenue and cash flow projections and discount rates.

(i) Earnings per share:

Basic earnings (loss) per share is computed by dividing net earnings (loss) available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted per share amounts are calculated using the treasury stock method. The treasury stock method increases the diluted weighted average number of shares outstanding to include additional shares from the assumed exercise of stock options, if dilutive. The number of additional shares is calculated by assuming that outstanding in-the-money stock options were exercised and the proceeds from such exercises, including any unamortized stock-based compensation cost, were used to acquire shares of common stock at the average market price during the year.

Garneau Inc.

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(j) Financial Instruments:

i) Classification and measurement

All financial instruments, including derivatives, must initially be recognized at fair value on the balance sheet. The Corporation classifies financial instruments into one of five categories: held-for-trading, held-to-maturity, loans and receivables, available-for-sale financial assets, and other financial liabilities. Subsequent measurement and changes in fair value depend on the financial instrument's initial classification. Loans and receivables, held-to-maturity investments and other financial liabilities are measured at amortized cost using the effective interest method of amortization. Held-for-trading financial instruments are measured at fair value with changes in fair value recognized in earnings. Available-for-sale financial assets are measured at fair value with changes in fair value recorded in other comprehensive income until the investment is derecognized or impaired, at which time the amounts would be recorded in net earnings.

The Corporation has the following financial instruments and has selected the following classifications:

- Cash and cash equivalents are classified as financial assets held for trading and are recorded at fair value, with realized and unrealized gains and losses reported in net earnings;
- Accounts receivable and unbilled revenue are classified as loans and receivables and are initially recorded at fair value, and subsequent to initial recognition are accounted for at amortized cost using the effective interest method;
- The Corporation has classified accounts payable and accrued liabilities, customer deposits, amounts due under its operating loan, demand loans and capital lease obligations as other financial liabilities. Other financial liabilities are accounted for on initial recognition at fair value, and subsequent to initial recognition at amortized cost using the effective interest method with gains and losses reported in net income in the period that the liability is derecognized; and
- The Corporation determined that none of its financial assets are classified as available-for-sale or held-to-maturity and none of its financial liabilities are classified as held-for-trading.

ii) Transaction costs

Transaction costs are incremental costs that are directly related to the acquisition or issuance of financial assets or liabilities and are expensed at the time of occurrence.

(k) Comparative figures:

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

(l) Recently adopted accounting pronouncements:

i) Capital Disclosures:

Effective January 1, 2008, the Corporation prospectively adopted the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 1535, *Capital Disclosures* ("CICA 1535"). CICA 1535 requires disclosure of an entity's objectives, policies and processes for managing capital, quantitative data about the entity in regards to capital and whether the entity has complied with any capital requirements

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and if it has not complied, the consequences of such non-compliance. The Corporation has provided the required disclosures in note 11 to its consolidated financial statements for the year ended December 31, 2008.

ii) Financial Instruments – Disclosure and Presentation:

Effective January 1, 2008, the Corporation adopted CICA Handbook Sections 3862, *Financial Instruments – Disclosures* (“CICA 3862”) and Handbook Section 3863, *Financial Instruments – Presentation* (“CICA 3863”), which replaced Section 3861, *Financial Instruments – Disclosure and Presentation*.

CICA 3862 requires entities to provide disclosures in their financial statements that enable users to evaluate the significance of financial instruments on the entity’s financial position and its performance and the nature and extent of risks from financial instruments to which the entity is exposed during the period and at the balance sheet date, and how the entity manages those risks. The Corporation has provided the required disclosures in note 12 to its consolidated financial statements for the year ended December 31, 2008.

CICA 3863 establishes standards for presentation of financial instruments and non-financial derivatives. It deals with the classification of financial instruments, from the perspective of the issuer, between liabilities and equity, the classification of related interest, dividends, gains and losses, and the circumstances in which financial assets and financial liabilities are offset. The adoption of this standard did not have a material impact on the presentation of financial instruments in the Corporation’s financial statements.

iii) Inventories:

Effective January 1, 2008, the Corporation adopted CICA Handbook Section 3031, *Inventories* (“CICA 3031”), which provides new guidance on the recognition, measurement and disclosure of inventories. The recognition and measurement changes include the elimination of the last-in first-out method, the requirement to measure inventories at the lower of cost and net realizable value, the allocation of overhead based on normal capacity, the use of the specific cost method for inventories that are not ordinarily interchangeable or goods and services produced for specific purposes, the requirement for an entity to use a consistent cost formula for inventory of a similar nature and use, and the reversal of previous write-downs to net realizable value when there is a subsequent increase in a value of inventories.

The Corporation retrospectively adopted the CICA 3031 requirements without restatement. The adoption of CICA 3031 did not have a material effect on the opening deficit or net loss for the year ended December 31, 2008.

(m) Future Canadian accounting pronouncements

i) Goodwill and intangible assets:

In 2008, the CICA issued Handbook Section 3064, *Goodwill and Intangible Assets* (“CICA 3064”). CICA 3064, which replaces Section 3062, *Goodwill and Other Intangible Assets*, and Section 3450, *Research and Development Costs*, establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets. This new standard is effective for the Corporation’s interim and annual consolidated financial statements commencing January 1, 2009. The Corporation is assessing the impact of the new standard on its consolidated financial statements.

Garneau Inc.

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ii) Business Combinations:

In October of 2008, the CICA issued Handbook Section 1582, *Business Combinations* (“CICA 1582”), concurrently with Handbook Sections 1601, *Consolidated Financial Statements* (“CICA 1601”), and 1602, *Non-controlling Interests* (“CICA 1602”). CICA 1582, which replaces Handbook Section 1581, *Business Combinations*, establishes standards for the measurement of a business combination and the recognition and measurement of assets acquired and liabilities assumed. CICA 1601, which replaces Handbook Section 1600, carries forward the existing Canadian guidance on aspects of the preparation of consolidated financial statements subsequent to acquisition, other than non-controlling interests. CICA 1602 establishes guidance for the treatment of non-controlling interests subsequent to acquisition through a business combination. These new standards are effective for the Corporation’s interim and annual consolidated financial statements commencing on January 1, 2011 with earlier adoption permitted as of the beginning of a fiscal year. The Corporation is assessing the impact of the new standards on its consolidated financial statements.

iii) Credit Risk and the Fair Value of Financial Assets and Financial Liabilities:

In January 2009, the CICA issued EIC Abstract 173, “Credit Risk and the Fair Value of Financial Assets and Financial Liabilities”. The EIC requires the Corporation to take into account the Corporation’s own credit risk and the credit risk of the counterparty in determining the fair value of financial assets and financial liabilities, including derivative instruments. The Corporation is currently assessing the impact of the new standard on its consolidated financial statements.

iv) International Financial Reporting Standards (“IFRS”):

In 2006, the Canadian Accounting Standards Board (“AcSB”) published a new strategic plan that significantly affects financial reporting requirements for Canadian public companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with IFRS over an expected five-year transitional period. In February 2008, the AcSB confirmed that IFRS will be mandatory in Canada for profit-oriented publicly accountable entities for fiscal periods beginning on or after January 1, 2011. The Corporation’s first annual IFRS financial statements will be for the year ending December 31, 2011 and will include the comparative period of 2010. Starting in the first quarter of 2011, the Corporation will provide unaudited consolidated financial information in accordance with IFRS including comparative figures for 2010.

The Corporation has completed a preliminary assessment of the accounting and reporting differences under IFRS as compared to Canadian GAAP; however, management has not yet finalized its determination of the impact of these differences on the consolidated financial statements. As this assessment is finalized, the Corporation intends to disclose such impacts in its future consolidated financial statements. In the period leading up to the changeover, the AcSB will continue to issue accounting standards that are converged with IFRS, thus mitigating the impact of adopting IFRS at the changeover date. The International Accounting Standards Board will also continue to issue new accounting standards during the conversion period and, as a result, the final impact of IFRS on the Corporation’s consolidated financial statements will only be measured once all the IFRS standards applicable at the conversion date are known.

Garneau Inc.**Notes to the Consolidated Financial Statements****For the years ended December 31, 2008 and 2007***(Amounts in thousands of Canadian dollars, except per share amounts or unless otherwise specified)***4. INVENTORIES**

	2008	2007
Raw materials	\$1,038	\$1,406
Work in progress	1,805	-
Finished goods	360	2,021
	\$3,203	\$3,427

The Corporation recognized \$6,751 of inventories as an expense which is included in cost of sales during the year (2007 – \$5,632). During the year \$340 was recorded in cost of sales for the write-down of inventory to estimated net realizable value (2007 – \$20).

Included in the cost of work in progress inventory are direct product costs, direct labour and an allocation of variable and fixed manufacturing overhead including amortization. Amortization expense included in direct costs for the year ended December 31, 2008 and its comparative period is not material.

All of the Corporation's inventory is pledged as security for the demand debt facility (note 2).

5. PROPERTY, PLANT AND EQUIPMENT

2008			
	Cost	Accumulated amortization	Net book value
Land and land improvements	\$ 4,704	\$ 2,148	\$ 2,556
Buildings	6,209	2,667	3,542
Machinery, equipment and extrusion plant	29,702	17,596	12,106
Equipment under construction	1,697	-	1,697
	42,312	22,411	19,901
Equipment under capital lease	718	390	328
	\$ 43,030	\$ 22,801	\$ 20,229
2007			
	Cost	Accumulated amortization	Net book value
Land and land improvements	\$ 4,704	\$ 1,985	\$ 2,719
Buildings	6,132	2,358	3,774
Machinery, equipment and extrusion plant	29,558	15,793	13,765
Equipment under construction	473	-	473
	40,867	20,136	20,731
Equipment under capital lease	718	267	451
	\$ 41,585	\$ 20,403	\$ 21,182

During the year ended December 31, 2008 additions of plant and equipment included \$ nil (2007: \$164) under capital leases. During the year ended December 31, 2008, depreciation of equipment under capital leases of \$123 was recorded (2007: \$160). On March 17, 2009, the Corporation disposed of certain machinery and equipment for total proceeds of \$190.

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At December 31, 2008 the Corporation performed impairment tests of its amortizable property and equipment. As a result of these impairments tests, the Corporation recorded impairment losses reflecting Corporation specific factors and the current economic conditions which are affecting the oil and gas industry in Alberta. For amortizable assets within the Pipeline segment, management determined that the undiscounted future cash flows from a specific asset group were below the carrying value of the net assets of that asset group, and the assets were written down to fair value. Fair value of the group of assets was determined by reference to anticipated proceeds that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. The impairment loss related to amortizable assets of the Pipeline segment was \$425 which has been included in the caption impairment of long-lived assets in the Statement of Operations.

6. CAPITAL LEASE OBLIGATIONS

The Corporation has financed certain equipment by entering into capital leasing arrangements. Capital lease repayments are scheduled as follows:

2009	\$156
2010	35
2011	67
<hr/>	
Total minimum lease payments	258
Less amount representing interest at rates ranging from 6% to 8%	(22)
<hr/>	
Present value of capital lease payments	\$236

Interest of \$22 (2007 - \$32) relating to capital lease obligations has been included in interest expense on the statement of operations. As a result of cross-covenant violations related to the debt demand facility (note 2), the Corporation has classified the entire capital lease obligation as a current liability.

7. SHARE CAPITAL

(a) Authorized:

Unlimited number of common shares.

(b) Issued:

	Number of common shares	Amount
Balance at December 31, 2006	12,048,527	\$21,401
Issued for cash during 2007 on exercise of options	43,250	27
Transfer from contributed surplus for stock options exercised	-	10
Balance at December 31, 2007	12,091,777	\$21,438
Issued for cash during 2008 on exercise of options	26,750	16
Transfer from contributed surplus for stock options exercised	-	6
Balance at December 31, 2008	12,118,527	\$21,460

Garneau Inc.**Notes to the Consolidated Financial Statements****For the years ended December 31, 2008 and 2007***(Amounts in thousands of Canadian dollars, except per share amounts or unless otherwise specified)***(c) Stock-Based Compensation Plan:**

The Corporation has implemented a stock option plan for directors, officers, employees and consultants and reserved a rolling 10% of the outstanding common shares for the plan. The exercise price of the share purchase options reflects the market price of the shares at the date the options are granted. The Board of Directors, at their discretion, determines the vesting period at the time of issuance. Stock options may be exercisable; subject to the provisions of the plan requiring acceleration of rights of exercise, until such date as may be determined from time to time by the Board of Directors provided that no stock option may be exercised more than 10 years from the date of grant. The options vest between 36 and 48 months from the date of grant and have a maximum term of five years. Options may be exercised at a price determined at the time the option is awarded, and vest as follows: no options vest on the award date, and 25%-33% vest on each subsequent anniversary date.

The continuity of the Corporation's outstanding and exercisable stock options for the years ended December 31, 2008 and 2007 is as follows:

	2008		2007	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Outstanding at beginning of year	891,800	\$1.34	920,550	\$1.31
Granted	200,000	0.32	50,000	1.14
Exercised	(26,750)	0.60	(43,250)	0.61
Forfeited	(380,250)	1.40	(35,500)	1.10
Outstanding at end of year	684,800	1.04	891,800	1.34
Options exercisable at end of year	360,885	1.28	388,710	1.20

The following options are outstanding as of December 31, 2008:

Number of Options		Expiry Date	Exercise	
Outstanding	Vested		Price per Share	
100,000	-	November 17, 2013	\$	0.20
50,000	-	September 26, 2013	\$	0.26
50,000	-	May 28, 2013	\$	0.60
59,700	59,700	September 18, 2010	\$	0.61
9,200	9,200	September 28, 2009	\$	1.00
40,400	40,400	September 9, 2010	\$	1.10
375,500	251,585	November 10, 2011	\$	1.48
684,800	360,885			

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At December 31, 2008, the weighted average remaining contractual life of outstanding option awards is 3.2 years (December 31, 2007 – 3.6 years). The fair value of stock options granted is estimated at the grant date using the Black-Scholes option pricing model using the following weighted average assumptions:

Year Ended	<u>2008</u>	<u>2007</u>
Expected dividends	Nil	Nil
Risk-free interest rate	2.90%	4.25%
Expected life	3 yrs	3 yrs
Expected volatility	85%	63%

During the year ended December 31, 2008, no modifications were made to stock options. During the year ended December 31, 2007, 63,200 stock options with an original expiry date of September 18, 2007 were modified to expire on September 18, 2010. The additional incremental value between the fair value of the modified award and the value of the original option of \$13 was recorded as an additional compensation expense in 2007.

Total stock based compensation expense for the year ended December 2008 was \$96 (2007- \$171). In 2008, the Corporation granted 200,000 (2007- 50,000) options to purchase common shares at a weighted average exercise price of \$0.32 (2007 – \$1.14) under the Corporation’s stock-option plan, and the weighted average fair value of each option granted in 2008 was determined to be \$0.18 (2007 - \$1.34).

(d) Employee Ownership Plan

The Corporation has an Employee Share Ownership Plan in place under which employees may contribute 5% of eligible compensation each year to purchase common shares of the Corporation. The Corporation will match the employee contribution and the Corporation’s contribution vests on December 31st of each year. If the Corporation wishes, it is authorized to issue up to 1,000,000 common shares under the Plan.

Employee and Corporation contributions for 2008 totaled \$222 (2007 - \$235) and were used to purchase 560,132 (2007 – 225,265) common shares of the Corporation on the open market.

(e) Contributed Surplus

A summary of the status of the Corporation’s contributed surplus account as of December 31, 2008 and 2007, and changes during the years ended on those dates is presented below:

Year Ended	<u>2008</u>	<u>2007</u>
Contributed surplus at beginning of the year	\$ 260	\$ 99
Stock-based compensation expense	\$96	171
Stock options exercised	(6)	(10)
<u>Contributed surplus at the end of year</u>	<u>\$ 350</u>	<u>\$ 260</u>

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(f) Earnings (Loss) per Share:

Year Ended	2008	2007
Basic earnings (loss) per share		
Earnings (loss) available to common shareholders	\$(6,661)	\$(4,728)
Weighted average number of common shares	12,116,402	12,063,933
Basic loss per share	(0.55)	\$(0.39)
Diluted earnings (loss) per share		
Loss available to common shareholders	\$(6,661)	\$(4,728)
Weighted average number of common shares	12,116,402	12,063,933
Dilutive effect of:		
Stock options	-	-
Weighted average number of diluted common shares	12,116,402	12,063,933
Diluted loss per share	(0.55)	\$(0.39)

8. COMMITMENTS

The Corporation is committed to operating lease payments for premises, automobiles, mobile and office equipment in the following approximate amounts:

2009	\$204
2010	178
2011	81
2012	48
	<u>\$511</u>

9. CONTINGENCIES

The Corporation has been named a defendant in a lawsuit and has received claims in the aggregate amount of \$2.0 million. In the opinion of management, this matter is without substantial merit and no provision has been made for the claim in these financial statements.

During the year, one charge under the Alberta Occupational Health and Safety Act has been laid against the Corporation with respect to a workplace accident that occurred in 2006. The Corporation has pled not guilty, but if convicted could be liable to pay a fine of not more than \$500,000 plus 15% of the total fine. The outcome of this matter is not determinable at this time and no provision has been made in these financial statements for this claim.

Garneau Inc.**Notes to the Consolidated Financial Statements****For the years ended December 31, 2008 and 2007***(Amounts in thousands of Canadian dollars, except per share amounts or unless otherwise specified)***10. INCOME TAXES**

Income tax expense differs from the amount that would be computed by applying the combined Federal and Provincial statutory income tax rate of 29.5% (2007: 32.12%) to loss before income taxes. The reasons for the differences are as follows:

	2008	2007
Expected income taxes (recovery) at statutory rates	\$ (1,965)	\$ (1,713)
Increase (decrease) resulting from:		
Other amounts	567	205
Change in valuation allowance	1,398	902
	<u>\$ -</u>	<u>\$ (606)</u>

The tax effects of temporary differences that give rise to significant portions of the future tax assets and future tax liabilities are presented below:

	2008	2007
Future tax assets:		
Losses carried forward	\$ 3,142	\$ 2,232
Other	716	266
	<u>3,858</u>	<u>2,498</u>
Less valuation allowance	<u>(2,455)</u>	<u>(1,057)</u>
	1,403	1,441
Future tax liabilities:		
Property, plant and equipment – excess of net book value over undepreciated capital cost	1,403	1,441
	<u>1,403</u>	<u>1,441</u>
Net future tax liability	<u>\$ -</u>	<u>\$ -</u>

At December 31, 2008, the Corporation has net operating loss carry forwards for income tax purposes of \$12.7 million which are available to offset future taxable income, if any, expiring from 2009 through 2028. These losses will expire as follows:

2009	\$505
2010	115
2014	1,195
2015	110
2026 and beyond	<u>10,775</u>
	\$12,700

11. CAPITAL DISCLOSURES

The Corporation's objectives when managing capital are to safeguard the entity's ability to continue as a going concern, so that it can continue to provide an adequate return for shareholders, and benefits to other stakeholders, by pricing products and services commensurately with the level of risk. The Corporation manages its capital structure, and makes adjustments to it, in light of changes in economic conditions and the risk characteristics of the underlying assets. The Corporation defines

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capital that it manages as the aggregate of its shareholders' equity, which is comprised of issued capital, contributed surplus and deficit. In order to maintain or adjust its capital structure, the Corporation may purchase shares for cancellation pursuant to normal course issuer bids, issue new shares, issue or repay debt or sell non-core assets to reduce debt.

The Corporation monitors capital on the basis of its debt-to-tangible net worth covenant as defined within its demand loan facility. This ratio is calculated as total debt divided by equity. Total debt is calculated as the total of current liabilities, and long-term liabilities less future income taxes. Equity comprises all components of shareholders' equity (i.e. share capital, contributed surplus and deficit). There were no significant changes to the capital structure during the year ended December 31, 2008. The Corporation has not distributed, nor does it currently plan to distribute, any dividends to its shareholders. During the year ended December 31, 2008, the Corporation's strategy, which was unchanged from 2007, was to maintain the debt-to-tangible net worth ratio below 2.5:1. The debt-to-tangible net worth ratio calculations at December 31, 2008 and at December 31, 2007, were as follows:

<i>(In thousands of Canadian dollars)</i>	December 31, 2008	December 31, 2007
Operating loan	\$ 3,095	\$ 3,141
Demand loans	7,601	8,209
Other liabilities	6,225	2,349
Total debt	16,921	13,699
Share capital	\$ 21,460	\$ 21,438
Contributed surplus	350	260
Deficit	(12,173)	(5,512)
Equity	9,637	16,186
Debt-to-tangible net worth	1.76-1	.85-1

The Corporation is subject to restrictive covenants related to its operating loan and its demand loans (note 2) that is measured on a quarterly basis. These covenants include, but are not limited to, the ratio of debt to tangible net worth, the ratio of current assets to current liabilities, and the debt service coverage ratio. The Corporation was not in compliance with its debt service coverage ratio or the working capital ratio covenant under this agreement as at and for the year ended December 31, 2008 (see notes 1 and 2). Failure to meet the terms of these covenants may constitute a default, which resulted in the acceleration of the requirement to repay the debt obligation subsequent to year end. The Corporation is also subject to externally imposed capital requirements under its demand debt facility, which contains certain restrictive covenants including, but not limited to, incurring additional debt, making capital expenditures, or making payments to shareholders. Other than the restrictive covenants associated with the debt obligations noted above, and certain capital leases, the Corporation is not subject to any contractual or regulatory imposed capital requirements.

Garneau Inc.**Notes to the Consolidated Financial Statements****For the years ended December 31, 2008 and 2007**

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12. FINANCIAL INSTRUMENTS

a) Fair values

The carrying values of accounts receivable, unbilled revenue, and accounts payable and accrued liabilities approximate their fair values due to the relatively short periods to maturity of the instruments. The fair values of the Corporation's obligations under capital leases, operating loan and demand loans are not significantly different than their carrying values as they bear interest at floating rates and are due on demand.

Fair values of financial instruments are determined by reference to quoted bid or asking price, as appropriate, in active markets at period-end dates. In the absence of an active market, the Corporation determines fair value by using valuation techniques that refer to observable market data or estimated market prices. These include comparisons with similar instruments that have observable market prices and other valuation techniques used by market participants. Fair values determined using valuation models require the use of assumptions about the amount and timing of estimated future cash flows and discount rates.

The fair values of financial assets and liabilities, together with the carrying amounts shown on the balance sheet, are as follows:

<i>(In thousands of Canadian dollars)</i>	December 31, 2008	
	Carrying amount	Fair value
Accounts receivable	1,811	1,811
Unbilled revenue	1,146	1,146
Demand loans	(7,601)	(7,601)
Operating loan	(3,095)	(3,095)
Capital lease obligations	(236)	(236)
Accounts payable and accrued liabilities	(3,366)	(3,366)
	(11,341)	(11,341)
Unrecognized loss	-	-

b) Credit risk

Credit risk is the risk of financial loss that the Corporation would experience if a counterparty to a financial instrument, in which the Corporation has an amount owing from the counterparty, failed to meet its obligations in accordance with the terms and conditions of its contract with the Corporation. The carrying amount of financial assets represents the maximum credit exposure to the Corporation.

The Corporation manages the credit risk associated with its cash by holding its funds with reputable financial institutions. Substantially all of the Corporation's accounts receivable are with companies in the oil and gas industry in Western Canada and with two international customers. The Corporation regularly monitors the activity and balances in these accounts to manage its credit risk. The Corporation's 10 largest customers accounted for 94% of accounts receivable outstanding at December 31, 2008. Three customers accounted for 36%, 26%, and 14% of total accounts receivable, respectively. In 2007, the Corporation's 13 largest customers accounted for 95% of accounts receivable outstanding at year end. During the year ended December 31, 2007, four customers accounted for 27%, 15%, 14% and 12% of total accounts receivable, respectively.

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Management has established a credit policy under which each new customer is analyzed individually for credit worthiness before the Corporation's standard payment and delivery terms and conditions are offered. The Corporation's review includes external ratings, where available, and in certain cases bank references. The Corporation's credit review procedures are informal but subject to ongoing management review of both the amount and aging of receivable balances. The Corporation reviews its accounts receivable accounts regularly and amounts are written down to their expected realizable value when outstanding amounts are determined not to be fully collectible. This generally occurs when the customer has indicated an inability to pay, the Corporation is unable to communicate with the customer over an extended period of time, and other methods to obtain payment have been considered and have not been successful. Bad debt expense is charged to net income in the period that the account is determined to be doubtful. Estimates of the allowance for doubtful accounts are determined on a customer-by-customer evaluation of collectability at each reporting date taking into consideration the following factors: the length of time the receivable has been outstanding, specific knowledge of each customer's financial condition and historical experience.

The aging of accounts receivable as at December 31, 2008 is as follows:

(In thousands of Canadian dollars)	December 31, 2008
	Gross
Not past due	\$1,206
Past due 1-15 days	230
Past due 16-30 days	74
Past due 31-60 days	225
More than 61 days	375
Total	2,110
Allowance for doubtful accounts	(299)
Net	\$1,811

The change in the allowance for doubtful accounts specific to trade receivables during the period is as follows:

Allowance for doubtful accounts	
Balance at December 31, 2007	\$109
Additional allowance	190
Receivables written-off, net of recoveries	-
Balance at December 31, 2008	\$299

c) Liquidity risk

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they become due. As disclosed in note 2, the Corporation was not in compliance with certain financial covenants contained in its loan agreement, which have not been waived by its lender. Based on the Corporation's current projections, the Corporation believes it is unlikely that it will be in compliance with the existing loan agreement financial covenants during 2009. Subsequent to year end, the Corporation's lender has demanded repayment of all amounts owing to it and stated that it will exercise such rights as it considers necessary to collect all amounts owing. Future operations are dependant on the Corporation's ability to secure financing arrangements to meet its obligations and to generate sustainable profits in the future (note 1).

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The following are the contractual maturities of financial liabilities, including interest payments and excluding the impact of any option to purchase equipment at the end of the term:

December 31, 2008	Carrying amount	Contractual cash flows	12 months or less	2010-2011	2012-2013	Thereafter
Operating loan	3,095	3,171	3,171			
Demand loans	7,601	7,723	7,723	-	-	-
Capital leases	236	258	258	-	-	-
Trade and other payables	3,366	3,366	3,366	-	-	-
Total	14,298	14,518	14,518	-	-	-

d) Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and equity prices will affect the Corporation's earnings or the value of its holdings of financial instruments. The objective of management is to manage and control market risk exposures within acceptable parameters, while optimizing the return on risk.

(i) Foreign exchange risk

Foreign currency exchange risk is the risk that the fair value of recognized assets and liabilities or future cash flows will fluctuate as a result of changes in foreign exchange rates. At December 31, 2008, the Corporation has not entered into any derivative instruments to mitigate this risk. Within its Fabrication Segment, the Corporation has certain customers based outside of Canada and therefore is exposed to foreign currency exchange risk. As at December 31, 2008, holding all other variables constant, a \$0.01 strengthening (weakening) of the Canadian dollar against the US dollar would not materially effect net equity or net loss for the year.

(ii) Interest rate risk

Interest rate risk is the risk that the fair value of the future cash flows of a financial instrument will fluctuate because of changes in market rate interest. The Corporation is subject to interest rate cash flow risk to the extent that its credit facilities are based on floating rates of interest. At December 31, 2008, the Corporation's operating loan bore interest at 5.0% (2007: 6.375%), calculated as bank prime plus 1.5% (2007: bank prime plus 0.375%). The Corporation's demand loans bore interest at 5.5% (2007: 6.875%), calculated as bank prime plus 2.0% (2007: bank prime plus 0.875%).

At December 31, 2008, the Corporation has not entered into any derivative instruments to mitigate these risks. A 100 basis points increase in the interest rates on the Corporation's operating loan and demand loans as at December 31, 2008, holding all other variables constant, would have decreased equity and increased net loss after tax by approximately \$77 on an annual basis. If interest rates decreased by 100 basis points, there would have been an equal and opposite impact on equity and net loss.

Garneau Inc.**Notes to the Consolidated Financial Statements****For the years ended December 31, 2008 and 2007***(Amounts in thousands of Canadian dollars, except per share amounts or unless otherwise specified)***13. SEGMENT DISCLOSURES**

Management has determined that the Corporation operates in two reportable business segments which are Fabrication and Pipeline, which follow the organization, management and reporting structure of the Corporation. The Corporation's reportable segments are strategic business units that offer different products, services, processes and marketing strategies. The accounting policies of the segments are the same as those described in the summary of significant accounting policies.

	Year ended December 31, 2008			Year ended December 31, 2007		
	Fabrication	Pipeline	Total	Fabrication	Pipeline	Total
Revenue	\$ 3,876	\$ 13,411	\$ 17,287	\$ 7,149	\$ 13,012	\$ 20,161
Gross margin	601	3,071	3,672	561	3,155	3,716
	15.5%	22.9%	21.2%	7.8%	24.2%	18.4%
Amortization	307	2,135	2,442	150	2,038	2,188
Interest expense	165	572	737	-	507	507
Selling, general and administrative	2,218	3,915	6,133	779	5,236	6,015
Research and development	-	297	297	-	192	192
Bad debts	-	190	190	--	94	94
Foreign exchange (gain) loss	(44)	74	30	-	(18)	(18)
Impairment of long-lived assets	-	425	425	-	-	-
Gain on disposal of property, plant and equipment	(11)	(4)	(15)	-	(4)	(4)
Other financing costs	23	79	102	41	76	117
Other expenses (income), net	655	(663)	(8)	1,373	(1,414)	(41)
Earnings (loss) before income taxes	(2,713)	(3,948)	(6,661)	(1,782)	(3,552)	(5,334)
Capital expenditures	-	1,917	1,917	154	2,098	2,252

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(Amounts in thousands of Canadian dollars, except per share amounts or unless otherwise specified)

	As at December 31, 2008			As at December 31, 2007		
	Fabrication	Pipeline	Total	Fabrication	Pipeline	Total
Property, plant and equipment	4,729	38,301	43,030	4,751	36,834	41,585
Accumulated amortization	(2,146)	(20,655)	(22,801)	(2,014)	(18,389)	(20,403)
Net book value	2,583	17,646	20,229	2,737	18,445	21,182
Total assets	8,706	17,852	26,558	4,263	25,622	29,885

During the year ended December 31, 2008, one customer in the Pipeline segment accounted for 15.4% of consolidated revenues (2007 - 12.8%). The Corporation generated revenues in the Fabrication segment from customers based in the U.S. of approximately \$0.2 million (2007 - \$1.2 million) largely from one customer.

Gross margin is determined by deducting operating costs from revenue. Operating costs consists of all direct material, labour and plant overhead costs. All of the Corporation's assets are located in Canada.

Garneau Inc.**Notes to the Consolidated Financial Statements****For the years ended December 31, 2008 and 2007***(Amounts in thousands of Canadian dollars, except per share amounts or unless otherwise specified)***14. SUPPLEMENTARY CASH FLOW INFORMATION**

Year Ended		2008		2007
Accounts receivable	\$	2,908	\$	9,574
Unbilled revenue		(980)		996
Prepaid expenses and deposits		228		(315)
Inventories		224		(360)
Accounts payable and accrued liabilities		1,512		(5,353)
Deferred revenue		1,775		-
Billings in excess of costs incurred		370		(204)
Customer deposits		366		-
Change in non-cash working capital		6,403		4,338

Year Ended		2008		2007
Interest paid	\$	714	\$	507

15. RELATED PARTY TRANSACTIONS

The Corporation entered into certain transactions for contract manufacturing design services with a former director of the Corporation. For the year ended December 31, 2008 the consulting fees paid for these services were \$48 (2007: \$132), which are recorded as part of selling, general and administrative expenses in the consolidated statements of operations. The Corporation also entered into certain transactions with the wife of a director of the Corporation related to the rental of a loader. For the year ended December 31, 2008, the rental fees paid for these services were \$40 (2007: \$31), which are recorded as part of Pipeline operating costs in the consolidated statements of operations.

All related party transactions described above were measured at the exchange amount, being the consideration established and agreed to by the related parties.

Garneau Inc.
Notes to the Consolidated Financial Statements
For the years ended December 31, 2008 and 2007

(Amounts in thousands of Canadian dollars, except per share amounts or unless otherwise specified)

DIRECTORS

Glen Garneau
President and Chief Executive Officer

John W. Carruthers^{1,2,3,4}
President, Enbridge Gateway Pipelines Inc.

Daniel R. Motyka^{1,2,3,4}
COO, CTI Resources Corporation

Frank Deys⁴
President, Igloo Prebuilt Inc.

OFFICERS

Glen Garneau
President and Chief Executive Officer

Richard Hughes
Chief Financial Officer (CFO)

Jay P. Reid
Corporate Secretary

- ¹ *Member of Audit Committee*
- ² *Member of Compensation Committee*
- ³ *Member of Corporate Governance Committee*
- ⁴ *Member of Special Committee*

HEADQUARTERS

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REGISTRAR AND TRANSFER AGENT

Olympia Trust Company
Edmonton, Alberta

INVESTOR CONTACT

Darlene Kirkpatrick

INVESTOR RELATIONS

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STOCK EXCHANGE

TSX

SYMBOL

GAR