Pacific Safety Products Inc.

REPORT TO SHAREHOLDERS

MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE SIX MONTHS ENDED DECEMBER 31, 2011 and 2010

Management's Discussion and Analysis
December 31, 2011 and 2010
(in Canadian dollars)

This Management's Discussion and Analysis ("MD&A") of the financial position and results of operations of Pacific Safety Products Inc. (the "Company" or "PSP") has been prepared as of February 28, 2012 and should be read together with the Company's unaudited condensed consolidated interim financial statements for the six months ended December 31, 2011, the audited annual consolidated financial statements and the notes thereto for the year ended June 30, 2011, and the Management Information Circular dated November 17, 2011. Management is responsible for the preparation and integrity of the consolidated financial statements, including maintenance of appropriate information systems, procedures and internal controls, and to ensure that information used internally or disclosed externally, including the consolidated financial statements and management's discussion and analysis, is complete and reliable. All Figures are in **Canadian dollars except as otherwise noted.**

The financial data has been prepared in accordance with IAS 34 *Interim Financial Reporting* and International Financial Reporting Standards ("IFRS"), except where otherwise stated, and the Company's reporting currency is the Canadian dollar. Pacific Safety Products Inc. is a reporting issuer in Canada in the provinces of British Columbia, Alberta, and Ontario. The Company trades on the TSX Venture Exchange under the symbol PSP. Additional regulatory information relating to Pacific Safety Products Inc. can be found at the System for Electronic Document Analysis and Retrieval ("SEDAR") website at www.sedar.com.

FORWARD-LOOKING INFORMATION

A number of the matters discussed in the MD&A deal with potential future circumstances and developments and may constitute "forward-looking" information within the meaning of applicable securities laws. These forward-looking statements relate to anticipated or assumed events or results including, without limitation, projected costs and capital expenditures, future tax losses, plans with respect to internal controls and the Company's outlook, business and capital management strategy, direction, plans, growth opportunities and objectives. Generally, forward-looking information can be identified as such because of the context of the statements and often include words or phrases such as "will", "believes", "anticipates", "predicts", "plans", "intends", "estimates", "expects", "continues", "is pursuing", "improving", "projects", "indicates", or words or phrases of a similar nature.

The forward-looking information is based on current expectations and assumptions regarding expected growth, results of operations, financial performance and business prospects and opportunities. Forward-looking information is subject to known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company, or general industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. These factors include, but are not limited to, the possible failure to successfully plan and execute business improvement strategies, failure to consummate the proposed sale of substantially all of the Company's assets, restrictions and covenants contained in the Company's credit agreements, the potential impact of the current economic downturn on the Company's business, the unpredictability of purchasing patterns by governmental agencies, the possibility of a deterioration in the Company's working capital position, the impact that changes in supplier payment terms or slow payment of accounts receivable could have on the Company's liquidity, the unavailability of or increase in price of external capital to finance the Company's research, development and growth initiatives, changes in the laws, regulations, policies and economic conditions, including inflation, interest and foreign currency exchange rate fluctuations of countries in which the Company does business, competition in the Company's markets, successful integration of structural changes, including restructuring plans, acquisitions, divestitures and alliances, cost of raw material, the uncertainty associated with the outcome of research and development of new products, including regulatory approval and market acceptance, and seasonality of sales in some products, as well as other factors described below under "Part VII: Risks and Uncertainties" and the Company's other filings with applicable securities regulatory authorities which are available at www.sedar.com. The impact of any one risk factor on a particular forward-looking statement is not determinable with certainty as such factors are interdependent upon other factors, and management's course of action would depend upon its assessment of the future, considering all information then available.

Although the Company believes that the expectations and assumptions conveyed by the forward-looking information are reasonable based on information available to it as of February 28, 2012, no assurances can be given as to future results, levels of activity and achievements. All subsequent forward-looking information, whether written or oral, attributable to the Company or persons acting on its behalf, are expressly qualified in their entirety by these cautionary statements and readers are cautioned not to place undue reliance or importance on this information. The Company assumes no obligation to update forward-looking statements should circumstances or management's estimates or opinions change, except as required by applicable law.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Mission

...we bring everyday heroes home safely.™

This MD&A is organized into the following parts:

I. Business Overview and Recent Events
II. Results
III. Cash Flow
IV. Liquidity and Capital Resources
V. Quarterly Results
VI. Significant Accounting Policies and Estimates
VII. Risks and Uncertainties
VIII. Other Information

Part I: BUSINESS OVERVIEW AND RECENT EVENTS

Business Overview

PSP is an established industry leader in the defence and security market. The Company is engaged in the design, production, sale and distribution of protective and duty products for law enforcement, security and defence. PSP's products are worn or included in equipment used by officers, agents, guards and military personnel. The Company has a significant market position in Canada, where it is one of the largest soft body armour manufacturers. The Company, through its wholly-owned subsidiary, Sentry Armor Systems Inc. ("Sentry"), provides body armour products to U.S.-based law enforcement and private security firms. The Company's business strategy is to be a preferred supplier of body armour and other personal protection solutions throughout North America.

PSP has a significant recurring revenue stream from its Canadian customers in the form of long-standing contracts with terms of up to five years. These contracts are with federal, provincial and municipal organizations and agencies. The Company also pursues long-term defence contracts. PSP has been successful in supplying the Canadian military with fragmentation protection products and chemical and biological protection suits. The Company's U.S. business is primarily supplying state, county and municipal law enforcement agencies with soft body armour. These products are sold primarily through a network of third party distributors.

PSP has a research and development program that works cooperatively with customers on new product design. The Company also conducts independent research in future technologies and products that will enhance user effectiveness, and increase value and survivability. PSP's current research and development programs are focused on the certification of certain product lines as required by the U.S. Department of Justice.

PSP has manufacturing operations in Arnprior, Ontario and Dover, Tennessee and its head office is located in Arnprior, Ontario. Its design and production facilities are all ISO9001:2008 registered and compliant to BA9000 (National Institute of Justice Body Armor Quality Management Requirements). Founded in 1984, PSP has grown to currently include more than 140 employees at its Canadian and U.S. facilities.

Recent Events

On August 17, 2010, the Company issued a $1 million unsecured convertible debenture in favour of a group of investors.

On October 20, 2010, the Company signed a letter of intent to complete a business combination by way of a court approved plan of arrangement (the "Plan of Arrangement") with Zuni Holdings Inc. ("Zuni"), an NEX listed company. On November 18, 2010, PSP and Zuni signed a definitive arrangement agreement (the "Arrangement Agreement") specifying the terms on which the Plan of Arrangement would be completed.

On December 31, 2010 pursuant to the Plan of Arrangement, PSP acquired all of the outstanding common shares of Zuni in exchange for PSP common shares at an agreed exchange ratio of one PSP common share for each Zuni common share. Zuni was amalgamated with a wholly-owned subsidiary of PSP incorporated for the purpose of carrying out the Plan of Arrangement. The amalgamated entity was continued as Zuni Holdings Inc., a subsidiary of PSP. The transaction has been accounted for as the acquisition of the assets and liabilities of Zuni in exchange for PSP common shares valued at the effective date of the acquisition.

This transaction strengthened the capital position of PSP and restricted cash of $2.5 million was released on June 11, 2011. The working capital ratio at December 31, 2011, is 1.74 compared to 1.69 at June 30, 2011 and 1.05 at June 30, 2010. The debt to tangible net worth ratio at December 31, 2011 is 1.72 compared to 1.87 at June 30, 2011 and 25.9 at June 30, 2010. The debt to tangible net worth ratio does not have a standardized meaning as prescribed by GAAP. The Company defines debt as total liabilities less convertible debentures, and tangible net worth as the sum of shareholders' equity and convertible debentures less intangible assets.

On May 5, 2011, the Company completed the sale of certain assets of APS Distributors, a division of PSP located in Bedford, Nova Scotia for a purchase price of $500,000 before transaction costs. Proceeds of the sale, net of an $18,000 holdback, were used to reduce debt obligations.

On August 31, 2011, PSP signed an agreement ("Agreement") with a major Canadian bank (the "Bank") for a replacement credit facility in the amount of $1.0 million. The new facility is secured by cash collateral of $1.0 million and a general security agreement over all personal property of PSP and its subsidiaries. The Agreement has no financial covenants and is subject to certain general covenants as outlined in the Agreement.

On January 23, 2012, the Company announced that it has entered into a letter of intent ("LOI") to sell substantially all of its assets on a cash-free, debt-free basis for cash payable at closing (the "Sale Transaction"). During an exclusivity period, the potential purchaser is completing a due diligence review, and the parties are endeavoring to negotiate a mutually satisfactory definitive purchase agreement.

Throughout the last 18 months the Company has successfully implemented many significant steps in its business transformation process including: building a new management team, setting a clear strategic direction built around personal protection solutions, building out its NIJ.06-certified body armour product portfolio, sub-letting its former head office space in Kanata, upgrading its quality assurance processes, implementation of continuous improvement programs throughout the Company, and working closely with its customers and suppliers among other achievements. Notably, effective January 16, 2012, the Company was awarded a new contract by the Ontario Ministry of Community Safety and Correctional Services for the delivery and disposal of ballistic personal soft body armour systems ("Contract"). This omnibus contract allows Municipal and Provincial agencies to acquire PSP's products through pre-negotiated arrangements. This Contract has an initial period of performance of three years with an option for an additional two years. Based on historical data the Company estimates the potential sales value of this Contract to be between $12.5 million to $15 million, including the option years. The Company was the incumbent.

In the event the proposed Sale Transaction does not proceed, at this stage in the transformation, the Company continues to focus on adding value for its customers in conjunction with revenue stability and growth. In order to further strengthen the Company's financial position and address its liquidity requirements, the Company continues to consider and evaluate on an ongoing basis, all alternatives available to it. These alternatives include, without limitation, seeking additional sources of financing, identifying and pursuing strategic partnerships, and other value enhancing opportunities. However, there can be no assurance that such efforts will result in the Company pursuing any such alternative or, if pursued, there can be no assurance any such alternative will be successfully completed and implemented.

The Company's ability 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 Company's ability to complete the Sale Transaction or restore profitable operations and raise additional capital.

Part II: RESULTS

SUMMARY OF OPERATIONS	***THREE MONTHS ENDED DECEMBER 31, 2011***	*THREE MONTHS ENDED DECEMBER 31, 2010*	***SIX MONTHS ENDED DECEMBER 31, 2011***	*SIX MONTHS ENDED DECEMBER 31, 2010*
SALES	**$ 3,638,271**	$ 5,094,773	**$ 7,124,333**	$ 9,433,864
COST OF SALES	**2,614,578**	3,989,643	**5,252,972**	7,380,371
GROSS MARGIN	**1,023,693**	1,105,130	**1,871,361**	2,053,493
EXPENSES	**1,216,087**	1,350,771	**2,543,573**	2,876,532
LOSS BEFORE OTHER ITEMS	**(192,394)**	(245,641)	**(672,212)**	(823,039)
OTHER ITEMS	**1,213,723**	13,939	**1,037,601**	63,359
LOSS BEFORE INCOME TAXES	**(1,406,117)**	(259,580)	**(1,709,813)**	(886,398)
INCOME TAX EXPENSE (RECOVERY)	**(8,728)**	–	**(15,047)**	–
NET LOSS FOR THE PERIOD	**$ (1,397,389)**	$ (259,580)	**$ (1,694,766)**	$ (886,398)
OTHER COMPREHENSIVE INCOME (LOSS)	**(81,446)**	(124,798)	**190,933**	(256,332)
TOTAL COMPREHENSIVE LOSS FOR THE PERIOD	**$ (1,478,835)**	$ (384,378)	**$ (1,503,833)**	$ (1,142,730)
BASIC AND DILUTED LOSS PER SHARE	**$ (0.024)**	$ (0.010)	**$ (0.029)**	$ (0.034)
WEIGHTED AVERAGE BASIC COMMON SHARES ISSUED AND OUTSTANDING - BASIC AND DILUTED	**57,454,895**	26,072,331	**57,162,318**	25,906,742

FINANCIAL POSITION	***AS AT DECEMBER 31, 2011***	*AS ATJUNE 30, 2011*
TOTAL ASSETS	**$ 6,493,852**	$ 8,676,113
TOTAL LONG-TERM FINANCIAL LIABILITIES	**$ 1,529,373**	$ 1,581,916

Sales

Sales for the three months ended December 31, 2011 were $3.6 million, a decrease of $1.5 million or 28.6% as compared to $5.1 million in the same period in the prior year. The decrease is attributed to a decline in the distribution business pursuant to its sale in May, 2011 and core law enforcement sales in both Canada and the United States. Sales to Canadian customers for the three months ended December 31, 2011 were $1.8 million, a decline of $1.4 million or 44.2% compared to the same period in the prior year. The decrease is primarily attributed to the decline in the distribution business pursuant to its sale in May, 2011 and contract timing, partially offset by an increase in contract sales to the Canadian Department of National Defence (“DND”). Sales to U.S. and International customers for the three months ended December 31, 2011 were $1.8 million consistent with the same period in the prior year.

Sales for the six months ended December 31, 2011 were $7.1 million, a decrease of $2.3 million or 24.5% as compared to $9.4 million in the same period in the prior year. The decrease is attributed to a decline in the distribution business pursuant to its sale in May, 2011 and core law enforcement sales in both Canada and the United States. Sales to Canadian customers for the six months ended December 31, 2011 were $3.4 million, a decline of $2.2 million or 39.0% compared to the same period in the prior year. The decrease is primarily attributed to the decline in the distribution business pursuant to its sale in May, 2011 and contract timing, partially offset by an increase in contract sales to the Canadian Department of National Defence (“DND”). Sales to U.S. and International customers for the six months ended December 31, 2011 were $3.7 million, a decrease of $0.1 million or 3.0% compared to the prior year. The decrease is primarily related to a reduction in international law enforcement sales.

Gross Margin

For the three months ended December 31, 2011, gross margin as a percentage of sales was 28.1%, which was an increase over gross margin of 21.7% during the same period in the prior year. The increase is primarily related to product mix and sale of the distribution business in May 2011.

For the six months ended December 31, 2011, gross margin as a percentage of sales was 26.3%, which was an increase over gross margin of 21.8% during the same period in the prior year. The increase is primarily related to product mix and sale of the distribution business in May 2011.

Operating Expenses

For the three months ended December 31, 2011, operating expenses were $1.2 million, a decrease of $0.1 million or 10.0% as compared to the same period in the prior year. The decrease in expenses is primarily related to cost reduction initiatives implemented over the last 12 months, lower commissions in connection with lower sales volumes, and lower amortization expense partially offset by expenses related to the entities acquired pursuant to the Plan of Arrangement.

For the three months ended December 31, 2011, sales and marketing expenses were $0.41 million as compared to $0.52 million during the same period in the prior year. The decrease is primarily related to a reduction in head count, lower commissions, other cost reduction initiatives, and a reduction in amortization expense as a result of disposal and impairment of intangible assets compared to the same period in the prior year.

For the three months ended December 31, 2011, research and development expenses were $0.10 million as compared to $0.16 million during the same period in the prior year. The development costs expense is primarily related to the development and certification of certain product lines in accordance with U.S. Department of Justice standards. The reduction in expense is due to lower amortization expense as a result of impairment of product development costs capitalized.

For the three months ended December 31, 2011, general and administration expenses were $0.71 million as compared to $0.67 million during the same period in the prior year. The increase is primarily due to expenses related to the entities acquired pursuant to the Plan of Arrangement, partially offset by cost reduction initiatives.

For the six months ended December 31, 2011, operating expenses were $2.5 million, a decrease of $0.3 million or 11.6% as compared to the same period in the prior year. The decrease in expenses is primarily related to cost reduction initiatives implemented over the last 12 months, lower commissions in connection with lower sales volumes, and lower amortization expense partially offset by expenses related to the entities acquired pursuant to the Plan of Arrangement.

For the six months ended December 31, 2011, sales and marketing expenses were $0.85 million as compared to $1.19 million during the same period in the prior year. The decrease is primarily related to a reduction in head count, lower commissions, other cost reduction initiatives, and a reduction in amortization expense as a result of disposal and impairment of intangible assets compared to the same period in the prior year.

For the six months ended December 31, 2011, research and development expenses were $0.18 million as compared to $0.27 million during the same period in the prior year. The development costs expense is primarily related to the development and certification of certain product lines in accordance with U.S. Department of Justice standards. The reduction in expense is due to lower amortization expense as a result of impairment of product development costs capitalized.

For the six months ended December 31, 2011, general and administration expenses were $1.52 million as compared to $1.41 million during the same period in the prior year. The increase is primarily related to the management team being in place for the full six months, professional fees related to IFRS implementation and expenses related to the entities acquired pursuant to the Plan of Arrangement, partially offset by cost reduction initiatives.

Foreign exchange losses (gains)

For the three months ended December 31, 2011, foreign exchange gains were $0.02 million as compared to $0.09 million during the same period in the prior year. The decrease is primarily related to the impact of the devaluation of the Canadian dollar against the U.S. dollar with respect to purchases of materials in U.S. funds.

For the six months ended December 31, 2011, foreign exchange losses were $0.07 million as compared to a gain of $0.15 million during the same period in the prior year. The decrease is primarily related to the impact of devaluation of the Canadian dollar against the U.S. dollar with respect to purchases of materials in U.S. funds.

Finance costs

For the three months ended December 31, 2011, interest expense on bank indebtedness was $0.01 million, a decrease from $0.03 million during the prior year due to lower utilization of banking facilities. For the three months ended December 31, 2011, interest expense on the long-term debt was $0.01 million consistent with the same period in the prior year.

For the three months ended December 31, 2011, interest on convertible debentures issued on August 17, 2010 was $0.03 million and the Company recorded an interest expense for accretion of the convertible debentures of $0.02 million, consistent with the same period in the prior year.

For the six months ended December 31, 2011, interest expense on bank indebtedness was $0.02 million, a decrease from $0.08 million during the prior year due to lower utilization of banking facilities and certain one-time charges incurred in the same period in the prior

year. For the six months ended December 31, 2011, interest expense on the long-term debt was $0.03 million consistent with the same period in the prior year.

For the six months ended December 31, 2011, interest on convertible debentures issued on August 17, 2010 was $0.05 million and the Company recorded an interest expense for accretion of the convertible debentures of $0.05 million, consistent with the partial period from date of issuance in the prior year.

Onerous contract charges (settlement)

For the six months ended December 31, 2011, the net recovery related to onerous contracts was $0.3 million with no comparable amount during the same period in the prior year.

On August 16, 2011 the Company signed a sublease for the remaining lease term for its former head office premises in Kanata, Ontario. The Company recognized a provision for the discounted future lease payments to which the Company is committed less expected future sublease income in the amount of $0.1 million. Pursuant to the Plan of Arrangement the Company assumed a provision for discounted future lease payments related to the vacated manufacturing facility of a Zuni subsidiary that no longer had any operating business activities. A settlement was reached with the landlord and the lease was terminated on September 30, 2011 resulting in a release of the provision in the amount of $0.4 million.

Long-lived asset impairment

At December 31, 2011, it was determined that the remaining intangible assets of both the Canada CGU and the US CGU were fully impaired. A draft LOI to sell substantially all of the assets of the Company was received prior to December 31, 2011 and was signed on January 20, 2012. The value of the estimated net proceeds indicated that there was a potential impairment. As a result management reviewed the recoverable value of each CGU and determined that the fair value less costs to sell for each CGU represented the recoverable value. Fair value was determined based on the signed LOI. The carrying value of net assets expected to be included in the sale, excluding intangible assets, exceeds the estimated net proceeds of sale. Therefore an impairment loss of $1.2 million was recognized at December 31, 2011.

Income Taxes

Income tax expense varies from the amount that would be computed by applying the combined federal and provincial tax rate as a result of the tax effect of items not deductible for tax purposes, the tax benefit of losses not recognized and other items.

Net loss for the period

For the three months ended December 31, 2011, the Company recorded a net loss of $1.4 million compared to a net loss of $0.3 million during the same period in the prior year. The increase in net loss is primarily due to the long-lived asset impairment charge of $1.2 million.

For the six months ended December 31, 2011, the Company recorded a net loss of $1.7 million compared to a net loss of $0.9 million during the same period in the prior year. The increase is primarily due to the long-lived asset impairment charge partially offset by a reduction in operating expenses and settlement of certain property lease obligations.

Other comprehensive income (loss)

For the three months ended December 31, 2011, the Company recorded other comprehensive loss of $0.08 million compared to other comprehensive loss of $0.12 million during the same period in the prior year. The decrease in other comprehensive income is due to foreign currency translation differences relating to foreign operations.

For the six months ended December 31, 2011, the Company recorded other comprehensive income of $0.19 million compared to other comprehensive loss of $0.26 million during the same period in the prior year. The increase in other comprehensive income is due to foreign currency translation differences relating to foreign operations.

Adjusted Earnings Before Interest, Taxes, Depreciation and Amortization ("Adjusted EBITDA")

Adjusted EBITDA is not a recognized performance measure under GAAP and does not have a standardized meaning prescribed by GAAP. The term EBITDA consists of net loss and excludes interest, income tax expense (recovery), depreciation and amortization. Adjusted EBITDA excludes stock-based compensation, foreign exchange and one-time charges and gains. Adjusted EBITDA is included as a supplemental disclosure because management believes that such a measurement provides a better assessment of the Company's operations on a continuing basis by eliminating certain non-cash charges and charges that are nonrecurring. The most directly comparable measure to Adjusted EBITDA calculated in accordance with GAAP is net loss for the period.

For the three months ended December 31, 2011 Adjusted EBITDA was a loss of $0.09 million consistent with an Adjusted EBITDA loss of $0.02 million during the same period in the prior year.

For the six months ended December 31, 2011 Adjusted EBITDA was a loss of $0.46 million consistent with an Adjusted EBITDA loss of

$0.41 million during the same period in the prior year.

The following is a reconciliation of net loss for the period to Adjusted EBITDA:

	THREE MONTHS ENDED DECEMBER 31, 2011	*THREE MONTHS ENDED DECEMBER 31, 2010*	**SIX MONTHS ENDED DECEMBER 31, 2011**	*SIX MONTHS ENDED DECEMBER 31, 2010*
Net loss for the period	**$ (1,397,389)**	$ (259,580)	**$ (1,694,766)**	$ (886,398)
Foreign exchange losses (gains)	**(18,967)**	(91,065)	**67,524**	(155,454)
Finance costs, net	**72,785**	87,905	**142,129**	178,975
Income taxes (recovery)	**(8,728)**	–	**(15,047)**	–
Stock-based compensation	**13,948**	–	**32,712**	–
Depreciation and Amortization	**90,150**	220,741	**179,922**	413,683
Onerous contract charges (settlement)	**–**	–	**(331,957)**	–
Loss on assets sale of assets	**–**	17,099	**–**	39,838
Long-lived asset impairment	**1,159,905**	–	**1,159,905**	–
Adjusted EBITDA	**$ (88,296)**	$ (24,900)	**$ (459,578)**	$ (409,356)

Part III: CASH FLOW

CASH FLOW FROM (USED IN)	**THREE MONTHS ENDED DECEMBER 31, 2011**	*THREE MONTHS ENDED DECEMBER 31, 2010*	**SIX MONTHS ENDED DECEMBER 31, 2011**	*SIX MONTHS ENDED DECEMBER 31, 2010*
Operating activities	**$ (385,364)**	$ 556,187	**$ (787,657)**	$ 400,429
Investing activities	**(48,017)**	(95,241)	**(196,198)**	(6,289)
Financing activities	**(192,963)**	1,527,126	**(171,578)**	1,652,406
Increase (decrease) in cash and cash equivalents	**$ (626,344)**	$ 1,988,072	**$ (1,155,433)**	$ 2,046,546

Cash flow used in operating activities for the three months ended December 31, 2011 was $0.4 million as compared to cash flow from operating activities of $0.6 million during the same period in the prior year. The increased use of cash in operating activities is primarily due to the decline in sales, delayed payment of suppliers in the prior year and settlement of certain liabilities acquired pursuant to the Plan of Arrangement.

Cash flow used in investing activities for the three months ended December 31, 2011 was $0.05 million as compared to cash flow used in investing activities of $0.1 million during same period in the prior year.

Cash flow used in financing activities for the three months ended December 31, 2011 was $0.2 million as compared to cash flow from financing activities of $1.5 million during the same period in the prior year. Cash flow from financing activities for the three months ended December 31, 2010 included cash acquired pursuant to the plan of arrangement of $1.9 million offset by share issue costs of $0.3 million.

Cash flow used in operating activities for the six months ended December 31, 2011 was $0.8 million as compared to cash flow from operating activities of $0.4 million during the same period in the prior year. The increased use of cash in operating activities is primarily due to the decline in sales, delayed payment of suppliers in the prior year and settlement of certain liabilities acquired pursuant to the Plan of Arrangement.

Cash flow used in investing activities for the six months ended December 31, 2011 was $0.2 million as compared to cash flow used in investing activities of $0.01 million during same period in the prior year. Investment in capital assets of $0.2 million was consistent year over year and was offset by proceeds from the sale of assets of $0.2 million during the same period in the prior year.

Cash flow used in financing activities for the six months ended December 31, 2011 was $0.2 million as compared to cash flow from financing activities of $1.7 million during the same period in the prior year. During the six months ended December 31, 2010, proceeds from the issuance of convertible debentures were used to reduce bank indebtedness, cash acquired pursuant to the plan of arrangement was $1.9 million and share issue costs were $0.3 million.

Part IV: LIQUIDITY AND CAPITAL RESOURCES

AS AT	***DECEMBER 31, 2011***	*JUNE 30, 2011*
Cash and cash equivalents	**$ 1,773,072**	$ 2,897,735
Bank indebtedness	**(628,608)**	(693,026)
Working capital	**2,501,399**	2,868,874
Long-term debt (long-term portion only)	**(732,260)**	(839,420)
Convertible debentures	**(797,113)**	(742,496)
Shareholders' equity	**(1,586,824)**	(2,964,144)

The Company's objective when managing liquidity and capital resources is to ensure that it has sufficient liquidity to support its financial obligations and fund its operating and strategic objectives.

The Company's operations and capital expenditures are primarily financed through the use of its credit facility and working capital. The Company cannot conclude that existing cash resources, together with cash expected to be generated by operations, will be sufficient to meet operational and capital expenditure requirements and meet working capital needs for at least the next 12 months based on current projections. The Company anticipates minimal capital expenditures in 2012 primarily related to ongoing repairs and maintenance. In order to address the Company's initial cash requirements, the merger with Zuni was completed by way of a Plan of Arrangement effective December 31, 2010.

The Company cannot predict the amount or timing of its need for additional funds under various circumstances, such as continuing operations, new product development, changes to capital structure, or the continued weakness in economic conditions affecting the sectors within which the Company operates. There can be no assurance that, if deemed necessary, additional credit facilities could be obtained in order to permit the repayment of indebtedness under the Company's existing credit facility, or that, if such a replacement facility was obtained, it could be obtained at costs, or on terms and conditions comparable to those of the Company's current indebtedness.

Working Capital

At December 31, 2011, PSP's working capital was $2.5 million compared to $2.9 million as at June 30, 2011. The decrease in working capital is primarily related to a reduction in cash and cash equivalents of $1.1 million offset by a reduction in provisions of $0.5 million and a reduction in other current liabilities of $0.2 million.

Accounts receivable as at December 31, 2011 were $2.3 million consistent with $2.4 million as at June 30, 2011.

Inventories as at December 31, 2011 were $1.5 million as compared to $1.3 million as at June 30, 2011. The increase is related to finished goods in inventory at December 31, 2011 offset by a related amount in deferred revenue.

Accounts payable and accrued liabilities as at December 31, 2011 were $2.1 million and is comparable to the $2.3 million as at June 30, 2011.

Provisions as at December 31, 2011, were $0.2 million compared to $0.7 million as at June 30, 2011. The decrease reflects the recovery on settlement of a lease obligation in the six months ended December 31, 2011.

Bank Indebtedness

PSP signed an Agreement with a Canadian bank on August 31, 2011 for a replacement credit facility in the amount of $1.0 million. The new facility is a revolving demand facility available by way of overdraft with interest payable monthly calculated at the bank prime lending rate plus 1.95% per annum. The facility is secured by cash collateral of $1.0 million and a general security agreement over all personal property of PSP and its subsidiaries. The Agreement has no financial covenants and is subject to certain general covenants as outlined in the Agreement. At December 31, 2011, the amount drawn on the overdraft facility of $0.6 million is included in bank indebtedness, and cash collateral held in a GIC with the Bank in the amount of $1.0 million is included in cash and cash equivalents.

Sentry had an agreement with a United States bank to provide advances repayable on demand with interest payable monthly calculated at the bank prime lending rate plus 2.00% per annum. The loan was secured by a first priority general security agreement over U.S. accounts receivable, inventory and an assignment of insurance. The maximum operating line was $1.4 million USD subject to margin requirements and covenants set by the lenders. At December 31, 2011, the amount drawn on the line of credit was $Nil. On January 27, 2012 the United States bank was closed and a receiver was appointed. As a result funding was suspended. The loan facility was not being utilized, and the Company is in the process of closing the account and having the security released.

Long-term Debt

The Company has a $1.4 million secured term loan with the Business Development Bank of Canada ("BDC" or the "Lender"). At December 31, 2011, the principal outstanding on the loan was $0.9 million.

Convertible Debentures

On August 17, 2010, the Company completed a private placement for gross proceeds of $1,000,000. Pursuant to the private placement, the Company issued 40 units (the "Units") at a purchase price of $25,000 per Unit. Each Unit consisted of $25,000 in principal amount of unsecured convertible debentures (the "Debentures") and 62,500 detachable common share purchase warrants (the "Warrants").

The Debentures mature three years from the date of issuance and bear interest at a rate of 10% per annum, payable annually in cash or common shares at the option of the Company. The Company elected to settle interest payable on convertible debentures as of August 17, 2011 in the amount of $100,000 with the issuance of 1,145,408 common shares. The holder has the right to convert all (but not less than all), principal and accrued interest at any time to common shares at a rate of one common share per $0.10 of indebtedness.

The Warrants had a one-year term and expired unexercised on August 17, 2011.

Certain Directors of the Company beneficially own or control, directly or indirectly, $750,000 aggregate principal amount of the Debentures.

The Debentures contain certain default provisions that would provide the holders the right to demand repayment. The Company was in compliance with these conditions at December 31, 2011.

Deferred Income Taxes

At December 31, 2011, the Company had approximately $4.2 million in Canadian tax non-capital loss carryforwards and approximately $3.3 million in U.S. tax loss carryforwards available, excluding loss carryforwards of Zuni and its subsidiaries which have no operating business activities.

Equity Instruments and Other Paid-in Capital

At December 31, 2011, the Company's issued and outstanding shares were 57,454,895. At June 30, 2011, the Company's issued and outstanding shares were 56,309,487. On August 17, 2011 the Company issued 1,145,408 common shares in settlement of interest payable on convertible debentures in the amount of $100,000.

The Company's contributed surplus balance was $1.8 million at December 31, 2011 and June 30, 2011. Stock-based compensation expense for the six months ending December 31, 2011 was $0.03 million.

Other paid-in capital of $0.2 million at December 31, 2011 reflects the allocation of the equity component of convertible debentures, net of issue costs.

Capital Management

The Company's capital management strategy is designed to maintain financial strength and flexibility to support profitable growth. The Company's capital consists of accumulated debt, which is comprised of long-term debt, convertible debentures, bank indebtedness and shareholders' equity, excluding other comprehensive income (loss). The Company manages its capital structure and makes adjustments to it, based on the level of funds available to the Company to manage its operations. See "Bank Indebtedness", "Long-term Debt" and "Convertible Debentures".

The Company has not established a quantitative return on capital criteria; but rather promotes year-over-year sustainable growth.

The Company must adhere to certain financial covenants related to debt. See "Bank Indebtedness", "Long-term Debt" and "Convertible Debentures".

There have been no changes in the Company's approach to capital management during the period.

Part V: QUARTERLY RESULTS

Fiscal 2012			**December 31, 2011**[1]	**September 30, 2011**[1]
Sales			**$ 3,638,271**	**$ 3,486,062**
Net loss for the period			**(1,397,389)**	**(297,377)**
Basic and diluted loss per share			**(0.024)**	**(0.005)**

Fiscal 2011	June 30, 2011[1]	March 31, 2011[1]	December 31, 2010[1]	September 30, 2010[1]
Sales	$ 4,943,820	$ 8,286,012	$ 5,094,773	$ 4,339,091
Net loss for the period	(3,114,818)	(64,664)	(259,580)	(626,818)
Basic and diluted loss per share	(0.055)	(0.001)	(0.010)	(0.024)

Fiscal 2010	June 30, 2010[2]	March 31, 2010[2]	December 31, 2009[2]	September 30, 2009[2]
Sales	$ 7,125,500	$ 7,731,869	$ 7,472,312	$ 7,659,574
Net loss for the period	(2,439,037)	(87,378)	(158,984)	(363,783)
Basic and diluted loss per share	(0.095)	(0.003)	(0.006)	(0.014)

[1] Presented in accordance with IFRS
[2] Presented in accordance with previous Canadian GAAP

Significant Fluctuations in Quarterly Results

As identified in the table above not all comparative quarterly information has been restated in accordance with IFRS. For this reason the value of the information for comparative purposes may be limited.

For the three months ended December 31, 2011, the Company recorded a net loss from operations of $1.4 million or $0.024 per share. The increase in the loss compared to the prior quarter is primarily due to the long-lived asset impairment charge of $1.2 million.

For the three months ended September 30, 2011, the Company recorded a net loss from operations of $0.3 million or $0.005 per share. The decrease in the loss compared to the prior quarter is due to the loss on sale of APS assets and disposal of certain intangible assets of $1.5 million recorded in the prior quarter and settlement of an onerous contract obligation in the three months ended September 30, 2011.

Part VI: SIGNIFICANT ACCOUNTING POLICIES AND ESTIMATES

Transition to IFRS

The condensed consolidated interim financial statements have been prepared in accordance with IAS 34 *Interim Financial Reporting* and IFRS 1 *First-time Adoption of International Financial Reporting Standards* has been applied. The effective date of transition for the Company was July 1, 2010 and comparative information in the financial statements has been restated in accordance with IFRS.

The Company's IFRS accounting policies are provided in note 3 to the condensed consolidated interim financial statements for the three months ended September 30, 2011.

An explanation of how the transition to IFRS has affected the consolidated financial statements of the Company is provided in note 17 to the condensed consolidated interim financial statements. Reconciliations from previous Canadian Generally Accepted Accounting Principles to IFRS are provided in the note.

No material changes in internal control over financial reporting or disclosure controls and procedures resulted from the adoption and implementation of IFRS.

Use of estimates and judgments

The preparation of the condensed consolidated interim financial statements in conformity with IFRS requires management to make

judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

In the process of applying the Company's accounting policies, management has made the following estimates and judgments, which have the most significant effect on the amounts recognized in the condensed consolidated interim financial statements:

Impairment of non-financial assets
Impairment exists when the carrying value of a non-financial asset or cash-generating unit exceeds its recoverable amount, which is the higher of its fair value less costs to sell and its value in use. The value in use calculation is based on a discounted cash flow model. The recoverable amount is most sensitive to the discount rate used for the discounted cash flow model as well as the expected future cash flows and the growth rates used.

Depreciation and amortization rates
In calculating the depreciation and amortization expense, management is required to make estimates of the expected useful lives of property and equipment and intangible assets.

Taxes
Deferred tax assets, if any, are recognized for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilized. Significant management judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and the level of future taxable profits together with future tax planning strategies.

Canadian GAAP to IFRS adjustments

The following is a summary of the significant changes resulting from the adoption of IFRS. For a full explanation of all changes refer to note 16 of the condensed consolidated interim financial statements for the three months ended September 30, 2011 and note 17 of the condensed consolidated interim financial statements for the six months ended December 31, 2011.

- The Company elected under IFRS 1 *First-time adoption of IFRS*, to measure certain items of property and equipment at fair value and to deem the fair value as the new carrying cost as of July 1, 2010. Fair value was determined by a third party certified asset appraiser and resulted in a $0.3 million decrease in the value of property and equipment.

- The Company assessed the recoverable amount of its cash generating units at July 1, 2010 on transition to IFRS. The recoverable amount was based on a value in use calculation. Under Canadian GAAP, the recoverable amount was calculated on an undiscounted basis, using higher long-term growth assumptions than are permissible under IFRS, and no impairment was recognized. Under IFRS an impairment loss of $0.2 million was recorded at July 1, 2010. A further impairment loss of $1.1 million was recorded in the year ended June 30, 2011.

- Under IFRS the Company determined that the functional currency of the U.S. operating subsidiary, Sentry Armor Systems Inc., is the U.S. dollar. Sales prices, labour and material costs of the U.S. operating subsidiary are determined in U.S. dollars which are primary indicators of the functional currency in accordance with IFRS. Under Canadian GAAP, the U.S. operating subsidiary was accounted for as an integrated foreign operation. The U.S operating subsidiary is generating positive cash flows in U.S. dollars and is no longer dependent on funding from the Canadian parent company.

- The Company elected, under IFRS 1 *First-time adoption of IFRS*, to deem all foreign currency translation differences that arose prior to the date of transition to be nil at the date of transition. Foreign currency translation differences with respect to the U.S. operating subsidiary were $0.3 million and $0.4 million at December 31, 2010 and June 30, 2011, respectively, resulting in a reduction to foreign exchange losses recorded under Canadian GAAP. Under IFRS foreign currency translation differences are recorded in other comprehensive income.

Part VII: RISKS AND UNCERTAINTIES

In the normal course of business, the Company's operations continue to be influenced by a number of internal and external factors, and are exposed to risks and uncertainties, that can affect its business, financial condition and operating results. The activities of the Company are subject to ongoing operational risks, including the performance of key suppliers, product performance, government and other industry regulations, and reliance on information systems, all of which may affect the ability of the Company to meet its obligations. The ongoing ability to meet the needs of the market place is dependent upon the development and introduction of new products. While management believes its innovation and technology make it a leader in the industry, revenue and results may be affected if products are not accepted in the market place, are not approved by regulatory authorities, or if products are not brought to market in a timely manner.

PSP operates in markets subject to government purchasing patterns and large tenders that are at times unpredictable and create fluctuations in the production load throughout the year. Government purchasing is typically tender driven and subject to competitive bidding. These buying patterns create the necessity of being able to quickly increase and decrease production capacity. PSP has

addressed this risk by using a casual pool of staff and cell-based manufacturing in which production staff is grouped into cells. Cells can quickly be added or reduced in order to mitigate the impact of large contracts on regular production of core products. In addition, large contracts often create a situation where a significant portion of the Company's revenue and accounts receivable may be from a small number of customers increasing the risks of economic dependence and concentration of credit.

The Company's working capital position is dependent on the timely collection of accounts receivable, inventory management and scheduled supplier payments. A change in supplier payment terms or slow collection of accounts receivable could adversely affect the Company's liquidity. Management has implemented controls to ensure accounts receivable are current and suppliers payments are largely within terms. However, based on the current estimates, the Company cannot conclude that existing cash resources, together with cash expected to be generated by operations, will be sufficient to meet operating, capital and working capital requirements for at least the next twelve-month period.

Going Concern

There is significant doubt about the appropriateness of the going concern assumption because the Company reported a net loss of $1.7 million for the six months ended December 31, 2011 and a deficit of $20.5 million as at December 31, 2011.

The Company's ability to continue as a going concern and to realize the carrying value of its assets and discharge its liabilities and commitments when due is dependent upon the Company's ability to complete the proposed sale or restore profitable operations and raise additional capital.

No Record of Recent Profitability

The Company incurred a loss of $1.7 million during the six months ended December 31, 2011, has cumulative losses of $20.5 million as at December 31, 2011 and there can be no assurance that the future business activities of the Company will restore profitability. The Company's ability to operate profitably and generate positive cash flow in the future will be affected by a variety of factors (including its ability to further develop and test its solutions on schedule and on budget, the pace at which it secures additional customers, the time and expense required for the roll-out of its products, its success in marketing such product to its customers, the intensity of the competition experienced by the Company and the availability of additional capital to pursue its business plan, including development of new products). An inability to generate sufficient funds from operations will have a materially adverse effect on the Company's business, results of operations and financial condition.

Defaults under Credit Agreements

The credit facility with the Canadian bank is a demand facility. In the event that the Company was in default under the terms of the agreement, the bank may thereafter demand repayment of all amounts owing under the bank indebtedness and by virtue of the inter-lender agreement, the Lender and the Debenture holder may also demand repayment.

For further discussion with respect to defaults under the Company's credit agreements, refer to the Bank Indebtedness, Long-term Debt and Convertible Debentures sections in Part IV of this MD&A.

Risks relating to proposed Sale Transaction

The completion of the proposed Sale Transaction is subject to a number of conditions, certain of which are outside the control of the Company. These conditions include, but are not limited to, completion of due diligence by the potential purchaser, negotiation of a mutually satisfactory definitive purchase agreement, and TSX Venture Exchange and shareholder approval. There can be no assurance that the Sale Transaction will be completed as proposed or at all.

There can be no assurance that the net proceeds of the Sale Transaction would represent a premium to the current trading price of the Company's securities. If the Sale Transaction is not completed or approved there can be assurance that the Board of Directors would be able to enter into another transaction on equivalent or more attractive terms than the LOI.

Other Risks

Refer to the Company's June 30, 2011 consolidated financial statements note 15 for other risks including credit risk, interest risk, foreign exchange risk, liquidity risk, and fair value of financial instruments.

Part VIII: OTHER INFORMATION

The authorized share capital of the Company consists of an unlimited number of common shares. As of February 28, 2012, there were 57,454,895 common shares outstanding. As of February 28, 2012, there were 4,875,000 options outstanding.

Condensed Consolidated Interim Financial Statements of

PACIFIC SAFETY PRODUCTS INC.

Six months ended December 31, 2011 and 2010

(Unaudited)

PACIFIC SAFETY PRODUCTS INC.
CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS
(Unaudited)

Notice to Reader

The accompanying condensed consolidated interim financial statements have been prepared by and are the responsibility of the Company's management. The Company's independent auditor has not performed a review of these condensed consolidated interim financial statements in accordance with the standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

Douglas Lucky
Chief Executive Officer

February 28, 2012

PACIFIC SAFETY PRODUCTS INC.
CONDENSED CONSOLIDATED INTERIM STATEMENT OF FINANCIAL POSITION
(Unaudited)

(In Canadian dollars)

	December 31, 2011	June 30, 2011
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents (note 7)	**$ 1,773,072**	$ 2,897,735
Accounts receivable	**2,333,946**	2,431,490
Inventories	**1,515,825**	1,349,006
Prepaid expenses and deposits	**215,077**	279,560
Investment tax credits recoverable	**41,134**	41,136
	5,879,054	6,998,927
NON-CURRENT ASSETS		
Property and equipment (note 5)	**614,798**	633,199
Intangible assets (note 6)	**–**	1,043,987
	614,798	1,677,186
TOTAL ASSETS	**$ 6,493,852**	$ 8,676,113
LIABILITIES AND EQUITY		
CURRENT LIABILITIES		
Bank indebtedness (note 7)	**$ 628,608**	$ 693,026
Accounts payable and accrued liabilities	**2,101,964**	2,323,137
Provisions (note 10)	**214,985**	721,398
Deferred revenue	**217,778**	73,134
Income taxes payable	**–**	105,038
Current portion of long-term debt (note 8)	**214,320**	214,320
	3,377,655	4,130,053
NON-CURRENT LIABILITIES		
Long-term debt (note 8)	**732,260**	839,420
Convertible debentures (note 9)	**797,113**	742,496
	1,529,373	1,581,916
TOTAL LIABILITIES	**4,907,028**	5,711,969
EQUITY		
Share capital (note 11)	**20,180,222**	20,080,222
Warrants (note 11)	**–**	45,500
Contributed surplus	**1,840,040**	1,768,027
Other paid-in capital	**234,953**	234,953
Deficit	**(20,491,511)**	(18,796,745)
Accumulated other comprehensive income	**(176,880)**	(367,813)
Total equity	**1,586,824**	2,964,144
TOTAL LIABILITIES AND EQUITY	**$ 6,493,852**	$ 8,676,113

Going concern (note 2(e))
Subsequent events (note 16)

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

PACIFIC SAFETY PRODUCTS INC.
CONDENSED CONSOLIDATED INTERIM STATEMENT OF COMPREHENSIVE INCOME
(Unaudited)

(In Canadian dollars)

	Three months ended December 31, 2011	Three months ended December 31, 2010	**Six months ended December 31, 2011**	Six months ended December 31, 2010
SALES	**$ 3,638,271**	$ 5,094,773	**$ 7,124,333**	$ 9,433,864
COST OF SALES	**2,614,578**	3,989,643	**5,252,972**	7,380,371
GROSS MARGIN	**1,023,693**	1,105,130	**1,871,361**	2,053,493
OPERATING EXPENSES				
Sales and marketing	**406,470**	524,827	**848,594**	1,192,599
Research and development	**99,958**	156,472	**177,084**	275,108
General and administration	**709,659**	669,472	**1,517,895**	1,408,825
Total operating expenses	**1,216,087**	1,350,771	**2,543,573**	2,876,532
LOSS BEFORE OTHER ITEMS	**(192,394)**	(245,641)	**(672,212)**	(823,039)
OTHER ITEMS				
Foreign exchange losses (gains)	**(18,967)**	(91,065)	**67,524**	(155,454)
Finance income (note 13)	**(637)**	–	**(3,853)**	–
Finance costs (note 13)	**73,422**	87,905	**145,982**	178,975
Long-lived asset impairment (note 6)	**1,159,905**	–	**1,159,905**	–
Onerous contract charges (settlement) (note 10)	–	–	**(331,957)**	–
Loss on sale of assets	–	17,099	–	39,838
Total other items	**1,213,723**	13,939	**1,037,601**	63,359
LOSS BEFORE INCOME TAXES	**(1,406,117)**	(259,580)	**(1,709,813)**	(886,398)
INCOME TAXES				
Current income tax recovery	**(2,529)**	–	**(8,848)**	–
Deferred income tax recovery	**(6,199)**	–	**(6,199)**	–
Total income tax recovery	**(8,728)**	–	**(15,047)**	–
NET LOSS FOR THE PERIOD	**(1,397,389)**	(259,580)	**(1,694,766)**	(886,398)
OTHER COMPREHENSIVE INCOME (LOSS)				
Foreign currency translation differences – foreign operations	**(81,446)**	(124,798)	**190,933**	(256,332)
TOTAL COMPREHENSIVE LOSS FOR THE PERIOD	**$ (1,478,835)**	$ (384,378)	**$ (1,503,833)**	$ (1,142,730)
LOSS PER SHARE *(note 14)* ***BASIC AND DILUTED***	**$ (0.024)**	$ (0.010)	**$ (0.029)**	$ (0.034)
WEIGHTED AVERAGE COMMON SHARES ISSUED AND OUTSTANDING *(note 14)* ***BASIC AND DILUTED***	**57,454,895**	26,072,331	**57,162,318**	25,906,742

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

PACIFIC SAFETY PRODUCTS INC.
CONDENSED CONSOLIDATED INTERIM STATEMENT OF CHANGES IN EQUITY
(Unaudited)

FOR THE SIX MONTHS ENDED DECEMBER 31, 2011 and 2010
(In Canadian dollars)

	Share capital	Warrants	Contributed surplus	Other paid-in capital	Deficit	Cumulative translation account	Total
Balance, July 1, 2010	$ 17,614,731	$ –	$ 1,194,176	$ –	$(14,730,865)	$ –	$ 4,078,042
Net loss for the period	–	–	–	–	(886,398)	–	(886,398)
Other comprehensive income (loss):							
Foreign currency translation differences	–	–	–	–	–	(256,332)	(256,332)
Total comprehensive loss	–	–	–	–	(886,398)	(256,332)	(1,142,730)
Issuance of warrants	–	45,500	–	–	–	–	45,500
Issuance of convertible debentures	–	–	–	234,953	–	–	234,953
Issuance of shares under Plan of Arrangement	2,742,150	–	–	–	–	–	2,742,150
Share issue costs	(277,326)	–	–	–	–	–	(277,326)
Fair value of options issued	–	–	106,400	–	–	–	106,400
Excess value of net assets acquired over consideration paid	–	–	361,225	–	–	–	361,225
Total amounts attributable to owners	2,464,824	45,500	467,625	234,953	–	–	3,212,902
Balance, December 31, 2010	$ 20,079,555	$ 45,500	$ 1,661,801	$ 234,953	$(15,617,263)	$ (256,332)	$ 6,148,214
Balance, July 1, 2011	**$ 20,080,222**	**$ 45,500**	**$ 1,768,027**	**$ 234,953**	**$(18,796,745)**	**$ (367,813)**	**$ 2,964,144**
Net loss for the period	**–**	**–**	**–**	**–**	**(1,694,766)**	**–**	**(1,694,766)**
Other comprehensive income (loss):							
Foreign currency translation differences	**–**	**–**	**–**	**–**	**–**	**190,933**	**190,933**
Total comprehensive income (loss)	**–**	**–**	**–**	**–**	**(1,694,766)**	**190,933**	**(1,503,833)**
Issuance of shares	**100,000**	**–**	**–**	**–**	**–**	**–**	**100,000**
Share-based compensation expense	**–**	**–**	**32,712**	**–**	**–**	**–**	**32,712**
Warrants expired	**–**	**(45,500)**	**39,301**	**–**	**–**	**–**	**(6,199)**
Total amounts attributable to owners	**100,000**	**(45,500)**	**72,013**	**–**	**–**	**–**	**126,513**
Balance, December 31, 2011	**$ 20,180,222**	**$ –**	**$ 1,840,040**	**$ 234,953**	**$(20,491,511)**	**$ (176,880)**	**$ 1,586,824**

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

PACIFIC SAFETY PRODUCTS INC.
CONDENSED CONSOLIDATED INTERIM STATEMENT OF CASH FLOWS
(Unaudited)

(In Canadian dollars)

	Three months ended December 31, 2011	Three months ended December 31, 2010	**Six months ended December 31, 2011**	Six months ended December 31, 2010
CASH FLOW FROM OPERATING ACTIVITIES				
Cash receipts from customers	**$ 3,811,451**	$ 5,258,919	**$ 7,432,374**	$ 10,499,671
Cash paid to suppliers and employees	**(4,070,587)**	(4,661,200)	**(8,079,136)**	(9,989,106)
Interest paid	**(24,356)**	(41,532)	**(48,558)**	(110,136)
Interest received	**637**	–	**3,853**	–
Income taxes recovered	**–**	–	**6,319**	–
Income taxes paid	**(102,509)**	–	**(102,509)**	–
NET CASH FROM (USED IN) OPERATING ACTIVITIES	**(385,364)**	556,187	**(787,657)**	400,429
CASH FLOW FROM INVESTING ACTIVITIES				
Purchase of property and equipment	**(4,060)**	(664)	**(62,199)**	(3,484)
Investment in intangible assets	**(43,957)**	(77,478)	**(133,999)**	(213,182)
Proceeds from sale of assets, net of selling costs	**–**	(17,099)	**–**	210,377
NET CASH FROM (USED IN) INVESTING ACTIVITIES	**(48,017)**	(95,241)	**(196,198)**	(6,289)
CASH FLOW FROM FINANCING ACTIVITIES				
Proceeds from issue of convertible debentures, net of issue costs	**–**	–	**–**	935,000
Repayment of long-term debt	**(53,580)**	–	**(107,160)**	(17,860)
Decrease in bank indebtedness	**(139,383)**	(88,190)	**(64,418)**	(880,050)
Cash acquired pursuant to plan of arrangement (note 4)	**–**	1,892,642	**–**	1,892,642
Share issue costs (note 4)	**–**	(277,326)	**–**	(277,326)
NET CASH FROM (USED IN) FINANCING ACTIVITIES	**(192,963)**	1,527,126	**(171,578)**	1,652,406
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**(626,344)**	1,988,072	**(1,155,433)**	2,046,546
CASH AND CASH EQUIVALENTS, BEGINNING	**2,405,445**	–	**2,897,735**	–
Effect of exchange rate fluctuations on cash held	**(6,029)**	(57,061)	**30,770**	(115,535)
CASH AND CASH EQUIVALENTS, ENDING	**$ 1,773,072**	$ 1,931,011	**$ 1,773,072**	$ 1,931,011

Cash and cash equivalents consist of:		
Cash	**$ 133,072**	$ 1,931,011
Guaranteed Investment Certificates (note 7)	**1,640,000**	–
	$ 1,773,072	$ 1,931,011

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

1. REPORTING ENTITY

Pacific Safety Products Inc. ("PSP" or the "Company") is a company domiciled in Canada and incorporated under the Canada Business Corporation Act. The address of the Company's head office is 124 Fourth Avenue, Arnprior, Ontario K7S 0A9. The Company manufactures and sells a comprehensive line of protective products for the defence and security markets.

The condensed consolidated interim financial statements of the Company as at and for the six months ended December 31, 2011 comprise the Company and its subsidiaries. Nexus Armour Inc. ("Nexus") is a wholly-owned subsidiary of PSP and is the parent company of Sentry Armor Systems Inc. ("Sentry"). Sentry is incorporated in the State of Delaware, USA and commenced operations in Dover, Tennessee on July 5, 2006. In accordance with the terms of a Plan of Arrangement, Zuni Holdings Inc. ("Zuni") became a wholly-owned subsidiary of PSP effective December 31, 2010. Zuni is the parent company of MTI Leewood GmbH and MTI Specialty Silicones Inc. Zuni and its subsidiaries have no operating business activities.

2. BASIS OF PREPARATION

(a) Statement of compliance

These condensed consolidated interim financial statements have been prepared in accordance with IAS 34 *Interim Financial Reporting*. These condensed consolidated interim financial statements are part of the period covered by the Company's first annual financial statements prepared in accordance with International Financial Reporting Standards ("IFRS") and IFRS 1 *First-time Adoption of International Financial Reporting Standards* has been applied. The condensed consolidated interim financial statements do not include all of the information required for full annual consolidated financial statements.

An explanation of how the transition to IFRS has affected the reported financial position, financial performance and cash flows of the Company is provided in note 17. Reconciliations from previous Canadian Generally Accepted Accounting Principles ("Canadian GAAP") to IFRS are provided in the note.

The condensed consolidated interim financial statements were authorized for issue by the Board of Directors on February 28, 2012.

(b) Basis of measurement

These condensed consolidated interim financial statements have been prepared on the historical cost basis except as permitted by IFRS and as otherwise indicated within these notes.

(c) Functional and presentation currency

These condensed consolidated interim financial statements are presented in Canadian dollars, which is the Company's functional currency.

(d) Use of estimates and judgments

The preparation of the condensed consolidated interim financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

In the process of applying the Company's accounting policies, management has made the following estimates and judgments, which have the most significant effect on the amounts recognized in the condensed consolidated interim financial statements:

Impairment of non-financial assets

Impairment exists when the carrying value of a non-financial asset or cash-generating unit exceeds its recoverable amount, which is the higher of its fair value less costs to sell and its value in use. The value in use calculation is based on a discounted cash flow model. The recoverable amount is most sensitive to the discount rate used for the discounted cash flow model as well as the expected future cash flows and the growth rates used.

Depreciation and amortization rates

In calculating the depreciation and amortization expense, management is required to make estimates of the expected useful lives of property and equipment and intangible assets.

2. BASIS OF PREPARATION (CONTINUED)

(d) Use of estimates and judgments (continued)

Taxes
Deferred tax assets, if any, are recognized for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilized. Significant management judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and the level of future taxable profits together with future tax planning strategies.

(e) Going concern

These condensed consolidated interim financial statements have been prepared in accordance with IFRS on a going concern basis, which assumes that the future operations will allow for the realization of assets and discharge of liabilities and commitments in the normal course of business. Should the Company be unable to continue as a going concern, it may be unable to realize the carrying value of its assets and to meet its liabilities as they become due. There is significant doubt about the appropriateness of the use of the going concern assumption because the Company incurred a net loss of $1.7 million for the six months ended December 31, 2011 and has a deficit of $20.5 million as at December 31, 2011.

In order to further strengthen the Company's financial position and address its liquidity requirements, the Company continues to consider and evaluate on an ongoing basis, all alternatives available to it. These alternatives include, without limitation, seeking additional sources of financing, identifying and pursuing strategic partnerships, and other value enhancing opportunities. However, there can be no assurance that such efforts will result in the Company pursuing any such alternative or, if pursued, there can be no assurance any such alternative will be successfully completed and implemented (note 16).

The Company's ability 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 Company’s ability to complete the sale of substantially all of its assets (note 16) or to restore profitable operations and raise additional capital. These condensed consolidated interim financial statements do not include any adjustments to the carrying value and classification of assets and liabilities that would be necessary should the Company be unable to continue as a going concern, and such adjustments could be material.

3. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out in note 3 to the condensed consolidated interim financial statements for the three months ended September 30, 2011 have been applied consistently to all periods presented in these condensed consolidated interim financial statements and in preparing the opening IFRS statement of financial position at July 1, 2010 for the purposes of the transition to IFRS.

4. PLAN OF ARRANGEMENT

Pursuant to a Plan of Arrangement effective December 31, 2010, the Company acquired all of the outstanding common shares of Zuni in exchange for PSP common shares at an agreed exchange ratio of one PSP common share for each Zuni common share. Zuni was amalgamated with a wholly-owned subsidiary of PSP incorporated for the purpose of carrying out the Plan of Arrangement. The amalgamated entity was continued as Zuni Holdings Inc., a subsidiary of PSP.

This transaction has been accounted for as the acquisition of the assets and liabilities of Zuni in exchange for PSP common shares valued at the date of completion of the acquisition. The number of PSP common shares issued was 30,468,334 and the PSP share price was $0.09 resulting in purchase consideration of $2,742,150 related to the shares issued.

The Company also issued 2,000,000 replacement stock options and recorded the fair value of the options of $106,400 in purchase consideration. In accordance with the terms of the Plan of Arrangement, 2,000,000 Zuni stock options outstanding immediately prior to the transaction were exchanged for PSP replacement stock options at an exercise price of $0.10. The PSP replacement stock options were fair-valued using the Black-Scholes option pricing model at the effective date of the transaction using the following assumptions:

	PSP
Remaining life	4.6 years
Volatility	77%
Dividends	–
Risk-free interest rate	2.4%

A summary of net assets acquired is as follows:

Assets acquired:		
Cash	$	1,892,642
Restricted cash		2,649,699
Accounts receivable and prepaid expenses		372,446
Asset held for sale		184,124
		5,098,911
Liabilities assumed:		
Accounts payable and accrued liabilities		(1,789,243)
Income taxes payable		(99,893)
		(1,889,136)
Excess value of net assets acquired over consideration paid		(361,225)
Total purchase consideration	$	2,848,550

All costs incurred by the Company relating to the Plan of Arrangement have been recorded as share issue costs and presented as a reduction in share capital.

5. PROPERTY AND EQUIPMENT

	Manufacturing equipment	Office equipment	Computer equipment	Leasehold improvements	Total
Cost or deemed cost					
As at July 1, 2010	$ 603,903	$ 109,162	$ 48,653	$ 229,131	$ 990,849
Additions	7,933	–	16,770	–	24,703
Disposals	–	(59,267)	(33,267)	(39,606)	(132,140)
Effect of movements in exchange rates	(28,997)	(781)	(529)	(2,032)	(32,339)
As at June 30, 2011	582,839	49,114	31,627	187,493	851,073
Additions	6,249	–	2,323	53,627	62,199
Disposals	–	–	–	(10,436)	(10,436)
Effect of movements in exchange rates	15,416	410	486	5,101	21,413
As at December 31, 2011	$ 604,504	$ 49,524	$ 34,436	$ 235,785	$ 924,249
Depreciation and impairment losses					
As at July 1, 2010	$ –	$ 45,711	$ 31,951	$ 25,417	$ 103,079
Depreciation	176,709	16,500	7,566	31,102	231,877
Disposals	–	(49,448)	(32,809)	(28,927)	(111,184)
Effect of movements in exchange rates	(5,336)	(144)	(158)	(260)	(5,898)
As at June 30, 2011	171,373	12,619	6,550	27,332	217,874
Depreciation	62,324	4,742	4,398	18,566	90,030
Disposals	–	–	–	(1,864)	(1,864)
Effect of movements in exchange rates	2,998	80	94	239	3,411
As at December 31, 2011	$ 236,695	$ 17,441	$ 11,042	$ 44,273	$ 309,451
Net book value					
As at June 30, 2011	$ 411,466	$ 36,495	$ 25,077	$ 160,161	$ 633,199
As at December 31, 2011	**$ 367,809**	**$ 32,083**	**$ 23,394**	**$ 191,512**	**$ 614,798**

6. *INTANGIBLE ASSETS*

	Product development	Patents and trademarks	Tradenames	Software	Customer relationships	Total
Cost						
As at July 1, 2010	$ 1,668,232	$ 138,966	$ 525,233	$ 649,793	$ 2,947,796	$ 5,930,020
Additions	288,441	5,069	–	–	–	293,510
Disposals	–	–	–	–	(1,644,146)	(1,644,146)
Effect of movements in exchange rates	–	–	(49,385)	(5,910)	(122,577)	(177,872)
As at June 30, 2011	1,956,673	144,035	475,848	643,883	1,181,073	4,401,512
Additions	133,160	625	–	214	–	133,999
Effect of movements in exchange rates	–	–	25,902	3,099	64,289	93,290
As at December 31, 2011	$ 2,089,833	$ 144,660	$ 501,750	$ 647,196	$ 1,245,362	$ 4,628,801
Amortization and impairment losses						
As at July 1, 2010	$ 663,896	$ 99,237	$ 110,877	$ 497,341	$ 770,521	$ 2,141,872
Amortization	316,905	13,564	36,702	44,740	224,064	635,975
Impairment	975,872	31,234	–	88,894	–	1,096,000
Disposals	–	–	–	–	(437,790)	(437,790)
Effect of movements in exchange rates	–	–	(15,404)	(5,086)	(58,042)	(78,532)
As at June 30, 2011	1,956,673	144,035	132,175	625,889	498,753	3,357,525
Amortization	255	19	18,352	3,356	67,910	89,892
Impairment	132,905	606	347,963	16,438	661,993	1,159,905
Effect of movements in exchange rates	–	–	3,260	1,513	16,706	21,479
As at December 31, 2011	$ 2,089,833	$ 144,660	$ 501,750	$ 647,196	$ 1,245,362	$ 4,628,801
Net book value						
As at June 30, 2011	$ –	$ –	$ 343,673	$ 17,994	$ 682,320	$ 1,043,987
At December 31, 2011	**$ –**	**$ –**	**$ –**	**$ –**	**$ –**	**$ –**

Impairment
At June 30, 2011, due to continuing losses, negative cash flow from operating activities, and the reduction in projected revenue in Canada following the sale of the distribution division, the Company assessed the recoverable amount of its cash generating units ("CGUs"). The recoverable amount of the CGUs was based on a value in use calculation.

Value in use was based on cash flows expected to be generated from each of the Company's two CGUs. The two CGUs are assets of the Canadian ("Canada") and U.S. operations ("USA"). Cash flows were projected up to the date that the assets within the CGUs are expected to be consumed by the entity. For Canada the expected life of the CGU was 6 years and the life of the USA CGU was 6 years. The key assumptions used in the value in use calculations of the CGUs are:

- Expected life of the CGUs' assets
- Projection of cash inflows and outflows
- Discount rates

The value in use was determined using pre-tax discount rates of 25.15% and 25.55% for the Canada and USA CGUs, respectively. The discount rates applied reflect the Company's weighted average cost of capital adjusted for the risks specific to the CGU. Cash flows were projected based on past experience, actual operating results and the Company's operating plan

6. INTANGIBLE ASSETS (CONTINUED)

extrapolated for a 5 year period. A zero growth rate was assumed beyond year 5.

Based on the value in use assessment, the carrying amount of the Canada CGU at June 30, 2011 was determined to be $1,096,000 higher than its recoverable amount and an impairment loss was recognized. The impairment loss was allocated pro rata to the intangible assets comprising the Canada CGU. The recoverable amount of the USA CGU based on the value in use calculation exceeded the carrying amount therefore no impairment loss was recognized.

At December 31, 2011, it was determined that the remaining intangible assets of both the Canada CGU ($134,125) and the US CGU ($1,025,780) were fully impaired. A draft letter of intent ("LOI") to sell substantially all of the assets of the Company was received prior to December 31, 2011 and was signed on January 20, 2012. The value of the estimated net proceeds indicated that there was a potential impairment. As a result management reviewed the recoverable value of each CGU and determined that the fair value less costs to sell for each CGU represented the recoverable value. Fair value was determined based on the signed LOI. The carrying value of net assets expected to be included in the sale, excluding intangible assets, exceeds the estimated net proceeds of sale. Therefore an impairment loss of $1,159,905 was recognized at December 31, 2011.

7. BANK INDEBTEDNESS

PSP signed an Agreement with a Canadian bank (the "Bank") on August 31, 2011 for a replacement credit facility in the amount of $1.0 million. The facility is a revolving demand facility available by way of overdraft with interest payable monthly calculated at the bank prime lending rate plus 1.95% per annum. The facility is secured by cash collateral of $1.0 million and a general security agreement over all personal property of PSP and its subsidiaries. The Agreement has no financial covenants and is subject to certain general covenants as outlined in the Agreement. At December 31, 2011, the amount drawn on the overdraft facility of $628,608 is included in bank indebtedness, and cash collateral held in a GIC with the Bank in the amount of $1,040,000 is included in cash and cash equivalents.

Sentry had an agreement with a United States bank to provide advances repayable on demand with interest payable monthly calculated at the bank prime lending rate plus 2.00% per annum. The loan was secured by a first priority general security agreement over U.S. accounts receivable, inventory and an assignment of insurance. The maximum operating line was $1.4 million USD subject to margin requirements and covenants set by the lenders. At December 31, 2011, the amount drawn on the line of credit was $Nil. On January 27, 2012 the United States bank was closed and a receiver was appointed. As a result funding was suspended. The loan facility was not being utilized, and the Company is in the process of closing the account and having the security released.

8. LONG-TERM DEBT

	December 31, 2011	June 30, 2011
Secured term loan with interest payable monthly calculated at the Lender's floating base rate of 5% at June 30, 2011 plus a variance of 0.75% per annum on the principal outstanding. The principal is repayable by one installment of $17,620 on December 23, 2008, 83 consecutive monthly payments of $17,860 commencing January 23, 2009 with the final payment on May 23, 2016. This loan is secured by a first security interest in all present and after-acquired personal property, subject only to a prior charge with respect to receivables and inventory in favour of the bank providing a Canadian credit facility. The Lender agreed to a six-month postponement of principal payments pursuant to a letter agreement dated August 4, 2010. All other terms and conditions of the debt facility remain unchanged. Principal payments resumed on February 23, 2011.	**$ 946,580**	$ 1,053,740
Less current portion	**(214,320)**	(214,320)
	$ 732,260	$ 839,420

8. LONG-TERM DEBT (CONTINUED)

The principal installments required to be paid over the next five years are as follows:

Years ending December 31,		
2012	$	214,320
2013		214,320
2014		214,320
2015		214,320
2016		89,300
	$	946,580

9. CONVERTIBLE DEBENTURES

On August 17, 2010, the Company completed a private placement of $1,000,000 aggregate principal amount, consisting of 40 units (the "Units") at a purchase price of $25,000 per Unit. Each Unit consists of $25,000 in principal amount of unsecured convertible debentures (the "Debentures") and 62,500 detachable common share purchase warrants (the "Warrants").

The Debentures mature three years from the date of issuance and bear interest at a rate of 10% per annum, payable annually in cash or common shares at the option of the Company. The Company elected to settle interest payable on convertible debentures as of August 17, 2011 in the amount of $100,000 with the issuance of 1,145,408 common shares. The holder has the right to convert all (but not less than all) principal and accrued interest at any time to common shares at a rate of one common share per $0.10 of indebtedness (the "Conversion Option").

The Warrants have a one-year term with an exercise price of $0.10 per common share during the first six-months and an exercise price of $0.12 per common share during the second six-months of the term. The Warrants expired unexercised on August 17, 2011.

On the date of issuance, the gross proceeds in the amount of $1,000,000 have been allocated based on the fair values of the Debentures ($700,049) and Warrants ($45,500) with the residual being allocated to the Conversion Option ($254,451). The fair value of the Debentures is classified as a liability, while the fair values of the Conversion Option and Warrants have been classified as separate components of shareholders' equity.

Over the three-year term, the Debentures are accreted to their principal amount through a periodic charge to accretion expense with a corresponding credit to the liability component. The accretion expense is based on the effective interest method. For the six months ended December 31, 2011, the Company recorded accretion expense of $47,424 (six months ended December 31, 2010 - $31,670) related to the Debentures.

The Company incurred transaction costs of $65,000 in connection with the issuance of the Debentures. These costs were allocated to Debenture issuance costs ($45,503) and to equity issuance costs ($19,497) based on the relative fair values of the debt and equity components.

The fair value of the Debentures was estimated using the present value of future cash flows using a discount rate of 18%. The fair value of the Warrants was estimated using the Black-Scholes option pricing model assuming no expected dividends, a volatility of the Company's share price of 101%, a risk-free interest rate of 1.4%, and an expected life of one year.

Certain Directors of the Company beneficially own or control, directly or indirectly, $750,000 aggregate principal amount of the Debentures.

The Debentures contain certain default provisions that would provide the holders the right to demand repayment. The Company was in compliance with these conditions at December 31, 2011.

10. PROVISIONS

The provision for warranties is based on estimates made from historical data associated with similar products. At December 31, 2011 the warranty liability was $83,434 (June 30, 2011 - $73,252).

During the year ended June 30, 2010, the Company implemented a restructuring plan directed at reducing costs. The balance in the restructuring provision at December 31, 2011 was $16,379 (June 30, 2011 - $16,379).

On August 16, 2011 the Company signed a sublease for the remaining lease term for its former head office premises in Kanata, Ontario. The Company recognized a provision for the discounted future lease payments to which the Company is committed less expected future sublease income in the amount of $122,308. The balance in the provision for onerous contracts at December 31, 2011 was $115,172.

Pursuant to the Plan of Arrangement (note 4) the Company assumed a provision for discounted future lease payments related to the vacated manufacturing facility of a Zuni subsidiary that no longer had any operating business activities. The balance on the provision for this onerous contract at June 30, 2011 was $631,767. A settlement was reached with the landlord and the lease was terminated on September 30, 2011 resulting in a release of the provision in the amount of $462,838.

11. EQUITY INSTRUMENTS

(a) Authorized and issued

The authorized share capital of the Company consists of unlimited voting common shares without par value.

		December 31, 2011		June 30, 2011
	Number of Shares	**Amount**	Number of Shares	Amount
Beginning balance	**56,309,487**	**$ 20,080,222**	25,741,153	$ 17,614,731
Shares issued under the Plan of Arrangement (note 4)	**–**	**–**	30,468,334	2,742,150
Share issue costs (note 4)	**–**	**–**	–	(283,659)
Shares issued in settlement of Debenture interest	**1,145,408**	**100,000**	–	–
Restricted shares	**–**	**–**	100,000	7,000
Balance, end of period	**57,454,895**	**$ 20,180,222**	56,309,487	$ 20,080,222

On August 17, 2011, the Company issued 1,145,408 common shares at a deemed price of $0.087305 per share in settlement of interest payable on the Debentures.

(b) Warrants

		December 31, 2011		June 30, 2011
	Number of Warrants	**Amount**	Number of Warrants	Amount
Private placement – August 17, 2010	**2,500,000**	**$ 45,500**	2,500,000	$ 45,500
Expired unexercised – August 17, 2011	**(2,500,000)**	**(45,500)**	–	–
Balance, end of period	**–**	**$ –**	2,500,000	$ 45,500

11. EQUITY INSTRUMENTS (CONTINUED)

(c) Stock Options

The Company had a stock option plan that provides options to purchase common shares of the Company for its management, executive officers and members of the Board of Directors. These options expire five years after the issue date or, in the event the employee's service ceases, at a date determined by the Board of Directors. Board members' options expire 90 days after termination or resignation, subject to certain exceptions whereby specific board members' options expire one year after resignation. The exercise price for these stock options is set at the average closing price over the previous 20 day trading period. Vesting periods are determined by the Board of Directors upon issuance.

On December 22, 2010, the Board approved the New PSP Stock Option Plan. Under the New PSP Stock Option Plan, the PSP Board determines the term of any options granted, which shall not exceed ten years from the date of grant. The exercise price and vesting periods will be determined by the Board of Directors upon issuance. The expiration of any PSP option will be accelerated if the participant's employment or other relationship with PSP terminates. Vested options may be exercised until the earlier of the fixed expiry date or a period of up to one year following the date the optionee ceases to be a participant as determined by the PSP Board at the time of the option grant.

The aggregate number of PSP shares that may be reserved for issuance pursuant to PSP options shall not exceed 10% of the outstanding PSP shares at the time of granting of a PSP option, less the aggregate number of shares reserved for issuance under any other PSP share compensation arrangement.

At December 31, 2011, the Company had 4,875,000 stock options outstanding with an exercise price of $0.10.

	Total	*Weighted Average Exercise Price*
Balance, June 30, 2011	4,884,000	$ 0.10
Expired	(9,000)	0.79
Balance, December 31, 2011	**4,875,000**	**$ 0.10**

Total Stock Option Pool Authorized	**5,745,489**
Total Stock Option Pool Remaining	**870,489**

The following table summarizes information regarding the Company's outstanding stock options at December 31, 2011:

Options Outstanding				*Options Exercisable*	
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$0.10	4,875,000	3.97	$ 0.10	4,166,667	$ 0.10

12. OPERATING SEGMENTS

The Company's principal business activity is the manufacture and sale of a comprehensive line of protective products and accessories for the defence and security market. The Company operates in Canada through its PSP and formerly APS Distributors divisions with operations based in Arnprior, Ontario and formerly Bedford, Nova Scotia respectively, and in the U.S. through its Sentry subsidiary located in Dover, Tennessee. Head office expenses, including the office of the CEO and public company costs, are reported as Corporate.

These segments represent the Company's reportable segments which are used to manage the business. The Company analyzes the performance of its operating segments based on revenue growth and operating profitability. Assets acquired pursuant to the Plan of Arrangement (note 4) are reported as Corporate assets.

	Canadian Operations	U.S. Operations	Corporate	Consolidated Total
For the three months ended December 31, 2011				
Revenue	**$ 1,805,930**	**$ 1,891,510**	**$ –**	**$ 3,697,440**
Elimination of inter-segment revenue	**(15,295)**	**(43,874)**	**–**	**(59,169)**
Total revenue	**1,790,635**	**1,847,636**	**–**	**3,638,271**
Gross margin	**585,921**	**437,772**	**–**	**1,023,693**
Operating expenses	**589,695**	**281,253**	**345,139**	**1,216,087**
Other items	**188,580**	**1,025,780**	**(637)**	**1,213,723**
Income tax expense (recovery)	**–**	**–**	**(8,728)**	**(8,728)**
Net income (loss) after taxes	**$ (192,354)**	**$ (869,261)**	**$ (335,774)**	**$ (1,397,389)**

	Canadian Operations	U.S. Operations	Corporate	Consolidated Total
For the three months ended December 31, 2010				
Revenue	$ 3,223,464	$ 1,884,218	$ –	$ 5,107,682
Elimination of inter-segment revenue	(11,309)	(1,600)	–	(12,909)
Total revenue	3,212,155	1,882,618	–	5,094,773
Gross margin	781,703	323,427	–	1,105,130
Operating expenses	759,218	259,641	331,912	1,350,771
Other items	9,187	4,752	–	13,939
Income tax expense (recovery)	–	–	–	–
Net income (loss) after taxes	$ 13,298	$ 59,034	$ (331,912)	$ (259,580)

12. OPERATING SEGMENTS (CONTINUED)

	Canadian Operations	U.S. Operations	Corporate	Consolidated Total
For the six months ended December 31, 2011				
Revenue	**$ 3,469,436**	**$ 3,736,446**	**$ –**	**$ 7,205,882**
Elimination of inter-segment revenue	**(30,886)**	**(50,663)**	**–**	**(81,549)**
Total revenue	**3,438,550**	**3,685,783**	**–**	**7,124,333**
Gross margin	**987,479**	**883,882**	**–**	**1,871,361**
Operating expenses	**1,220,134**	**556,871**	**766,568**	**2,543,573**
Other items	**477,983**	**1,026,309**	**(466,691)**	**1,037,601**
Income tax expense (recovery)	**–**	**–**	**(15,047)**	**(15,047)**
Net income (loss) after taxes	**$ (710,638)**	**$ (699,298)**	**$ (284,830)**	**$ (1,694,766)**

	Canadian Operations	U.S. Operations	Corporate	Consolidated Total
For the six months ended December 31, 2010				
Revenue	$ 5,735,564	$ 3,784,935	$ –	$ 9,520,499
Elimination of inter-segment revenue	(62,785)	(23,850)	–	(86,635)
Total revenue	5,672,779	3,761,085	–	9,433,864
Gross margin	1,199,395	854,098	–	2,053,493
Operating expenses	1,761,465	525,799	589,268	2,876,532
Other items	38,323	25,036	–	63,359
Income tax expense (recovery)	–	–	–	–
Net income (loss) after taxes	$ (600,393)	$ 303,263	$ (589,268)	$ (886,398)

12. OPERATING SEGMENTS (CONTINUED)

	Canadian Operations	U.S. Operations	Corporate	Consolidated Total
AS AT DECEMBER 31, 2011				
Assets				
Current assets	**$ 3,111,251**	**$ 2,079,512**	**$ 688,291**	**$ 5,879,054**
Property and equipment	**338,503**	**276,295**	**–**	**614,798**
Intangible assets	**–**	**–**	**–**	**–**
	$ 3,449,754	**$ 2,355,807**	**$ 688,291**	**$ 6,493,852**

	Canadian Operations	U.S. Operations	Corporate	Consolidated Total
AS AT JUNE 30, 2011				
Assets				
Current assets	$ 2,209,130	$ 1,780,366	$ 3,009,431	$ 6,998,927
Property and equipment	394,750	238,449	–	633,199
Intangible assets	–	1,043,987	–	1,043,987
	$ 2,603,880	$ 3,062,802	$ 3,009,431	$ 8,676,113

Sales for the six months ended December 31,	**2011**	2010
Canada	**$ 3,438,550**	$ 5,633,504
United States	**3,414,769**	3,461,926
International	**271,014**	338,434
	$ 7,124,333	$ 9,433,864

Included in sales for the six months ended December 31, 2011, were sales of $1.6 million to the Canadian Federal Government, which represents 22.0% of total sales. Sales for the six months ended December 31, 2010 included sales of $0.8 million to the Canadian Federal Government. The Company had no other significant sales (over 10% of revenue) to any one customer.

The Company experiences sales cycles that can be dependent on the award of contracts by major police agencies and federal government departments. These cycles are, at times, unpredictable and may cause variations in revenue and profitability.

13. FINANCE INCOME AND FINANCE COSTS

Recognized in profit or loss:

	Three months ended December 31, 2011	Three months ended December 31, 2010	**Six months ended December 31, 2011**	Six months ended December 31, 2010
Interest income on bank deposits	**$ 637**	$ –	**$ 3,853**	$ –
Finance income	**$ 637**	$ –	**$ 3,853**	$ –
Interest on bank indebtedness	**$ 10,276**	$ 28,683	**$ 19,466**	$ 82,890
Interest on long-term debt	**14,082**	12,849	**29,092**	27,246
Interest on convertible debentures	**25,000**	25,000	**50,000**	37,169
Accretion of convertible debentures	**24,064**	21,373	**47,424**	31,670
Finance costs	**$ 73,422**	$ 87,905	**$ 145,982**	$ 178,975

14. LOSS PER SHARE

As the Company incurred a net loss during the six months ended December 31, 2011 and 2010, the loss and diluted loss per common share are based on the weighted-average common shares outstanding during the period. The following outstanding instruments could have a dilutive effect in the future:

	As at December 31, 2011
Shares issuable on conversion of convertible debentures	**10,000,000**
Stock options	**4,875,000**
	14,875,000

15. RELATED PARTY TRANSACTIONS

Consulting expenses for services performed by a shareholder and director of the Company during the six months ended December 31, 2011 were $60,000 (six months ended December 31, 2010 - $Nil). These expenses are included in general and administrative expenses.

16. SUBSEQUENT EVENTS

On January 23, 2012, the Company announced that it has entered into a letter of intent to sell substantially all of its assets on a cash-free, debt-free basis for cash payable at closing. During an exclusivity period, the potential purchaser is completing a due diligence review, and the parties are endeavoring to negotiate a mutually satisfactory definitive purchase agreement.

17. EXPLANATION OF TRANSITION TO IFRS

As stated in Note 2(a), these condensed consolidated interim financial statements prepared in accordance with IAS 34 *Interim Financial Reporting*.

The accounting policies set out in note 3 to the condensed consolidated interim financial statements for the three months ended September 30, 2011 have been applied in preparing the condensed consolidated interim financial statements for the six months ended December 31, 2011, the comparative information for the six months ended December 31, 2010 and year ended June 30, 2011, and the opening IFRS statement of financial position at July 1, 2010.

An explanation of how the transition from previous Canadian GAAP to IFRS has affected the Company's financial position, financial performance and cash flows is set out in the following tables and the notes that accompany the tables.

17. EXPLANATION OF TRANSITION TO IFRS (CONTINUED)

Reconciliation of equity

December 31, 2010	Note	Canadian GAAP	Effect of transition to IFRS	IFRS
ASSETS				
CURRENT ASSETS				
Cash and cash equivalents		$ 1,931,011	$ –	$ 1,931,011
Restricted cash		2,649,699	–	2,649,699
Accounts receivable		3,314,665	–	3,314,665
Inventories		2,701,962	–	2,701,962
Prepaid expenses and deposit		273,980	–	273,980
Investment tax credits and recoverable		60,000	–	60,000
Assets held for sale		184,124	–	184,124
		11,115,441	–	11,115,441
NON-CURRENT ASSETS				
Property and equipment	a, b, e	1,258,749	(506,871)	751,878
Intangible assets	b, c, e	3,736,065	(108,630)	3,627,435
		4,994,814	(615,501)	4,379,313
TOTAL ASSETS		$ 16,110,255	$ (615,501)	$ 15,494,754
LIABILITIES AND EQUITY				
CURRENT LIABILITIES				
Bank indebtedness		$ 1,507,879	$ –	$ 1,507,879
Accounts payable and accrued liabilities	f	5,834,886	(853,252)	4,981,634
Provisions	f	–	853,252	853,252
Deferred revenue		69,821	–	69,821
Income taxes payable		99,893	–	99,893
Current portion of long-term debt		196,460	–	196,460
		7,708,939	–	7,708,939
NON-CURRENT LIABILITIES				
Long-term debt		946,580	–	946,580
Convertible debentures	d	676,576	14,445	691,021
		1,623,156	14,445	1,637,601
TOTAL LIABILITIES		9,332,095	14,445	9.346,540
EQUITY				
Share capital		20,079,555	–	20,079,555
Warrants		45,500	–	45,500
Contributed surplus		1,661,801	–	1,661,801
Other paid-in capital	d	290,980	(56,027)	234,953
Deficit	g	(15,299,676)	(317,587)	(15,617,263)
Accumulated other comprehensive income	e	–	(256,332)	(256,332)
		6,778,160	(629,946)	6,148,214
TOTAL LIABILITIES AND EQUITY		$ 16,110,255	$ (615,501)	$ 15,494,754

17. EXPLANATION OF TRANSITION TO IFRS (CONTINUED)

Reconciliation of comprehensive income

Three months ended December 31, 2010	Note	Canadian GAAP	Effect of transition to IFRS	IFRS
SALES		$ 5,094,773	$ –	$ 5,094,773
COST OF SALES	a	3,989,718	(75)	3,989,643
GROSS MARGIN		1,105,055	75	1,105,130
OPERATING EXPENSES				
Sales and marketing	b	437,389	87,438	524,827
Research and development	b	76,213	80,259	156,472
General and administration	b, d	654,613	14,859	669,472
Depreciation of property and equipment	a, b	38,738	(38,738)	–
Amortization of intangible assets	b, c	160,677	(160,677)	–
Total operating expenses		1,367,630	(16,859)	1,350,771
LOSS BEFORE OTHER ITEMS		(262,575)	16,934	(245,641)
OTHER ITEMS				
Foreign exchange loss (gain)	e	(11,099)	(79,966)	(91,065)
Finance income		–	–	–
Finance costs	d	91,159	(3,254)	87,905
Loss on sale of assets		17,099	–	17,099
Total other items		97,159	(83,220)	13,939
LOSS BEFORE INCOME TAXES		(359,734)	100,154	(259,580)
INCOME TAXES				
Current income tax expense		–	–	–
Deferred income tax expense		–	–	–
Total income tax expense		–	–	–
NET LOSS FOR THE PERIOD		(359,734)	100,154	(259,580)
OTHER COMPREHENSIVE INCOME (LOSS)				
Foreign currency translation differences – foreign operations	e	–	(124,798)	(124,798)
TOTAL COMPREHENSIVE LOSS FOR THE PERIOD		$ (359,734)	$ (24,644)	$ (384,378)

17. EXPLANATION OF TRANSITION TO IFRS (CONTINUED)

Reconciliation of comprehensive income (continued)

Six months ended December 31, 2010	Note	Canadian GAAP	Effect of transition to IFRS	IFRS
SALES		$ 9,433,864	$ –	$ 9,433,864
COST OF SALES	a	7,379,416	955	7,380,371
GROSS MARGIN		2,054,448	(955)	2,053,493
OPERATING EXPENSES				
Sales and marketing	b	1,024,073	168,526	1,192,599
Research and development	b	146,552	128,556	275,108
General and administration	b, d	1,422,399	(13,574)	1,408,825
Depreciation of property and equipment	a, b	77,015	(77,015)	–
Amortization of intangible assets	b, c	283,034	(283,034)	–
Total operating expenses		2,953,073	(76,541)	2,876,532
LOSS BEFORE OTHER ITEMS		(898,625)	75,586	(823,039)
OTHER ITEMS				
Foreign exchange loss (gain)	e	3,094	(158,548)	(155,454)
Finance income		–	–	–
Finance costs	d	183,753	(4,778)	178,975
Long-lived asset impairment		–	–	–
Loss on sale of assets		39,838	–	39,838
Total other items		226,685	(163,326)	63,359
LOSS BEFORE INCOME TAXES		(1,125,310)	238,912	(886,398)
INCOME TAXES				
Current income tax expense		–	–	–
Deferred income tax expense		–	–	–
Total income tax expense		–	–	–
NET LOSS FOR THE PERIOD		(1,125,310)	238,912	(886,398)
OTHER COMPREHENSIVE INCOME (LOSS)				
Foreign currency translation differences – foreign operations	e	–	(256,332)	(256,332)
TOTAL COMPREHENSIVE LOSS FOR THE PERIOD		$ (1,125,310)	$ (17,420)	$ (1,142,730)

17. EXPLANATION OF TRANSITION TO IFRS (CONTINUED)

Reconciliation of cash flows

There are no material differences between the statement of cash flows presented under IFRS and the statement of cash flows presented under previous Canadian GAAP.

Notes to the reconciliations

(a) Property and equipment

The Company elected under IFRS 1 *First-time adoption of IFRS*, to measure certain items of property and equipment at fair value and to deem the fair value as the new carrying cost as of July 1, 2010. Fair value was determined by a third party certified asset appraiser.

(b) Depreciation and amortization expenses

Under IFRS the Company has adopted classification of expenses by function in the Statement of Comprehensive Income. Depreciation and amortization expenses have been reclassified to the appropriate functional classification.

(c) Intangible assets

The Company assessed the recoverable amount of its CGUs at July 1, 2010 on transition to IFRS. The recoverable amount was based on a value in use calculation. Under Canadian GAAP, the recoverable amount was calculated on an undiscounted basis, using higher long-term growth assumptions than are permissible under IFRS, and no impairment was recognized.

Impairment testing was performed as at July 1, 2010 in accordance with IFRS, based on a value in use calculation.

Based on the value in use assessment, the carrying amount of the Canada CGU was determined to be $164,020 higher than its recoverable amount and an impairment loss was recognized. The impairment loss was allocated to property and equipment ($53,500) and pro rata to the intangible assets ($110,520) comprising the Canada CGU.

As described in note 6, in accordance with IFRS, the Company recognized a further impairment loss with respect to the Canada CGU at June 30, 2011 in the amount of $1,096,000.

(d) Convertible debentures

In accordance with IFRS the Company has restated the allocation of the proceeds assigned to the debt and equity components on the issuance of convertible debentures on August 17, 2010. Under Canadian GAAP, the proceeds were allocated based on the relative fair values. Under IFRS, the proceeds assigned to the debt and conversion option are allocated based on the fair value of the Debentures with the residual being allocated to the Conversion Option.

Under IFRS, directly attributable transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts. Under Canadian GAAP the Company had elected a policy to expense Debenture transaction costs as incurred.

16. EXPLANATION OF TRANSITION TO IFRS (CONTINUED)

The impact arising from these changes is summarized below:

		Three months ended December 31, 2010		Six months ended December 31, 2010
Consolidated statement of comprehensive income:				
Capitalization of debenture issue costs	$	3,242	$	(36,804)
Decrease in accretion of convertible debentures		(3,254)		(4,778)
Adjustment to Net loss	$	(12)	$	(41,582)

(e) Foreign currency translation – foreign operations

Under IFRS the Company has determined that the functional currency of the U.S. operating subsidiary, Sentry Armor Systems Inc., is the U.S. dollar. Sales prices, labour and material costs of the U.S. operating subsidiary are determined in U.S. dollars which are primary indicators of the functional currency in accordance with IFRS. Under Canadian GAAP, the U.S. operating subsidiary was accounted for as an integrated foreign operation. The U.S. operating subsidiary is generating positive cash flows in U.S. dollars and is no longer dependent on funding from the Canadian parent company.

The Company elected, under IFRS 1 *First-time adoption of IFRS*, to deem all foreign currency translation differences that arose prior to the date of transition to be nil at the date of transition. As a result foreign currency translation differences in the amount of $68,585 were reclassified to Deficit on July 1, 2010.

Cumulative foreign currency translation differences with respect to the U.S. operating subsidiary were $(256,332) and $(367,813) at December 31, 2010 and June 30, 2011, respectively, resulting in a reduction to foreign exchange losses recorded under Canadian GAAP. Under IFRS foreign currency translation differences are recorded in other comprehensive income.

(f) Provisions

Provisions for warranties, restructuring costs and onerous contracts were reclassified to Provisions under IFRS. They were previously classified as Accounts payable and accrued liabilities under Canadian GAAP.

(g) Deficit

The above adjustments to Deficit for differences between IFRS and Canadian GAAP can be summarized as follows:

		December 31, 2010
Property and equipment, fair value adjustment (a)	$	323,894
Impairment (a) (c)		164,020
Depreciation and amortization (a) (c)		(38,782)
Loss on sale of assets (c)		–
Debenture transaction costs (d)		(36,804)
Debenture accretion (d)		(4,778)
Foreign exchange losses (e)		(256,332)
Effect of movements in exchange rates (a) (c) (e)		166,369
TOTAL ADJUSTMENTS	$	317,587