Condensed interim consolidated financial statements of

Sustainable Energy Technologies Ltd.

December 31, 2012

Sustainable Energy Technologies Ltd.

December 31, 2012

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Sustainable Energy Technologies Ltd.

Condensed interim consolidated statements of financial position

Stated in Canadian dollars
(Unaudited)

	Note	December 31, 2012	September 30, 2012
		$	$
Assets			
Current:			
Cash		**237,322**	256,104
Cash held in trust	22	**250,000**	-
Accounts receivable and advances		**570,887**	913,426
Inventory	3	**2,684,385**	2,712,004
Prepaid expenses and deposits		**121,218**	168,587
		3,863,812	4,050,121
Non-current :			
Development costs	4	**848,070**	937,692
Capital assets	5	**84,161**	96,575
		4,796,043	5,084,388
Liabilities			
Current:			
Accounts payable and accrued liabilities		**2,396,550**	1,816,285
Bank debt	6	**1,005,642**	1,443,830
Due to director	16	**100,000**	-
Energy Northwest obligation - current portion	7	**55,000**	45,700
Government grant obligation - current portion	8	**71,437**	40,382
		3,628,629	3,346,197
Non-current:			
Energy Northwest obligation	7	**40,958**	44,900
Government grant obligation	8	**156,709**	176,354
Debentures	9	**558,680**	544,711
Preferred shares	10	**8,788,732**	7,929,418
		13,173,708	12,041,580
Shareholders' equity (deficiency)			
Share capital	11	**5,004,531**	5,004,531
Warrants	12	**2,267,284**	2,270,651
Equity component of preferred shares	10	**3,545,481**	3,387,391
Share-based payment reserve		**5,372,052**	5,317,378
Foreign currency translation reserve		**(174,644)**	(184,625)
Deficit		**(24,392,369)**	(22,752,518)
		(8,377,665)	(6,957,192)
		4,796,043	5,084,388

Going concern (Note 2(b)), Commitments (note 20) and Subsequent events (note 22)
The accompanying notes are an integral part of these consolidated financial statements

On behalf of the Board:

{signed} {signed}

Michael Carten, Director Robert Penner, Director

Sustainable Energy Technologies Ltd.

Condensed interim consolidated statements of loss and comprehensive loss
For the three month periods ended December 31,

Stated in Canadian dollars
(Unaudited)

	Note	2012	2011
		$	$
Sales		**70,161**	1,011,215
Cost of goods sold		**67,200**	774,589
Gross margin		**2,961**	236,626
Expenses			
General and administrative	16	**278,378**	438,577
Operations	16	**205,815**	281,170
Product research and development		**240,802**	221,821
Selling and marketing		**154,336**	211,972
		879,331	1,153,540
Loss before undernoted items		**(876,370)**	(916,914)
Financing costs	17	**(763,505)**	(619,539)
Interest and other		**24**	10,060
Net loss		**(1,639,851)**	(1,526,393)
Foreign currency adjustment to equity		**9,981**	(43,681)
Total comprehensive loss		**(1,629,870)**	(1,570,074)
Loss per common share			
Basic and diluted		**(0.08)**	(0.08)
Weighted average number of common shares			
Basic and diluted	11	**20,915,581**	20,026,994

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

Sustainable Energy Technologies Ltd.

Condensed interim consolidated statement of change in equity

For the three month periods ended December 31,

Stated in Canadian dollars
(Unaudited)

	Share Capital	Share based payment reserve	Warrants	Equity component of preferred shares	Deficit	Foreign currency translation reserve	Total
	$	$	$	$	$	$	$
Balance, October 1, 2012	5,004,531	5,317,378	2,270,651	3,387,391	(22,752,518)	(184,625)	(6,957,192)
							-
Loss for the period					(1,639,851)		(1,639,851)
Other comprehensive gain(loss)						9,981	9,981
Issue of share capital							-
Warrants issued			95,044				95,044
Warrants expired		98,411	(98,411)				-
Equity component of preferred shares				158,090			158,090
Share based payments		(43,737)					(43,737)
Balance, December 31, 2012	5,004,531	5,372,052	2,267,284	3,545,481	(24,392,369)	(174,644)	(8,377,665)
Balance, October 1, 2011	34,258,068	4,819,067	2,275,418	3,184,383	(47,434,153)	(171,906)	(3,069,123)
							-
Loss for the period	-	-	-	-	(1,526,393)	-	(1,526,393)
Other comprehensive gain(loss)	-	-	-	-	-	(43,681)	(43,681)
Issue of share capital	13,999	-	-	-	-	-	13,999
Warrants issued	-	-	98,411	-	-	-	98,411
Warrants expired	-	66,572	(66,572)	-		-	-
Equity component of preferred shares	-	-	-	426,900	-	-	426,900
Share based payments	-	26,751	-	-	-	-	26,751
Balance, December 31, 2011	34,272,067	4,912,390	2,307,257	3,611,283	(48,960,546)	(215,587)	(4,073,136)

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

Sustainable Energy Technologies Ltd.

Condensed interim consolidated statements of cash flows

For the three month periods end December 31,

Stated in Canadian dollars
(Unaudited)

	Note	2012	2011
		$	$
Operating activities			
Net loss		**(1,639,851)**	(1,526,393)
Amortization of capital assets and development costs		**109,899**	105,706
Share-based payments		**(43,737)**	26,751
Finance costs		**763,505**	619,488
Unrealized foreign exchange loss (gain)		**1,219**	(15,195)
		(808,965)	(789,643)
Net change in non-cash working capital	19	**910,721**	13,721
Cash flow provided/(used)in operating activities		**101,756**	(775,922)
Financing activities			
Bank debt		**(438,188)**	(224,972)
Repayment of government grant		**(2,000)**	-
Due to director		**100,000**	-
Proceeds from preferred shares		**500,000**	1,000,000
Cost of issuing preferred shares		**-**	(36,156)
Cash financing costs paid		**(34,086)**	(19,962)
Cash flow from financing activities		**125,726**	718,910
Investing activities			
Cash held in trust		**(250,000)**	-
Capital asset additions		**-**	(14,779)
Cash flow used in investing activities		**(250,000)**	(14,779)
Foreign exchange on cash held in foreign operations		**3,736**	(31,958)
Net change in cash		**(18,782)**	(103,749)
Cash, beginning of period		**256,104**	328,821
Cash, end of period		**237,322**	225,072

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

1. Description of the business

Sustainable Energy Technologies Ltd ("Sustainable Energy", "Sustainable" or the "Company"), incorporated under the Business Corporations Act of Alberta, develops and manufactures advanced power inverters for the emerging alternative and renewable energy industry - solar photovoltaic ("PV") systems, small wind turbines, fuel cells and all forms of energy storage. The Company is a publicly traded company headquartered at 609-14th St NW, Calgary, Alberta, Canada and its shares trade on the Toronto Stock Exchange Venture Exchange "TSX-V" under the symbol "STG".

2. Basis of preparation

(a) Statement of compliance

These unaudited interim condensed consolidated interim financial statements ("the financial statements") were prepared by management in accordance with International Accounting Standard ("IAS") 34, "Interim Financial Reporting" using accounting policies consistent with International Financial Reporting Standards (" IFRS"), as issued by the International Accounting Standards Board (" IASB"). The financial statements do not comprise of all the information required for annual audited consolidated financial statements and therefore should be read in conjunction with the annual audited consolidated financial statements for the year ended September 30, 2012, which were prepared in accordance with IFRS. These unaudited interim financial statements follow the same accounting policies as outlined in the notes 2 and 4 to the audited consolidated financial statements for the year ended September 30, 2012.

The preparation of financial statements requires the use of certain critical accounting estimates. It also requires management to exercise judgment in applying the Company's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements are consistent with those disclosed in Note 3 of the September 30, 2012 audit consolidated financial statements

These financial statements were approved and authorized for issuance by the Board of Directors of Company on February 28, 2013.

(b) Going concern

The consolidated financial statements were prepared on a going concern basis. The going concern basis assumes that the Company will continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities and commitments in the normal course of business.

At December 31, 2012, the Company had not yet achieved profitable operations since its inception and accumulated a deficit of $24,392,369, after a reclassification of $30,000,000 from share capital (2011 - $48,872,761) and recognized a cash flow surplus in 2013 of $101,756 (2011 - $(775,922)). Whether and when the Company can attain profitability and positive cash flows from operations is uncertain. The lack of profitable operations and cash flow deficiency may cast significant doubt on the Company's ability to continue as a going concern, the Company had a working capital surplus of $235,182 at December 31, 2012 (2011 - $2,072,353).

Stated in Canadian dollars

2. Basis of preparation (continued)

(b) Going concern (continued)

The ability to continue as a going concern is dependent on completing equity or debt financings or generating profitable operations in the future in order to meet liabilities as they come due and enable the Company to continue operations. The ability to continue as a going concern may be adversely impacted by the loss of customers and falling sales per customer. To address its financing requirements, the Company will seek financing through the issuance of common shares, First Preferred Shares and Units of STG Markets Limited Partnership and debentures. The outcome of these matters cannot be predicted at this time.

These condensed interim consolidated financial statements do not include any adjustments which could be significant to the amounts and classification of assets and liabilities that may be necessary should the Company be unable to obtain equity or debt financings or generate profitable operations in the future. Failure to continue as a going concern would require the restatement of assets, liabilities and shareholders' deficiency on a liquidation basis, which could differ materially from the going concern basis.

(c) Recently adopted accounting standards:

Recent accounting pronouncement that have been issued but are not yet effective are consistent with those disclosed in the Company's audited consolidated financial statements for the year ended September 30, 2012.

3. Inventory

The total carrying amount and classification of inventory was as follows:

	December 31, 2012	September 30, 2012
	$	$
Finished goods	**483,538**	488,205
Component	**2,096,962**	2,119,914
Other	**103,885**	103,885
	2,684,385	2,712,004

As at December 31, 2012, $2,684,385 (2011 - $3,339,977) of inventory was carried at cost and $nil (2011 - $nil) was carried at net realizable value.

4. Development costs

Carrying value	**December 31, 2012**	September 30, 2012
	$	$
Development of wind turbine technology	**1**	1
Development of power electronics intellectual property	**848,068**	937,690
Development of power electronics platform	**1**	1
Total	**848,070**	937,692

Stated in Canadian dollars

4. Development costs (continued)

Cost	Development of wind turbine technology	Development of power electronics intellectual property	Development of power electronics platform	Total
	$	$	$	$
Balance October 1, 2011	1,894,618	3,938,948	1,460,739	7,294,305
Foreign currency translation	-	(203,500)	(16,900)	(220,400)
Balance September 30, 2012	**1,894,618**	**3,735,448**	**1,443,839**	**7,073,905**
Foreign currency translation	**-**	**36,458**	**3,207**	**39,665**
Balance December 31, 2012	**1,894,618**	**3,771,906**	**1,447,046**	**7,113,570**

Accumulated amortization and impairment	Development of wind turbine technology	Development of power electronics intellectual property	Development of power electronics platform	Total
	$	$	$	$
Balance October 1, 2011	1,894,617	2,545,774	1,460,738	5,901,129
Amortization	-	395,546	-	395,546
Foreign currency translation	-	(143,562)	(16,900)	(160,462)
Balance September 30, 2012	**1,894,617**	**2,797,758**	**1,443,838**	**6,136,213**
Amortization	**-**	**97,486**	**-**	**97,486**
Foreign currency translation	**-**	**28,594**	**3,207**	**31,801**
Balance December 31, 2012	**1,894,617**	**2,923,838**	**1,447,045**	**6,265,500**

Depreciation of the intangible asset is included in the condensed interim consolidated statement of loss and comprehensive loss under the line item product research and development.

5. Capital assets

	December 31, 2012	September 30, 2012
	$	$
Carrying value		
Computer equipment and software	**17,878**	19,507
Lab equipment	**43,884**	51,107
Furniture and equipment	**20,283**	23,422
Dies and molds	**2,116**	2,539
Total	**84,161**	96,575

Sustainable Energy Technologies Ltd.

Notes to the condensed interim consolidated financial statements
December 31, 2012
Stated in Canadian dollars
(Unaudited)

5. Capital assets (continued)

Cost	**Computer equipment and software**	**Lab equipment**	**Furniture and equipment**	**Dies and models**	**Total**
	$	**$**		**$**	**$**
Balance September 30, 2012	477,011	580,984	136,236	35,797	1,230,028
Additions	-	-	-	-	-
Balance December 31, 2012	**477,011**	**580,984**	**136,236**	**35,797**	**1,230,028**

Accumulated amortization and impairment	**Computer equipment and software**	**Lab equipment**	**Furniture and equipment**	**Dies and models**	**Total**
	$	**$**		**$**	**$**
Balance September 30, 2012	457,504	529,877	112,814	33,258	1,133,453
Amortization	1,629	7,223	3,139	423	12,414
Balance December 31, 2012	**459,133**	**537,100**	**115,953**	**33,681**	**1,145,867**

Cost	Computer equipment and software	Lab equipment	Furniture and equipment	Dies and models	Total
	$	$	$	$	$
Balance October 1, 2011	483,385	578,872	160,801	43,189	1,266,247
Additions	8,364	2,112	4,223	4,648	19,347
Disposals	(14,738)	-	(28,788)	(12,040)	(55,566)
Balance September 30, 2012	477,011	580,984	136,236	35,797	1,230,028

Accumulated amortization and impairment	Computer equipment and software	Lab equipment	Furniture and equipment	Dies and models	Total
	$	$		$	$
Balance October 1, 2011	452,441	504,866	120,345	36,059	1,113,711
Amortization	19,354	25,020	8,693	9,667	62,734
Disposal	(14,291)	(9)	(16,224)	(12,468)	(42,992)
Balance September 30, 2012	457,504	529,877	112,814	33,258	1,133,453

Stated in Canadian dollars

6. Bank debt

The Company has a $1,500,000 operating line of credit. The operating line is secured by Doughty Hanson through an Equity Commitment Agreement. Interest is payable at the bank's prime rate plus 3% (2011 – prime rate plus 2.75%) and amounts outstanding are repayable upon demand.

7. Energy Northwest obligation

	December 31, 2012	September 30, 2012
	$	$
Obligation to Energy Northwest ($133,178 US)	**95,958**	90,600
Less: current portion of Energy Northwest obligation	**55,000**	45,700
	40,958	44,900

Energy Northwest (formerly "Washington Public Power Supply System") made contributions of services SEL towards the development of SEL's step wave power conversion technology valued at US$182,178. Under its agreement with SEL, Energy Northwest is entitled to annual compensation for such contribution in an amount equal to 10% of SEL's gross monthly sales: in any year; provided, however, that the compensation payable in any year is not to be less than US$7,000 and not more than 20% of Energy Northwest's total contribution plus interest calculated at an annual (APR) rate of 20% of the outstanding balance unpaid at the end of the year. Compensation payments are to be completed by January 1, 2016. The obligation is unsecured.

The compensation payable to Energy Northwest in any year until January 1, 2016 is dependent on product sales using the SWPC technology, subject to the above noted annual minimum and maximum thresholds in the year. As the sole basis for the repayment of the loan was linked to future gross sales in SEL, management has determined that the obligation to Energy Northwest contained an embedded derivative and accordingly the loan was required to be accounted for as an embedded derivative in accordance with IAS 39. This requires that the underlying liability and the embedded derivative be recognized at fair value with subsequent changes in value being recognized in the consolidated statement of loss and comprehensive loss each period. Due to the emerging nature of the Company's business, it has not possible to accurately forecast future product sales and the estimated amount payable to Energy Northwest until the end of the term of the Agreement. At September 30, 2012, the Company completed the development of the 3rd generation STX inverter, which does not use the SWPC technology, and the Company will cease production of inverters based on the SWPC technology resulting in the minimum compensation being payable to Energy Northwest in subsequent years.

Stated in Canadian dollars

8. Government grant obligation

National Research Council

The Company entered into an agreement with the National Research Council ("NRC") to fund 60% of the salaries it incurs to commercialize the universal electronic platform to a maximum of $245,241. The Company has received the maximum amount. A royalty of 1.9% of gross revenue after October 1, 2008 is payable until the National Research Council has recovered one and a half times the amount advanced to the Company or for a period of eleven years after the beginning of the repayment schedule. The remaining payable or potentially payable under the agreement is $314,120 (2012 - $324,120).

The carrying amount of the financial liability related to the government grant obligation is the following:

	December 31, 2012	September 30, 2012
	$	$
Government grant (NRC)	228,146	216,736
Less: current portion	(71,437)	(40,382)
Total	**156,709**	**176,354**

9. Debentures

On June 29, 2012, the Company issued $800,000 in 5-year subordinated debentures ("Debentures"), issued at an original issue discount of 12.5% to net the Company $699,875. The debentures bear interest at a rate of 3% per annum, plus an amount equal to 0.8% of the consolidated revenues realized by the Company and are both payable on a quarterly basis during the term of the debenture. The Debenture is callable by the Company at par at any time after the second anniversary of issue. The debentures are secured by a general security agreement. The principal amount of $800,000 is repayable in 12 equal quarterly payments commencing 2 years after issuance. The Company incurred transaction costs related to the issue of the debentures of $39,402. The effective interest rate on the debentures is estimated to be 25.83%.

The royalty payments on the debenture are linked to future gross sales of the Company. Management has determined that the royalty payments were required to be bifurcated and accounted for as an embedded derivative and accordingly the loan was required to be accounted for as an embedded derivative in accordance with IAS 39. This requires that the embedded derivative be recognized at fair value with subsequent changes in value being recognized in the consolidated statement of loss and comprehensive loss each period. At December 31, 2012, the embedded derivative was determined to have a fair value of $109,740 (2012 - $nil).

The required principal and interest repayments for the next five years are as follows:

Period ending December 31, 2013	$ 24,000
2014	156,833
2015	283,667
2016	275,667
2017	134,833

Stated in Canadian dollars

10. Preferred shares

Series 7	Debt component of preferred shares	Equity component of preferred shares	Warrant component of preferred shares	Total
	$	$	$	$
Balance at October 1, 2011	4,799,375	2,671,095	1,278,482	8,748,952
Accretion	1,938,009	-	-	1,938,009
Conversion of preferred shares	(414,322)	(205,761)	-	(620,083)
Balance at September 30, 2012	**6,323,062**	**2,465,334**	**1,278,482**	**10,066,878**
Accretion	533,250	-	-	533,250
Balance at December 31, 2012	**6,856,312**	**2,465,334**	**1,278,482**	**10,600,128**

Series 9	component of preferred shares	component of preferred shares	component of preferred shares	Total
	$	$	$	$
Balance at October 1, 2011	342,337	99,981	-	442,318
Accretion	116,888	-	-	116,888
Balance at September 30, 2012	**459,225**	**99,981**	**-**	**559,206**
Accretion	28,397	-	-	28,397
Balance at December 31, 2012	**487,622**	**99,981**	**-**	**587,603**

Series 10	component of preferred shares	component of preferred shares	component of preferred shares	Total
	$	$	$	$
Balance at October 1, 2011	-	-	-	-
Preferred shares	440,895	413,307	-	854,202
Accretion	147,640	-	-	147,640
Balance at September 30, 2012	**588,535**	**413,307**	**-**	**1,001,842**
Accretion	35,315	-	-	35,315
Balance at December 31, 2012	**623,850**	**413,307**	**-**	**1,037,157**

Stated in Canadian dollars

10. Preferred shares (continued)

Series 11	Debt component of preferred shares	Equity component of preferred shares	Warrant component of preferred shares	Total
	$	$	$	$
Balance at October 1, 2011	-	-	-	-
Preferred shares	219,770	145,663	98,411	463,844
Accretion	55,879	-	-	55,879
Balance at September 30, 2012	275,649	145,663	98,411	519,723
Warrants expired	-	-	(98,411)	(98,411)
Accretion	17,253	-	-	17,253
Balance at December 31, 2012	**292,902**	**145,663**	**-**	**438,565**

Series 12	Debt component of preferred shares	Equity component of preferred shares	Warrant component of preferred shares	Total
	$	$	$	$
Balance at September 30, 2011	-	-	-	-
Preferred shares	236,894	263,106	-	500,000
Accretion	46,053	-	-	46,053
Balance at September 30, 2012	282,947	263,106		546,053
Accretion	16,583	-	-	16,583
Balance at December 31, 2012	**299,530**	**263,106**	**-**	**562,636**

Series 13	Debt component of preferred shares	Equity component of preferred shares	Warrant component of preferred shares	Total
	$	$	$	$
Balance at September 30, 2012	-	-	-	-
Preferred shares	227,933	158,090	95,044	481,067
Accretion	583		-	583
Balance at December 31, 2012	**228,516**	**158,090**	**95,044**	**481,650**
Total preferred shares December 31, 2012	**8,788,732**	**3,545,481**	**1,373,526**	**13,707,739**
Total preferred shares September 30, 2012	7,929,418	3,387,391	1,376,839	12,693,648

10. Preferred shares (continued)

Series 7 Class A Unit consisted of one (1) redeemable 8%, voting, First Preferred Share, Series 7 (“Series 7 Preferred Shares”) and 2.8 detachable warrants (“Warrants”) to acquire one (1) non-voting common share at an exercise price of $3.00 per share until May 7, 2013. Series 7 Class B Unit consisted of one (1) Series 7 Preferred Share and 2.2 warrants to acquire one (1) voting common share at $3.00 per share until May 7, 2013.

Holders of Series 7 Preferred Shares are entitled to receive as and when declared by the Board of Directors out of moneys of the Company applicable to the payment of annual dividends an amount equal to 8% of the then applicable Series 7 Redemption Price payable semi-annually, the first of such dividends to become payable October 15, 2009. In the event the annual 8% dividend is not declared and paid, such dividend shall be accretive to the Series 7 Redemption Price.

After October 14, 2011, the Series 7 Preferred Shares can be redeemed by the Company if within the 90 day period preceding the date of notice of redemption, the weighted average trading price has exceeded $6.00 per share for at least 30 consecutive trading days and the average trading volume for such 30 consecutive trading days is at least $200,000, the Company may redeem all but not less than all the Series 7 Preferred Shares at the then applicable Series 7 Redemption Price subject to the prior right of holders to exercise their right to convert the Series 7 Preferred Shares into common shares of the Company.

Holders of the Series 7 Preferred Shares may convert, at any time, the Series 7 Preferred Shares into that number of fully paid and non-assessable common shares equal to the then applicable Series 7 Redemption Price divided by the conversion price of $1.50 per share. Series 7 Preferred Shares are automatically converted into common shares if (i) approved by a majority of the Series 7 Preferred Shares or (ii) the Company undertakes an underwritten public offering pursuant to a receipted prospectus or similar document for aggregate proceeds of $20 million at a price per share of at least $4.50.

The 1 First Preferred Share Series 8, entitles the holder to designate a representative to the board of directors of the Company for so long as the holder owns in the aggregate more than 10% of the issued and outstanding common shares of the Company on a fully diluted basis. The share is redeemable at a price of $1.00, at the option of the holder.

On August 23, 2010, the Company issued First Preferred Shares Series 9 for gross proceeds of $687,360. The Series 9 preferred shares are similar and rank pari passu to the Series 7 preferred shares, with the exception of the detachable warrants which were not issued as part of the Series 9 preferred shares. The 50,000 Series 9 shares are convertible at a price of $1.55.. Doughty Hanson was also given 516,129 warrants exercisable for 1 year at $1.55 as partial compensation for underwriting the equity commitment of $3,000,000.

On October 5, 2010, the Company issued 80,000 First Preferred Shares Series 10 to Doughty Hanson, which are similar to and rank pari passu with the Series 7 preferred shares, with the exception of the detachable warrants which were not issued as part of the Series 10 preferred shares. The Series 10 preferred shares resulted in a cash inflow of $800,000 and they are convertible at a price of $1.40 and mature 5 years and 1 day from the date of issuance.

10. Preferred shares (continued)

On October 25, 2011, the Company issued 50,000 First Preferred Shares Series 11 to Doughty Hanson, which are similar to and rank pari passu with the Series 7 preferred shares, The Series 11 preferred shares resulted in a cash inflow of $500,000 and they are convertible at a price of $1.15 and mature 5 years and 1 day from the date of issuance. The debt component was measured at the issue date at the present value of the cash payment of dividends and principal under the terms of the preferred shares using a discount rate of 23% and a five year term. The difference between the debt component, the value of the warrants and the face value of preferred shares is classified as equity component of preferred shares. The debt component is accreted to its face value through a charge to loss using the effective interest method. The transaction costs were $36,156. Doughty Hanson was also given 634,783 additional warrants exercisable for a period of one year at $1.15.

On December 19, 2011, the Company issued 50,000 First Preferred Shares Series 12 to Doughty Hanson, which are similar to and rank pari passu with the Series 7 preferred shares with the exception of the detachable warrants which were not issued as part of the Series 12 preferred shares.. The Series 12 preferred shares resulted in a cash inflow of $500,000 and they are convertible at a price of $0.80 and mature 5 years and 1 day from the date of issuance. The debt component was measured at the issue date at the present value of the cash payment of dividends and principal under the terms of the preferred shares using a discount rate of 23% and a five year term. The difference between the debt component and the face value of preferred shares is classified as equity. The debt component is accreted to its face value through a charge to loss using the effective interest method.

On December 27, 2012, the Company issued 50,000 First Preferred Shares Series 13 to Doughty Hanson, pursuant to a commitment agreement dated October 19, 2011, which are similar to and rank pari passu with the Series 7. The Series 13 preferred shares resulted in a cash inflow of $500,000 and they are convertible at a price of $0.40 and mature 5 years and 1 day from the date of issuance. The debt component was measured at the issue date at the present value of the cash payment of dividends and principal under the terms of the preferred shares using a discount rate of 23% and a five year term. The difference between the debt component and the face value of preferred shares is classified as equity. The debt component is accreted to its face value through a charge to loss using the effective interest method. The transaction costs were $18,934. Doughty Hanson was also given 1,250,000 additional warrants exercisable for a period of two years at $0.50.

11. Share capital

Authorized, unlimited number

The authorized capital of Sustainable consists of an unlimited number of common shares without nominal or par value, and an unlimited number of preferred shares, issuable in series, without nominal or par value.

Stated in Canadian dollars

11. Share capital (continued)

Unlimited number of common shares without par value
Unlimited number of First Preferred Shares Series 7 to 13

Issued

Common shares	Number of shares(1)	Amount $(1)
Balance, October 1, 2011	20,023,411	34,258,068
Issuance of common shares	280,000	140,000
Conversion of preferred shares	612,186	606,463
Adjustment on reduction of deficit	-	(30,000,000)
Balance, September 30, 2012	**20,915,597**	**5,004,531**
Conversion of preferred shares	-	-
Issuance of common shares	-	-
Balance, December 31, 2012	**20,915,597**	**5,004,531**

(1) Adjusted to reflect the 10:1 share consolidation completed on December 20, 2012

Adjustment to share capital and deficit

On August 21, 2012 the Company received shareholder approval to reduce the stated share capital and the deficit of the Company by $30,000,000.

Common share consolidation

On December 20, 2012, the Company completed a 10:1 share consolidation of all its outstanding common shares. As such, all common shares, per common share amounts, stock option and warrant figures in the current and comparative periods have been adjusted to reflect this change.

Restricted Shares

In June 2012, the Company issued debentures and in conjunction with the issuance of the debentures, a total of 280,000 restricted common shares of the Company were issued to the debenture holders (Note 9). A total of 32,000 (2011 – nil) shares were released immediately. The remaining shares will be released to the debenture holders on a quarterly basis ending.As at December 31, 2012 there were 217,000 (2011 – nil) shares remaining to be released.

Weighted average number of common shares

The weighted average number of shares for December 31, 2012 and December 31, 2011 was determined by excluding stock options and warrants because the Company was in a loss position. In calculating diluted common share amounts for December 31, 2012 and 2011, the Company excluded 1,026,587 (2011 – 976,587) preferred shares convertible into 8,178,078 (2011 – 6,928,078) common shares, 5,585,193 (2011 – 4,254,823) warrants and 1,559,372 (2011 – 1,344,530) options because the exercise price was greater than the average market price of its common shares during the period.

Stated in Canadian dollars

12. Warrants

Changes in the Company's purchase warrants are as follows:

	Issued with common or preferred shares	Broker warrants	Total purchase warrants	Allocated fair market value
				$
Balance, October 1, 2011	3,513,691	219,050	3,732,741	2,275,418
Warrants issued	1,834,783		1,834,783	362,411
Warrants expired	(484,848)	(112,700)	(597,549)	(367,178)
Balance September 30, 2012	4,863,626	106,350	4,969,976	2,270,651
Warrants expired	(634,783)		(634,783)	(98,411)
Warrants issued	1,250,000	-	1,250,000	95,044
Balance, December 31, 2012	**5,478,843**	**106,350**	**5,585,193**	**2,267,284**

(1) Adjusted to reflect the 10:1 share consolidation completed on December 20, 2012

- 634,783 purchase warrants were issued to Doughty Hanson on October 25, 2011 exercisable for a period of one year at $1.15. These warrants were partial compensation for underwriting the equity commitment of $1,500,000 in October 2011. The Black Scholes option model was used to calculate the fair value of the warrants using a nil dividend yield, a 1.18% interest rate and a volatility of 100%. The fair market value at issuance was $98,411.
- 1,200,000 additional warrants were issued to Doughty Hanson on May 1, 2012 exercisable for a period of one year at $0.50. These warrants were compensation for extending the equity commitment agreement of $1,500,000 as security for the bank line to April 30, 2013. The Black Scholes option model was used to calculate the fair value of the warrants using a nil dividend yield, a 1.06% interest rate and a volatility of 113%. The fair market value at issuance was $264,000.
- 1,250,000 additional warrants were issued to Doughty Hanson on December 27, 2012 exercisable for a period of five years at $0.50. These warrants were issued in conjunction with the issue of Series 13 Preferred Shares. The Black Scholes option model was used to calculate the fair value of the warrants using a nil dividend yield, a 1.31% interest rate and a volatility of 114.49%. The fair market value at issuance was $95,044.

13. Share based payments

The Company has established an option plan (the "Plan") whereby the Company may grant options to purchase common shares to directors, officers, employees, and consultants. Options generally vest over a 3-year period with 1/6 vesting every 6 months. The Company's plan allows for a maximum term on any options to be ten years. The Company, at the discretion of the Board of Directors, may issue options to a maximum of 3,289,432. The plan was approved by the shareholders on September 2, 2010. The minimum price at which the options may be granted is the closing price on the TSX-V on the date of issue.

Stated in Canadian dollars

13. Share based payments (continued)

The following summarizes information about stock options outstanding as at December 31, 2012:

	Number of options to employees	average price to employees	Number of options to non-employees	Weighted average price to non-employees
		$		$
Balance, October 1, 2011	1,315,301	1.80	129,230	2.30
Granted	250,000	1.00	200,000	1.00
Forfeited	(235,158)	2.00	-	-
Balance, September 30, 2012	**1,330,142**	**1.60**	**329,230**	**1.50**
Forfeited	**(100,000)**	**1.74**	**-**	**-**
Balance, December 31, 2012	**1,230,142**	**1.28**	**329,230**	**1.50**

(1) Adjusted to reflect the 10:1 share consolidation completed on December 20, 2012

	Outstanding options			Exercisable options	
Range of exercise prices	Options	Weighted average price	Weighted average years to expiry	Options	Weighted average price
		$			$
$0.50–$1.00	450,000	1.00	9.25	75,000	1.00
$1.40–$1.60	475,000	1.46	6.75	446,667	1.46
$1.70–$1.90	231,872	1.79	3.12	228,539	1.78
$2.00–$2.50	342,500	2.09	5.50	342,500	2.24
$2.60–$3.50	40,000	3.50	5.44	40,000	3.50
$3.60–$4.00	20,000	4.00	7.02	16,667	4.00
Balance December 31, 2012	**1,559,372**	**1.31**	**6.62**	**1,149,372**	**1.71**

(1) Adjusted to reflect the 10:1 share consolidation completed on December 20, 2012

The total share-based compensation calculated for the period ended December 30, 2012 was a recovery of $43,737 (2011 – expense of $26,751).

14. Capital management

The Company's objectives when managing capital is to safeguard the entity's ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders. The Company sets the amount of capital in proportion to risk. The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. The Company's objective is met by obtaining adequate equity funding to provide for the possibility that cash flows from operations will not be sufficient to meet future cash flow requirements. The Board of Directors does not establish quantitative return on capital criteria for management; but rather promotes year over year sustainable profitable growth.

Stated in Canadian dollars

14. Capital management (continued)

The Company defines capital as the aggregate of total shareholders' equity, cash and cash equivalents and bank loan as follows:

	December 31, 2012	September 30, 2012
	$	$
Total shareholders' deficiency	**(8,377,666)**	(6,957,192)
Cash	**237,322**	256,104
Bank loan	**(1,005,642)**	(1,443,830)
Total capital	**(9,145,986)**	(8,144,918)

There have been no changes to the Company's objectives in managing capital or in the management of capital since September 30, 2012. The Company presently has negative total capital and is currently working toward reversing this. (Note 2(b))

15. Financial instruments and financial risk management

Credit risk

The Company does not have any significant credit risk exposure to any single counterparty or any group of counterparties having similar characteristics at December 31, 2012. The credit risk on cash and cash equivalents is considered to be limited because the counterparties are financial institutions with high credit ratings assigned by international credit rating agencies. The Company submits all credit applications to the Export Development Corporation (EDC) for accounts receivable insurance and has a cash only policy if credit approval is not granted by EDC.

The following table illustrates the Company's receivables and advances:

	December 31, 2012	September 30, 2012
	$	$
Trade	**223,959**	596,115
Taxation authorities	**335,728**	308,511
Employee advances	**11,200**	8,800
	570,887	913,426

The Company assesses quarterly if there should be any impairment of the financial assets of the Company. During the period ended December 31, 2012 there was no impairment or allowance required on any of the financial assets of the Company.

The maximum exposure to credit risk is represented by the carrying amount on the statement of financial position. There are no material financial assets that the Company considers past due, as the $102,626 are over 90 days past due but are EDC insured and the accounts have subsequently been collected.

Stated in Canadian dollars

15. Financial instruments and financial risk management (continued)

Credit risk (continued)

The following is a schedule of trade receivables:

	December 31, 2012	September 30, 2012
	$	$
Neither impaired or past due	**49,851**	320,410
Not impaired but past due in the following periods		
31 - 60 days	**1,243**	101,739
61 - 90 days	**493**	71,339
over 90 days	**172,372**	102,627
	223,959	596,115

Liquidity risk

The Company's operating cash requirements, including amounts projected to complete the Company's existing capital expenditure program, are continuously monitored and adjusted as input variables change. These variables include but are not limited to available bank lines and government assistance. As these variables change, liquidity risks may necessitate the need for the Company to conduct equity issues or obtain project debt financing. There is no assurance that adequate funds from equity or debt markets will be available to the Company in a timely manner. The Company also mitigates liquidity risk by maintaining an insurance program to minimize exposure to insurable losses.

The following are the contractual maturities of financial liabilities at December 31, 2012:

Financial liabilities	< 1 Year	1-3 Years	Thereafter	Total
Accounts payable and accrued liabilities	**2,396,550**	**-**	**-**	**2,396,550**
Bank loan	**1,005,642**	**-**	**-**	**1,005,642**
Due to director	**100,000**			**100,000**
Energy Northwest obligation	**48,750**	**87,749**	**-**	**136,499**
Government grant obligation	**114,000**	**200,120**		**314,120**
Commitments (Note 20)	**177,104**	**312,000**	**-**	**489,104**
Debentures	**72,000**	**770,000**	**213,000**	**1,055,000**
Preferred shares Series 7, 9, 10, 11, 12 and 13	**-**	**11,791,418**	**3,405,427**	**15,196,845**
Total	**3,914,046**	**13,161,287**	**3,618,427**	**20,693,760**

15. Financial instruments and financial risk management (continued)

Foreign currency risk

The Company's exposure to currency risk on monetary assets and liabilities based on carrying amount in Canadian currency was as follows for the three month period ended December 31, 2012:

	Euros	US Dollars	Total
	$	$	$
Cash	59,704	127,509	187,213
Accounts receivable and advances	228,979	310,042	539,021
Accounts payable and accrued liabilities	427,268	29,441	456,709
Energy Northwest obligation	-	92,430	92,430
	715,951	559,422	1,275,373

Assuming all other variables remain constant, a $0.05 change in the Canadian/US exchange rate would affect the Company's net loss by approximately $4,619 for the period ended December 31, 2012 respectively, (2011 - $67,609). Assuming all other variables remain constant, a $0.05 change in the Canadian/Euro exchange rate would change the Company's net loss by approximately $1,951 for the period ended December 31, 2012 (2011- $31,719). An opposite change in the Canadian/Euro exchange rate will result in an opposite impact on net loss. The Company had no forward exchange rate contracts in place as at or during the period ended December 31, 2012.

Fair value of financial instruments

The carrying value and fair value of these financial instruments at December 31, 2012 is disclosed below by financial instrument category, as well as any related gain, loss, expense or revenue for the year period December 31, 2012:

Financial instrument	value	Fair value	Gain/(loss)
	$	$	$
Accounts receivable and advances	570,887	570,887	-
Accounts payable and accrued liabilities	2,396,550	2,396,550	-
Bank debt	1,005,642	1,005,642	-
Due to director	100,000	100,000	-
Energy Northwest obligation	95,958	95,958	-
Government grant obligation	228,146	228,146	-
Debentures	558,680	558,680	-
Preferred shares	8,788,732	8,788,732	-

The Company categorizes its financial instruments carried at fair value into one of three different levels depending on the observability of the inputs employed in the measurement. At December 31, 2012, the Company valued cash and cash equivalents using Level 1 input and the embedded derivatives on the Company's debentures (note 9) and Energy Northwest obligation (note 7) were measured at a fair value using level 3 inputs.

Stated in Canadian dollars

16. Related party transactions

Other than as disclosed elsewhere in the consolidated financial statements, the Company had the following related party transaction:

Included in general and administrative expense is salaries and benefits for key management personnel and directors of $77,468 (2011 - $96,542) and share based compensation of $Nil (2011 - $6,018). Included in operations expense are salaries, consulting fees and benefits for key management personnel and directors of $49,500 (2011 - $50,500) and share based compensation of $9,945 (2011 – 5,948).

Key management personnel and directors subscribed for $69,000 of the debentures (Note 9) issued in June 2012 and received 82,800 (2011 – nil) bonus shares (Note 10) valued at $4,140 (2011 - $nil) as at December 31, 2012. Interest expense of $2,423 ($2011 - $nil) has been included in financing costs related to these debentures.

In December, 2012 the Company received $100,000 from a director. The Company has agreed to issue to a director an $114,000 debenture at an original discount rate of 12.5% to net the Company $100,000, at the same terms as the debentures described in Note 9. This transaction is subject TSX-V approval and so the amount has been shown as a current liability until approval has been received.

Revenue and expense transactions are in the normal course of operations and were based on the exchange value of the service provided, which approximates those amounts of consideration with third parties.

17. Financing costs

	2012	2011
	$	$
Interest on northwest obligation	4,314	65,569
Interest on bank debt	19,966	16,924
Interest on debenture	28,090	-
Accretion of government grant obligation	13,411	-
Accretion of preferred shares	631,381	461,895
Amortization of financing fees	66,000	75,151
Other	343	-
Total	**763,505**	**619,539**

18. Personnel expenses

	2012	2011
	$	$
Wages	241,691	428,820
Benefits	12,026	28,286
Total	**253,717**	**457,106**

Stated in Canadian dollars

19. Supplemental information

The changes in non-cash working capital for the three month periods ended December 31, 2012 and 2011 are as follows:

	2012	2011
	$	$
Operating activities		
Decrease (increase) in assets		
Accounts receivable and advances	**350,890**	112,252
Prepaid expense and deposits	**(18,631)**	136,969
Inventory	**12,920**	250,099
	345,179	499,320
Increase (decrease) in liabilities		
Accounts payable and accrued liabilities	**565,542**	(485,599)
	910,721	13,721

20. Commitments

(a) At December 31, 2012, Sustainable Energy had commitments for premise, equipment leases, investor relation agreements, and software installation as follows:

	December 31, 2012
	$
Less than one year	**177,104**
Between one and five years	**312,000**
More than five years	**-**
	489,104

Subsequent to December 31, 2012, the Company entered into a new lease agreement for premises. The lease is for a 5 year term ending March 31, 2018. The lease has a renewal option for an additional 5 year term.

(b) Consulting services were provided in fiscal 1998 to the Company. Repayment including interest at an annual rate of 20% per year is contingent upon SEL achieving sales ($Nil to date) or capital funding of $2,000,000 US, $342,000 US has been received to December 31, 2012. At December 31, 2012, the total contingent amount payable including accrued interest was approximately $425,742 ($427,925 US) (2011 - $429,768, $373,911 US).

(c) There is a legal action for which the ultimate result cannot be ascertained at this time. Management does not expect the outcome of these proceedings to have a material effect on the financial position or results of operations.

Stated in Canadian dollars

20. Commitments (continued)

(d) The Company is party to an employment agreement with a director of the Company, under which payment of a portion of the director's compensation is contingent upon the Company realizing positive earnings for any one fiscal quarter before interest, taxes, depreciation and amortization, a change of control of the Company, liquidation or receivership of the Company or termination of the employment relationship. At December 31, 2012, the total contingent amount payable was approximately $300,000 (2011 - $150,000) and therefore, no amount has been included in accounts payable and accrued liabilities.

21. Segmented information

Geographic disclosures

	As at December 31, 2012		As at December 31, 2011	
	Revenues	**Assets***	Revenues	Assets*
	$	$	**$**	$
Canada	62,156	**84,161**	649,732	115,069
United States	8,005	**848,070**	-	1,291,281
Europe	-		371,492	14,865
Total	**70,161**	**932,231**	1,021,224	1,421,215

*Assets refer to the Company's development costs and capital assets.

Major customers

The Company had two customers where product sales were greater than 10% in the period. One customer had attributed sales of $44,624 and the other had attribute sales of $7,732 for period ended December 31, 2012 (2011 – two customers, $347,576 and $230,287).

22. Subsequent events

The Company agreed to sell a non-exclusive license during the quarter ended December 31, 2012 which allows the licensee to manufacture the Company's new STX inverter platform; however, the licensee has been unable to close on the purchase for financial reasons. As such, the licensee has forfeited a $250,000 deposit which will be applied to any license fee paid by tenKsolar as discussions are ongoing with tenKsolar about the license agreement.

On February 19, 2013, the Company announced an agreement in principle to supply a minimum of 10,000 inverters to a German manufacturer of solar energy management systems over a 2 year period beginning in the 3rd Quarter. The agreement is exclusive for European markets for the two year period and non-exclusive thereafter.