



Pacific Safety Products Inc.

REPORT TO SHAREHOLDERS

MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE
YEARS ENDED June 30, 2010 and 2009

Management's Discussion and Analysis

June 30, 2010 and 2009

(in thousands of 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 October 28, 2010 and should be read in conjunction with the audited consolidated financial statements and the notes therein. 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**.

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 strategy, direction, plans 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, restrictions and covenants contained in the Company's credit agreements and the existence of defaults under such covenants, failure to consummate the proposed merger, 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 or downsizing initiatives, 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 VIII: 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 October 28, 2010, 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 Strategy
- II. Results
- III. Cash Flow
- IV. Liquidity and Capital Resources
- V. Summary of Annual Information
- VI. Quarterly Results
- VII. Critical Accounting Estimates, Changes to Accounting Policies
- VIII. Risks and Uncertainties
- IX. Other Information

Part I: BUSINESS OVERVIEW AND STRATEGY

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 also provides specialized law enforcement and safety products through APS Distributors ("APS"), a division of PSP that services law enforcement and public safety agencies across Canada. 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 maintain its core body armour market while growing its portfolio of products so that more of what a customer wears or carries to the front line is sold by PSP.

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, 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, a distribution centre in Bedford, Nova Scotia and its head office is located in Ottawa, Ontario. Its design and production facilities are all ISO9001 compliant. Founded in 1984, PSP has grown to currently include more than 160 employees at its Canadian and U.S. facilities.

Throughout the year, the Company violated certain covenants as stipulated in its operating line credit facility with its principal Canadian lender (the "Bank"), and, in particular, the Company did not achieve its target ratio of debt to tangible net worth. On May 12, 2010, the Company entered into an arrangement agreement (the "Arrangement Agreement") with Revision Eyewear Inc. ("Revision"). The Arrangement Agreement contemplated that all of the outstanding common shares of PSP would be purchased by Revision at a price of \$0.18 per Common Share, payable in cash at closing. On May 25, 2010, the Company was notified by the Bank that it would continue to waive the covenant violations, subject to no further deterioration in the Company's financial position, confirmation of shareholder approval of the acquisition by Revision and the payment in full of all outstanding lines of credit by June 30, 2010.

On June 15, 2010, the Company announced that it agreed with Revision to terminate the Arrangement Agreement as several of PSP's larger shareholders had indicated that they would not support the Arrangement Agreement, and it was apparent that there was insufficient shareholder support to obtain the required two-thirds approval of the shareholders. On August 18, 2010, the Company sold certain of PSP's headborne systems, in particular, the helmet liner capability, to Revision for \$275,000 and a 4% royalty on gross sales over a five-year period (the "Headborne Sale"). On September 14, 2010, Revision exercised an option to purchase the remainder of the headborne systems for an additional \$100,000 and a 2.5% royalty on gross sales over a five-year period.

On June 24, 2010, the Company was notified by the Bank that the Company had not met the conditions stipulated in its letter of May 25, 2010 and, as a result, the Company was subjected to, among other things; (i) a reduction in the operating line to \$3 million from \$5 million, (ii) more stringent reporting requirements, and (iii) preparing detailed projections for the 2011 fiscal year, showing maintenance of the Bank's covenants at all times.

The Company signed a forbearance agreement (the "Forbearance Agreement") with the Bank on August 17, 2010. Under the terms of the Forbearance Agreement, additional general and financial covenants have been placed on the Company. The Bank has agreed, pursuant to the Forbearance Agreement, not to take steps to realize under the facility prior to February 28, 2011 (the "Forbearance Period") unless a terminating event as defined in the Forbearance Agreement occurs. In connection with the Forbearance Agreement, the Company notified the holder of long-term debt (the "Lender") and its U.S. operating lender.

A condition of the Company's Forbearance Agreement with its Bank required the Company to request from the Lender a six-month postponement of principal payments related to its long-term debt. The Lender has agreed to this request pursuant to a letter agreement dated August 4, 2010. All other terms and conditions of the debt facility remain unchanged.

On August 18, 2010, the Company issued a \$1 million unsecured convertible debenture in favour of a group of investors.

On October 20, 2010, the Company announced that it had signed a letter of intent (the "LOI") to complete a business combination ("Merger") by way of a court approved plan of arrangement of Zuni Holdings Inc. ("Zuni"), an NEX listed company. Under the LOI, PSP has agreed to acquire 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. Following completion of the Merger, PSP will be owned 45.8% by current PSP shareholders and 54.2% by current Zuni shareholders, based on the current shares issued and outstanding. On a partially diluted basis, assuming exercise or conversion of all outstanding warrants and debentures of PSP, PSP will be owned 55.7% by current PSP shareholders and 44.3% by current Zuni shareholders. Subject to certain closing conditions, and non-solicitation and termination provisions, the Merger is currently expected to close in late December, 2010.

PSP believes this transaction will solidify its capital position and allow it to take advantage of growth opportunities that are available to the Company.

There can be no assurance that the Bank will not exercise its rights and remedies during the continuance of any defaults. In addition, if the Bank exercises its rights and remedies, there can be no assurance that a replacement facility can be obtained in order to permit the repayment of indebtedness under the Company's existing operating line credit facilities, or that, if such a replacement facility is obtained, it will be obtained at costs, or on terms and conditions, comparable to those of the Company's current indebtedness.

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 obtain the ongoing support of its lenders, restore profitable operations and raise additional capital.

The financial data has been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") 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.

Market Conditions

The Company continues to operate in a challenging environment as evidenced by decreased revenue and a recent history of losses. The reduced sales volume reflects reduced customer buying activity and increased competition as both domestic and foreign suppliers pursue market opportunities. This trend of market contraction was identified during the first quarter of the current fiscal year. While there have been some signs of improvement, management continues to monitor market conditions closely. Many of PSP's major customers are government departments and agencies at the federal, provincial and municipal levels. These organizations are increasingly coming under budget pressures as governments attempt to reduce spending in light of the current economic environment. This may translate into lower sales volume and a reduced number of larger bid opportunities for PSP. This is a trend which began in the U.S. market last year but was offset by an increase in international orders fulfilled out of the U.S. operation Sentry. As a result, revenues for the year ended June 30, 2010 were 14.8% lower than the prior year.

The Company has also witnessed an increase in competition in the Canadian market with the emergence of new competitors, including those managed by former PSP officers. Management believes that the existence of the Company's long-term contracts in Canada will moderate the effects of this competition in the near term.

In response to market conditions, companies are reducing or eliminating operations and in two recent cases, major U.S. competitors have been forced into bankruptcy protection. During its fiscal year 2010, PSP significantly reduced its expense base, including voluntary reduction and/or elimination of base and other compensation for senior management. These actions and others have helped the Company moderate the impact of the current operating environment on the Company's financial position.

Part II: RESULTS

SUMMARY OF OPERATIONS	YEAR ENDED JUNE 30, 2010	YEAR ENDED JUNE 30, 2009	YEAR ENDED JUNE 30, 2008
SALES	\$ 29,843,080	\$ 35,035,486	\$ 34,797,956
COST OF SALES	23,933,060	26,580,658	26,734,003
GROSS MARGIN	5,910,020	8,454,828	8,063,953
EXPENSES	7,638,964	8,612,638	9,117,853
LOSS BEFORE OTHER ITEMS AND TAXES	(1,728,944)	(157,810)	(1,053,900)
OTHER ITEMS	1,387,893	8,871,640	(292,426)
LOSS BEFORE INCOME TAXES	(3,116,837)	(9,029,450)	(761,474)
INCOME TAX EXPENSE (RECOVERY)	(67,655)	181,212	(540,583)
NET AND COMPREHENSIVE LOSS	\$ (3,049,182)	\$ (9,210,662)	\$ (220,891)
BASIC AND DILUTED LOSS PER SHARE	\$ (0.119)	\$ (0.361)	\$ (0.009)
WEIGHTED AVERAGE BASIC COMMON SHARES ISSUED AND OUTSTANDING	25,690,173	25,486,166	25,068,430
FINANCIAL POSITION	JUNE 30, 2010	JUNE 30, 2009	JUNE 30, 2008
TOTAL ASSETS	\$ 12,140,618	\$ 15,500,340	\$ 26,629,732
TOTAL LONG-TERM FINANCIAL LIABILITIES	\$ 946,580	\$ 1,160,900	\$ 875,580

Sales

Sales for the year ended June 30, 2010 were \$29.8 million, a decrease of \$5.2 million or 14.8% as compared to the prior year. The decrease is attributed to a decline in core law enforcement sales in both Canada and the United States primarily as a result of curtailed government spending in light of the current economic environment. Sales from Canadian operations for the year ended June 30, 2010 were \$21.1 million, a decline of \$4.0 million or 16.0% compared to the prior year. The decrease was primarily attributed to the decline in core law enforcement sales partially offset by an increase in contract sales to the Canadian Department of National Defence ("DND"). The Company witnessed a marked decline in order intake from its largest customers. Sales from U.S. operations for the year ended June 30, 2010 were \$8.7 million, a decrease of \$1.3 million or 12.0% compared to the prior year. The decrease is primarily related to a reduction in international law enforcement sales.

Gross Margin

For the year ended June 30, 2010, gross margin as a percentage of sales was 19.8%, which was 4.3% lower than gross margin of 24.1% during the prior year. The decrease is primarily related to product mix, increased inventory provisions and write-offs of \$1.1 million compared to \$0.1 million in the prior year, and increased price competition. The Company's product mix has shifted from primarily core law enforcement sales to more third party product sales as a result of a significant sale to a U.S. federal government agency during the first quarter of the current year. The prior year also included significant international law enforcement sales, which tend to have higher gross margins. The industry wide contraction in sales also resulted in increased price competition.

Expenses

For the year ended June 30, 2010, expenses were \$7.6 million, a decrease of \$1.0 million or 11.3% as compared to the prior year. The decrease in expenses is primarily related to cost reduction initiatives implemented over the last 12 months, partially offset by increased costs related to the Arrangement Agreement.

For the year ended June 30, 2010, sales and marketing expenses were \$2.8 million as compared to \$3.6 million during the prior year. The decrease is primarily related to cost reduction initiatives implemented over the past two fiscal years.

For the year ended June 30, 2010, research and development expenses were \$0.2 million as compared to \$0.3 million during the prior year. The development costs expense is primarily related to the certification of certain product lines as required by the U.S. Department of Justice and the development of products related to the Company's next generation integrated helmet program.

For the year ended June 30, 2010, general and administrative expenses were \$3.5 million as compared to \$3.4 million during the prior year. The change is primarily related to the cost reduction initiatives implemented over the past two years, offset by increased expenses related to the Arrangement Agreement.

For the year ended June 30, 2010, interest expense on the operating lines of credit was \$0.2 million, due to higher utilization, as compared to \$0.1 million during the prior year. For the year ended June 30, 2010, interest expense on the long-term debt was \$0.06 million as compared to \$0.08 million during the prior year.

Restructuring Expenses

During the year, the Company incurred restructuring costs of approximately \$0.2 million related to a reduction in its workforce in order to align the Company's cost structure with reduced revenue expectations. As at June 30, 2010, the Company has \$0.1 million included in accounts payable and accrued liabilities related to restructuring activities.

Write-down of Investment Tax Credits Recoverable

Given the decline in revenues as compared to the prior year and a lack of profitability, management determined that it no longer met the generally accepted criteria for the recognition of investment tax credits. As a result, the Company wrote down its investment tax credits recoverable by \$0.6 million.

Loss on Assets Held for Sale

On June 15, 2010, the Company announced its intent to sell its headborne system assets. The Company recorded a loss of approximately \$0.6 million to write down these assets to their fair value less costs to sell.

Income Taxes

Income taxes were calculated at an effective rate of 2% for the year ended June 30, 2010. 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 and Comprehensive Loss

For the year ended June 30, 2010, the Company recorded a net and comprehensive loss of \$3.0 million as compared to net and comprehensive loss of \$9.2 million during the prior year. The decrease in net and comprehensive loss is primarily due to the Goodwill impairment charge recognized in the prior year, partially offset by a reduction in gross margin, the loss on sale of the Headborne assets, and write-down of investment tax credits recoverable during the current year.

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 and comprehensive loss and excludes interest, income tax expense / (recovery), depreciation and amortization. Adjusted EBITDA excludes stock-based compensation and one-time costs. 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 and comprehensive income (loss). The following is a reconciliation of the Company's Adjusted EBITDA to net and comprehensive loss.

For the year ended June 30, 2010 Adjusted EBITDA was a loss of \$0.5 million compared to an Adjusted EBITDA of \$1.2 million during the same period of the prior year. The decrease is primarily related to reduced sales volume and gross margins, partially offset by reduced operating expenses.

The following is a reconciliation of Net and Comprehensive Loss to Adjusted EBITDA:

	YEAR ENDED JUNE 30, 2010	YEAR ENDED JUNE 30, 2009	YEAR ENDED JUNE 30, 2008
Net and comprehensive loss	\$ (3,049,182)	\$ (9,210,662)	\$ (220,891)
Interest expense	268,890	206,977	273,231
Income taxes (recovery)	(67,655)	181,212	(540,583)
Stock-based compensation	17,185	167,795	158,811
Amortization	971,132	1,019,238	1,049,909
Gain on sale of building	-	-	(1,432,183)
Restructuring/relocation costs	188,545	417,419	1,139,757
Loss on assets held for sale	609,422	-	-
Write-down of investment tax credits recoverable	589,926	-	-
Goodwill impairment charge	-	8,454,221	-
Adjusted EBITDA	\$ (471,737)	\$ 1,236,200	\$ 428,051

Part III: CASH FLOW

CASH FLOW FROM (USED IN)	YEAR ENDED JUNE 30, 2010	YEAR ENDED JUNE 30, 2009	YEAR ENDED JUNE 30, 2008
Operating activities	\$ 1,431,446	\$ 19,220	\$ 547,714
Investing activities	(896,554)	(1,144,435)	(2,063,133)
Financing activities	(754,874)	687,940	1,284,532
	\$ (219,982)	\$ (437,275)	\$ (230,887)

Cash flow from operating activities for the year ended June 30, 2010 was \$1.4 million as compared to \$0.02 million during the prior year. The increase in cash flow from operating activities is primarily due to reduced investment in working capital related to the decline in sales volume.

Cash flow used in investing activities for the year ended June, 2010 was \$0.9 million as compared to \$1.1 million during the prior year. The decrease was due to reduced spending on property and equipment.

Cash flow used in financing activities for the year ended June 30, 2010 was \$0.8 million as compared to cash flow generated of \$0.7 million during the same period of the prior year. The decrease is primarily due to increased repayments on the Company's operating lines of credit as a result of reduced working capital requirements on lowered sales volume and reduced operating costs.

Part IV: LIQUIDITY AND CAPITAL RESOURCES

AS AT	JUNE 30, 2010	JUNE 30, 2009
Cash	\$ -	\$ 219,982
Operating lines of credit	(2,410,390)	(2,965,659)
Working capital (excluding assets held for sale)	98,489	2,171,088
Long-term debt (long-term portion only)	946,580	1,160,900
Shareholders' equity	4,634,541	7,651,824

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 facilities 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 2011 primarily related to ongoing repairs and maintenance. In order to address the Company's cash requirements, it has signed an LOI to complete a Merger with Zuni.

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 facilities, 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 June 30, 2010, PSP's working capital was \$0.1 million, excluding assets held for sale, as compared to a surplus of \$2.2 million as at June 30, 2009. The decrease in working capital is primarily related to the reduction in inventory net of reserves during the current year.

Accounts receivable as at June 30, 2010 were \$4.2 million compared to \$4.0 million as at June 30, 2009. The level of accounts receivable reflects the consistent level of sales in the fourth quarter of 2010 compared to the same period in the prior year.

Inventory as at June 30, 2010 decreased by \$1.9 million to \$2.3 million as compared to \$4.2 million as at June 30, 2009. This decrease is primarily related to reduced sales volume, increased inventory provisions related to delays in DND order intake and the completion of a significant DND contract during the year.

Bank Indebtedness

PSP has an agreement with the Bank to provide advances repayable on demand with interest payable monthly calculated at the bank prime lending rate plus 3.50% per annum. The loan is secured by a first priority general security agreement over Canadian accounts receivable and inventory. The maximum operating line is \$3.0 million and is subject to margin requirements and covenants set by the Bank. At June 30, 2010, the amount drawn on the line of credit was \$1.9 million.

PSP is required to meet certain covenants as outlined in its credit facility agreement with the Bank. At September 30, 2009, December 31, 2009, March 31, 2010 and June 30, 2010, the Company did not meet certain covenants as stipulated in its credit facility. The Bank has agreed, pursuant to a Forbearance Agreement dated August 17, 2010, not to take steps to realize under the facility prior to February 28, 2011 unless a terminating event as defined in the Forbearance Agreement occurs. During this Forbearance Period, the Company will be subject to amended financial covenants.

Sentry has 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 is secured by a first priority general security agreement over U.S. accounts receivable, inventory and an assignment of insurance. The maximum operating line is \$1.4 million USD and is subject to margin requirements and covenants set by the lenders. At June 30, 2010, the amount drawn on the line of credit was \$0.5 million.

Long-term Debt

The Company has a \$1.4 million secured term loan with the Business Development Bank of Canada ("BDC"). A condition of the Company's Forbearance Agreement with its Bank required the Company to request from BDC a six-month postponement of principal payments related to its long-term debt. BDC has agreed, pursuant to a letter agreement dated August 4, 2010, to this request. All other terms and conditions of the debt facility remain unchanged.

Future Income Taxes

At June 30, 2010, the Company had approximately \$3.0 million in Canadian non-capital tax loss carry forwards and \$2.8 million USD in U.S. tax loss carry forwards available. As at June 30, 2010, the Company increased its income tax valuation allowance by \$0.7 million to \$3.0 million from \$2.3 million. The increase is primarily related to the lack of profitability of the Company in the past several years.

Equity Instruments and Contributed Surplus

At June 30, 2010, the Company's issued and outstanding shares were 25,741,153 compared to 25,654,605 at June 30, 2009. The Company's Contributed Surplus balance was \$1.2 million at June 30, 2010 and June 30, 2009.

Contractual Obligations

The Company has obligations under long-term operating leases for premises and office equipment for various periods up to July, 2017.

Future minimum annual lease payments over the next five years and thereafter are as follows:

2011	\$	748,778
2012		696,198
2013		655,512
2014		646,045
2015		646,788
Thereafter		1,254,596
	\$	4,647,917

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 debt, 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" and "Long-term Debt".

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. As at June 30, 2010, the Company was in breach of certain financial covenants. See "Bank Indebtedness" and "Long-term Debt".

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

Part V: SUMMARY OF ANNUAL INFORMATION

(In Canadian dollars, except per share amounts)	Year ended June 30, 2010	Year ended June 30, 2009	Year ended June 30, 2008
Sales	\$ 29,843,080	\$ 35,035,486	\$ 34,797,956
Net and comprehensive loss for the year	(3,049,182)	(9,210,662)	(220,891)
Basic and diluted loss per share	(0.119)	(0.361)	(0.009)
Total assets	12,140,618	15,500,340	26,629,732
Total long-term financial liabilities	946,580	1,160,900	875,580

Part VI: QUARTERLY RESULTS

Fiscal 2010

(In Canadian dollars, except per share amounts)

	June 30, 2010	March 31, 2010	December 31, 2009	September 30, 2009
Sales	\$ 7,077,862	\$ 7,698,489	\$ 7,437,348	\$ 7,629,381
Net and comprehensive loss	(2,439,037)	(87,378)	(158,984)	(363,783)
Basic and diluted loss per share	(0.09)	–	(0.01)	(0.01)

Fiscal 2009

(in Canadian dollars, except
per share amounts)

	June 30, 2009	March 31, 2009	December 31, 2008	September 30, 2008
Sales	\$ 7,187,674	\$ 10,548,654	\$ 9,592,792	\$ 7,706,366
Loss and comprehensive loss	(9,677,628)	417,451	41,758	7,757
Basic and diluted loss per share	(0.38)	0.02	–	–

Significant Fluctuations in Quarterly Results

For the three months ended June 30, 2010, the Company recorded a loss from operations of \$2.4 million or \$0.09 per share. The increase in the loss compared to the prior quarter is primarily due to the reduction in sales and gross margin, costs associated with the Arrangement Agreement and the Headborne sale, and the write-down of investment tax credits.

For the three months ended June 30, 2009, the Company recorded a loss from operations of \$9.7 million or \$0.38 per share. The increase in the loss compared to the prior quarter is primarily due to a goodwill impairment charge of \$8.5 million.

Sales

Sales for the three months ended June 30, 2010 were \$7.1 million, a decrease of \$0.1 million or 1.5% as compared to the same period of the prior year. The decrease is primarily related to a decline in contract sales to DND due to the completion of a significant contract award, partially offset by increased sales from core U.S. law enforcement.

Gross Margin

For the three months ended June 30, 2010, gross margin as a percentage of sales was 17.8%, which was 3.9% lower than gross margin of 21.7% during the same period of the prior year. The decrease was primarily related to an increase in inventory provisions related to delays in the DND programs.

Expenses

For the three months ended June 30, 2010, expenses were \$2.2 million, which is consistent with the same period of the prior year.

For the three months ended June 30, 2010, sales and marketing expenses were \$0.6 million as compared to \$0.8 million during the same period of the prior year. The decrease is primarily related to cost reduction initiatives implemented during the year.

For the three months ended June 30, 2010, research and development expenses were \$0.03 million compared to \$0.09 million during the same period of the prior year. Expenses included in this category include the costs related to ballistic research materials, testing, product designs, patterns, labour and overhead.

For the three months ended June 30, 2010, general and administration expenses were \$1.2 million as compared to \$0.9 million during the same period of the prior year. The increase is primarily related to expenses related to the Arrangement Agreement mostly offset by cost reduction initiatives implemented during the year.

For the three months ended June 30, 2010, interest expense on the operating lines of credit was \$0.06 million compared to \$0.02 million during the same period of the prior year. Interest expense on long-term debt for the three months ended June 30, 2010, was \$0.01 million compared to \$0.02 million during the same period of the prior year.

Write-down of Investment Tax Credits Recoverable

Given the decline in revenue as compared to the prior year and a lack of profitability, management determined that it no longer met the generally accepted criteria for the recognition of investment tax credits. As a result, the Company wrote down its investment tax credits recoverable by \$0.6 million.

Loss on Assets Held for Sale

On June 15, 2010, the Company announced its intent to sell its headborne system assets. The Company recorded a loss of approximately \$0.6 million to write down these assets to their fair value less costs to sell.

Net and Comprehensive Loss

For the three months ended June 30, 2010, the Company recorded a net and comprehensive loss of \$2.4 million as compared to net and comprehensive loss of \$9.7 million during the same period of the prior year. The decrease in net and comprehensive loss is primarily due to the Goodwill impairment charge during the prior year, partially offset by a reduction in gross margin, loss on sale of Headborne assets, and write-down of investment tax credits receivable during the period.

Part VII: CRITICAL ACCOUNTING ESTIMATES, CHANGES TO ACCOUNTING POLICIES

Critical Accounting Estimates

The Company's significant accounting policies are described in note 2 to the consolidated financial statements. Management believes that the policies which are most subject to estimation and management's judgment are outlined below.

Property and Equipment

Amortization is recorded on property and equipment at rates ranging from 20% to 30% of the diminishing balance per year, based on the determination of their estimated useful lives. This determination is based on management's estimates. In the event that these estimates prove incorrect, the computation of amortization will not be appropriately reflected in future periods, or could result in recognition of an impairment loss in the consolidated statements of operations in future periods.

Product Development Costs

The Company recognizes certain costs related to the design and development of a modified or new product or process as an intangible asset if it is probable the expected future economic benefits attributable to the asset will flow to the Company and the cost can be measured reliably. In the event that the probability of future economic benefits proves incorrect, it could result in increased amortization expense, or the recognition of an impairment loss in future periods.

Future Tax Asset

The Company has a future tax asset of \$Nil. At June 30, 2010, the Company had approximately \$3.0 million in Canadian non-capital tax loss carry forwards and \$2.8 million USD of U.S. non-capital tax loss carry forwards available to reduce taxable income in future years. If the Company is able to generate sufficient taxable income to use these non-capital loss carry forwards, and to otherwise qualify according to local tax laws, then future tax expense on future years' taxable income could be reduced below the expected statutory amounts. The unused non-capital tax losses will expire between 2026 and 2030.

Intangibles

Amortization is recorded on acquired customer relationships, trade names and other intangibles on a straight-line basis over 3 to 15 years, which are the estimated useful lives of the assets. This determination is based on management's estimates. In the event that these estimates prove incorrect, the computation of amortization will be adjusted in future periods, or could result in recognition of an impairment loss in future periods.

Other Estimates

The Company also makes estimates for inventory obsolescence, doubtful accounts receivable, assets held for sale, stock-based compensation, future income taxes, investment tax credits recoverable, and long-lived asset impairment.

Inventory obsolescence is based on several considerations, including age and condition, current market for the finished product, estimated future customer needs and generally the changes occurring in technologies which could impact the usefulness of the inventory. Based on these factors, inventory items may be declared obsolete, disposed of at market value, if any, and written off.

The Company estimates the collectability of accounts receivable based on historical experience, age of the receivables, the specific customer's indebtedness to the Company and general market conditions. Based on these factors, the Company determines an appropriate amount to be provided as an allowance for doubtful accounts.

The asset classified as held for sale is measured at the lower of carrying amount and fair value less costs to sell. The fair value is estimated based on current market conditions at the end of the year.

The Company records compensation expense for stock options using the fair value method. The fair value of each option grant is estimated at the date of grant using the Black-Scholes option-pricing model. To apply this application, assumptions are made regarding the following risk factors: risk-free interest rate, stock volatility, expected life and expected dividend yield. The Company determines these factors based on market conditions and other information available on the date of the grant.

The amounts accrued to recognize investment tax credits and future income tax assets are based on the Company's estimate that it will likely have sufficient future taxable income to utilize these losses.

Management assesses intangible assets, property and equipment and product development costs for impairment. Management also assesses the useful lives of these assets.

By their nature, these estimates are subject to measurement uncertainty and the effects of changes in estimates and judgments will be recorded in the period such changes are made.

Adoption of New Accounting Standards

In February 2008, the Canadian Institute of Chartered Accountants ("CICA") issued Section 3064, "Goodwill and Intangible Assets", which replaced the existing Section 3062, "Goodwill and Other Intangible Assets", and Section 3450, "Research and Development Costs". The new standard provides guidance on the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The Company adopted this standard as at July 1, 2009 and it has had no material impact on the financial position or results of operations of the Company.

Future Changes in Accounting Standards

In 2005, the Canadian Accounting Standards Board ("AcSB") announced that accounting standards in Canada are to converge with IFRS. On February 13, 2008, the AcSB confirmed that the use of IFRS will be required by January 1, 2011, with appropriate comparative data from the prior year. Under IFRS, the primary audience is capital markets and as a result, there is significantly more disclosure required. Further, while IFRS uses a conceptual framework similar to Canadian GAAP, there are significant differences in accounting policy that must be addressed.

The Company formally commenced an IFRS conversion project in the fourth quarter of fiscal year 2008 and engaged the services of an external advisor with IFRS expertise to work with management. The Company has developed an IFRS changeover plan in preparation for the conversion to IFRS which addresses the following key elements:

- (i) Accounting policy changes and the impact on financial reporting
- (ii) Financial reporting expertise and training requirements
- (iii) Data systems and information technology impact
- (iv) Internal Control over financial reporting
- (v) Impact on business activities

An assessment was completed to examine the extent of the impact that the conversion may have on financial reporting, business processes, internal controls and information systems. The Company's plan is aimed in particular at identifying the differences between IFRS and the Company's current accounting policies, as well as assessing the impact of various accounting alternatives offered pursuant to IFRS. PSP's assessment of key areas, including Income Taxes, Foreign Exchange, and Property and Equipment continued in the fourth quarter of fiscal year 2010.

The Company will continue to evaluate these and other key areas in the coming quarters. The financial impact of the transition to IFRS cannot be reasonably estimated at this time.

Part VIII: 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 on 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 cell-based manufacturing in which production staff are 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.

Pacific Safety Products Inc. is required to meet certain covenants as outlined in its credit facility with its Bank. At September 30, 2009, December 31, 2009, March 31, 2010 and June 30, 2010, the Company did not meet certain covenants as stipulated in its credit facility. Pursuant to the Forbearance Agreement, the Bank agreed not to take steps to realize under the facility during the Forbearance Period unless a terminating event as defined in the Forbearance Agreement occurs. During this Forbearance Period, the Company will be subject to amended financial covenants. Should the Company fail to meet any of the conditions imposed by its lender, it would in turn trigger events of default with the Company's other lenders. Management believes that this event would lead to significant uncertainty as the Company would be subject to the demands of its lenders.

Going Concern

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 obtain the ongoing support of its lenders, restore profitable operations and raise additional capital.

No Record of Recent Profitability

The Company has incurred cumulative losses of \$12.4 million in the last three fiscal years, including \$3.0 million in 2010, \$9.2 million in 2009, and \$0.2 million in 2008 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 technology 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.

Limited Managerial and Operating Resources

The Company's operations continue to a generate significant burden on the Company's limited management and operating resources, and may require that the Company hire additional employees and procure additional technical resources, as well as support and administrative personnel. There is no guarantee that the Company will be able to attract and keep the required personnel to meet its requirements or that it will be able to promptly satisfy customers' needs. The Company's business and operating results could be materially and unfavourably affected if it is not able to manage its limited resources.

Defaults under Credit Agreements

Credit facilities with the Bank and the U.S. operating lender are demand facilities. In the event the Merger is not completed, or other liquidity is not created during the Forbearance Period, 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 U.S. operating lender may also demand repayment. Given its present resources, the Company would not be able to repay the indebtedness. In addition, if the Bank exercises its rights and remedies, there can be no assurance that a replacement facility can be obtained in order to permit the repayment of indebtedness under the Company's existing credit facilities, or that, if such a replacement facility is obtained, it will be obtained at costs, or on terms and conditions, comparable to those of the Company's current indebtedness. Consequently, the Bank and/or the Lender and U.S. operating lender would then be able to avail themselves of a number of remedies, including the court appointment of a receiver for the Company.

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

Risks Relating to the Merger

The following is a summary of certain risk factors relating to the proposed merger of the Company and Zuni.

There can be no certainty that all conditions precedent to the Merger will be satisfied.

The completion of the Merger is subject to a number of conditions precedent, certain of which are outside the control of the Company. There can be no certainty that these conditions will be satisfied or, if satisfied, when they will be satisfied. If the Merger is not completed, the market price of the Common Shares may decline to the extent that the market price reflects a market assumption that the Merger will be completed. If the Merger is not completed and the Board of Directors decides to seek another transaction, there can be no assurance that it will be able to find a party willing to pay or accept an equivalent or more attractive price than that reflected in the agreed exchange ratio under the LOI.

The termination fee provided under the LOI may discourage other parties from delivering a Superior Proposal.

Under the Merger LOI, the Company may be required to pay a termination fee. If the Merger is terminated and within six months of such termination the terminating party enters into an agreement relating to the acquisition of a material portion of the shares of such party, or such party's assets or business in whole or in substantial part, and such alternative transaction is consummated, then upon closing of such transaction the terminating party will pay to the non-terminating party: (i) \$150,000 if no definitive agreement in respect of the Merger has been executed; or (ii) \$150,000 plus expenses incurred by the non-terminating party in relation to the Merger up to a maximum of \$100,000 if a definitive agreement in respect of the Merger has been executed. This termination fee may discourage other parties from delivering a superior proposal, even if those parties would otherwise be willing to offer greater value to shareholders than that offered under the LOI with Zuni.

Other Risks

Refer to the Company's June 30, 2010 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 IX: OTHER INFORMATION

The authorized share capital of the Company consists of an unlimited number of common shares. As of October 28, 2010, there were 25,741,153 common shares outstanding.

The financial data has been prepared in accordance with Canadian generally accepted accounting principles and is reported in Canadian dollars except where otherwise stated.

The information contained herein is given as at October 28, 2010.

Additional information relating to Pacific Safety Products Inc. is available on SEDAR at www.sedar.com.

Consolidated Financial Statements of

PACIFIC SAFETY PRODUCTS INC.

Years ended June 30, 2010 and 2009



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AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheet of Pacific Safety Products Inc. as at June 30, 2010 and the consolidated statements of operations, comprehensive loss and deficit and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at June 30, 2010 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The consolidated financial statements as at June 30, 2009 and for the year then ended were audited by other auditors, who expressed an opinion without reservation on those statements in their report, dated October 14, 2009.

A handwritten signature in black ink that reads 'KPMG LLP'. The signature is written in a cursive, slightly slanted style. Below the signature is a horizontal line that starts under the 'K' and ends under the 'P', with a small upward tick at the end.

Chartered Accountants, Licensed Public Accountants

Ottawa, Canada

October 28, 2010

**PACIFIC SAFETY PRODUCTS INC.
CONSOLIDATED BALANCE SHEETS**

AS AT JUNE 30

	2010	2009
ASSETS		
CURRENT ASSETS		
Cash	\$ —	\$ 219,982
Accounts receivable	4,154,435	3,969,566
Inventory (note 6)	2,258,874	4,192,903
Prepaid expenses and deposits	204,677	403,641
Investment tax credits recoverable (note 7)	40,000	—
Future income taxes (note 7)	—	13,120
Assets held for sale (note 5, 22)	250,215	—
Total current assets	6,908,201	8,799,212
INVESTMENT TAX CREDITS RECOVERABLE (note 7)	—	534,494
PROPERTY AND EQUIPMENT (note 8)	1,426,667	1,710,647
PRODUCT DEVELOPMENT COSTS (note 9)	1,049,423	1,378,038
INTANGIBLE ASSETS (note 10)	2,756,327	3,077,949
TOTAL ASSETS	\$ 12,140,618	\$ 15,500,340
LIABILITIES		
CURRENT LIABILITIES		
Operating lines of credit (note 11)	\$ 2,410,390	\$ 2,965,659
Accounts payable and accrued liabilities	3,841,698	3,310,591
Deferred revenue	93,089	137,554
Current portion of long-term debt (note 12)	214,320	214,320
Total current liabilities	6,559,497	6,628,124
FUTURE INCOME TAXES (note 7)	—	59,492
LONG-TERM DEBT (note 12)	946,580	1,160,900
TOTAL LIABILITIES	7,506,077	7,848,516
SHAREHOLDERS' EQUITY		
Equity instruments (note 13)	17,614,731	17,600,017
Contributed surplus (note 14)	1,194,176	1,176,991
Deficit	(14,174,366)	(11,125,184)
Total shareholders' equity	4,634,541	7,651,824
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 12,140,618	\$ 15,500,340

Going concern (note 1)
Commitments (note 19)
Subsequent events (note 22)

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

ON BEHALF OF THE BOARD OF DIRECTORS:



Douglas Lucky, Director



Daniel Marks, Executive Chairman of the Board

PACIFIC SAFETY PRODUCTS INC.
CONSOLIDATED STATEMENTS OF OPERATIONS, COMPREHENSIVE LOSS AND DEFICIT

FOR THE YEARS ENDED JUNE 30

	2010	2009
SALES	\$ 29,843,080	\$ 35,035,486
COST OF SALES (note 6)	23,933,060	26,580,658
GROSS MARGIN	5,910,020	8,454,828
EXPENSES		
Sales and marketing	2,795,433	3,639,480
Research and development	225,694	269,551
General and administration	3,530,564	3,408,373
Interest on operating lines of credit	208,931	125,647
Interest on long-term debt	59,959	81,330
Foreign exchange losses	80,923	291,212
Amortization of property and equipment	205,929	197,416
Amortization of intangible assets and product development costs	531,531	599,629
Total expenses	7,638,964	8,612,638
LOSS BEFORE OTHER ITEMS	(1,728,944)	(157,810)
OTHER ITEMS		
Loss on assets held for sale (note 5)	609,422	—
Asset impairment and other charges (note 20)	—	8,454,221
Write-down of investment tax credits recoverable (note 7)	589,926	—
Restructuring charge (note 18)	188,545	417,419
Total other items	1,387,893	8,871,640
LOSS BEFORE INCOME TAXES	(3,116,837)	(9,029,450)
INCOME TAXES		
Current income tax recovery	(21,283)	(330,833)
Future income tax expense (recovery)	(46,372)	512,045
Total income tax expense (recovery) (note 7)	(67,655)	181,212
NET AND COMPREHENSIVE LOSS	(3,049,182)	(9,210,662)
DEFICIT, BEGINNING	(11,125,184)	(1,914,522)
DEFICIT, ENDING	\$ (14,174,366)	\$ (11,125,184)
LOSS PER SHARE		
BASIC AND DILUTED	\$ (0.119)	\$ (0.361)
WEIGHTED AVERAGE COMMON SHARES ISSUED AND OUTSTANDING		
BASIC AND DILUTED	25,690,173	25,486,166

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

PACIFIC SAFETY PRODUCTS INC.
CONSOLIDATED STATEMENTS OF CASH FLOW

FOR THE YEARS ENDED JUNE 30

	2010	2009
OPERATING ACTIVITIES		
Cash receipts from customers	\$ 29,613,745	\$ 35,665,376
Cash paid to suppliers and employees	(27,934,159)	(35,342,129)
Interest paid	(268,890)	(206,977)
Investment tax credits recovered	41,300	(97,050)
Income taxes paid	(20,550)	-
CASH FLOW FROM OPERATING ACTIVITIES	1,431,446	19,220
INVESTING ACTIVITIES		
Purchase of property and equipment	(206,461)	(447,499)
Investment in new product development	(665,604)	(682,479)
Investment in intangible assets	(24,489)	(14,457)
CASH FLOW USED IN INVESTING ACTIVITIES	(896,554)	(1,144,435)
FINANCING ACTIVITIES		
Proceeds from the issue of long-term debt	-	500,000
Repayment of long-term debt	(214,320)	(524,780)
Increase (decrease) in operating lines of credit	(555,268)	697,156
Proceeds from the issue of equity instruments	14,714	15,564
CASH FLOW FROM (USED IN) FINANCING ACTIVITIES	(754,874)	687,940
DECREASE IN CASH	(219,982)	(437,275)
CASH, BEGINNING	219,982	657,257
CASH, ENDING	\$ -	\$ 219,982

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

PACIFIC SAFETY PRODUCTS INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2010 AND 2009

Pacific Safety Products Inc. ("PSP"), incorporated under the British Columbia Business Corporations Act, manufactures, distributes and sells a complete line of protective products and accessories for the defence and security market. 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. APS Distributors ("APS") is a division of PSP located in Bedford, Nova Scotia and was acquired by PSP on October 31, 2007.

1. GOING CONCERN

These audited consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") 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 reported a net loss of \$3.0 million for the year ended June 30, 2010 and has working capital of only \$0.1 million, (excluding assets held for sale), and a deficit of \$14.2 million as at June 30, 2010. In addition, as described below, the Company has recently had to seek waivers from its lenders related to covenant violations on borrowings and entered into a forbearance agreement with its lenders.

Throughout the year, the Company violated certain covenants as stipulated in its operating line of credit facility with its principal Canadian lender (the "Bank"), and, in particular, the Company did not achieve its target ratio of debt to tangible net worth. On May 12, 2010, the Company entered into an arrangement agreement (the "Arrangement Agreement") with Revision Eyewear Inc. ("Revision"). The Arrangement Agreement contemplated that all of the outstanding common shares of PSP would be purchased by Revision at a price of \$0.18 per Common Share, payable in cash at closing. On May 25, 2010, the Company was notified by the Bank that it would continue to waive the covenant violations, subject to no further deterioration in the Company's financial position, confirmation of shareholder approval of the acquisition by Revision and the payment in full of all outstanding lines of credit by June 30, 2010.

On June 15, 2010, the Company announced that it agreed with Revision to terminate the Arrangement Agreement as several of PSP's larger shareholders had indicated that they would not support the Arrangement Agreement, and it was apparent that there was insufficient shareholder support to obtain the required two-thirds approval of the shareholders. On August 18, 2010, the Company sold certain of PSP's headborne systems, in particular, the helmet liner capability, to Revision for \$275,000 and a 4% royalty on gross sales over a five-year period (the "Headborne Sale"). On September 14, 2010, Revision exercised an option to purchase the remainder of the headborne systems for an additional \$100,000 and a 2.5% royalty on gross sales over a five-year period.

On June 24, 2010, the Company was notified by the Bank that the Company had not met the conditions stipulated in its letter of May 25, 2010 and, as a result, the Company was subjected to, among other things; (i) a reduction in the operating line to \$3 million from \$5 million, (ii) more stringent reporting requirements, and (iii) preparing detailed projections for the 2011 fiscal year, showing maintenance of the Bank's covenants at all times.

The Company signed a forbearance agreement (the "Forbearance Agreement") with the Bank on August 17, 2010. Under the terms of the Forbearance Agreement, additional general and financial covenants have been placed on the Company. The Bank has agreed, pursuant to the Forbearance Agreement, not to take steps to realize under the facility prior to February 28, 2011 (the "Forbearance Period") unless a terminating event as defined in the Forbearance Agreement occurs. In connection with the Forbearance Agreement, the Company notified the holder of long-term debt (the "Lender") and its U.S. operating lender.

A condition of the Company's Forbearance Agreement with its Bank required the Company to request from the Lender a six-month postponement of principal payments related to its long-term debt. The Lender has agreed to this request pursuant to a letter agreement dated August 4, 2010. All other terms and conditions of the debt facility remain unchanged (note 12).

On August 18, 2010, the Company issued a \$1 million unsecured convertible debenture in favour of a group of investors (note 22).

1. GOING CONCERN (continued)

On October 20, 2010, the Company announced that it had signed a letter of intent (the "LOI") to complete a business combination ("Merger") by way of a court approved plan of arrangement of Zuni Holdings Inc. ("Zuni"), an NEX listed company.

There can be no assurance that the Bank will not exercise its rights and remedies during the continuance of any defaults. In addition, if the Bank exercises its rights and remedies, there can be no assurance that a replacement facility can be obtained in order to permit the repayment of indebtedness under the Company's existing credit facilities, or that, if such a replacement facility is obtained, it will be obtained at costs, or on terms and conditions, comparable to those of the Company's current indebtedness.

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 obtain the ongoing support of its lenders, restore profitable operations and raise additional capital. These consolidated 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.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles and include the accounts of Pacific Safety Products Inc. and its wholly-owned subsidiaries, Nexus and Sentry. All intercompany transactions and balances are eliminated on consolidation.

Cash

Cash consists of unrestricted cash in bank accounts.

Inventory

Raw materials are measured at the lower of weighted average cost and net realizable value. Work-in-process and finished goods and samples are measured at the lower of average cost, which includes direct manufacturing expenses and an allocation of overhead, and net realizable value.

Property and Equipment

Property and equipment is recorded at cost. Amortization of property and equipment is calculated using the following methods and annual rates:

Office equipment	20% diminishing balance
Manufacturing equipment	20% diminishing balance
Computer equipment	30% diminishing balance
Test and design equipment	30% diminishing balance
Leasehold improvements	straight-line over five years or the term of the lease

Product Development Costs

Research and development costs include out-of-pocket cost and direct overhead. Research costs are expensed as incurred and are reduced by related government assistance and tax incentives. Product development costs are expensed as incurred unless they meet Canadian generally accepted accounting criteria for deferral and amortization. Amortization for product development costs commences in the year that the new product development is completed and commercial production commences. These costs are amortized using the straight-line method over five years.

Intangible Assets

Patents and trademarks are recorded at cost. Customer relationships, tradenames and non-compete agreements are recorded at cost which, for business acquisitions, represents the estimated fair market value at the date of the acquisition. Amortization of intangibles is calculated using the following methods and annual rates which are intended to reflect the assets' estimated useful life:

Deferred organization costs	straight-line over 5 years
Patents and trademarks	straight-line over 5 years
Customer relationships	straight-line over 10 to 15 years
Tradenames	straight-line over 15 years
Non-compete agreements	straight-line over 3 years

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Impairment of Long-lived Assets

Long-lived assets, including property and equipment, product development costs and intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability is measured by a comparison of the carrying amount to the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of the asset exceeds its estimated future cash flows, an impairment charge is recognized as the amount by which the carrying value of the asset exceeds the fair value of the asset. Assets to be disposed of are separately presented in the balance sheet and are reported at the lower of the carrying amount or fair value less costs to sell, and are no longer amortized.

Revenue Recognition

Revenue is recognized when there is evidence of arrangement, the amount is fixed or determinable, products are shipped to the customer, and collection is reasonably assured and is recorded net of discounts. Amounts received prior to the shipment of products are recognized as deferred revenue in the period received and recorded as revenue when the products are shipped.

Income Taxes

Income taxes are determined using the asset and liability method whereby future income tax assets and liabilities are recognized for the future income tax consequences attributable to temporary differences between the financial reporting basis and the income tax basis of assets and liabilities and operating loss carryforwards based on enacted income tax rates expected to apply in the periods in which the temporary differences are expected to be realized or settled.

Government Assistance

Government assistance related to capital expenditures is reflected as a reduction in the cost of such assets. Government assistance relating to research and development expenses is recorded as a reduction of expenses when the related expenditures are incurred and recovery is reasonably certain. When government assistance is received which relates to expenses of future periods, the amount is deferred and amortized to income as the related expenditures are incurred.

Loss Per Share

Basic loss per share is calculated by dividing the loss for the period by the weighted average number of common shares outstanding during the period. The Company uses the treasury stock method for calculating the dilutive effect of the outstanding stock options and other dilutive securities. Under the treasury stock method, the weighted average number of common shares outstanding used for the calculation of diluted loss per share assumes that the proceeds to be received on the exercise of dilutive share options are used to repurchase common shares at the average market price during the period.

Foreign Currency Translation

The measurement currency of the Company and its subsidiaries is the Canadian dollar. Integrated foreign operations and foreign denominated assets and liabilities of the Company are translated using the temporal method. Under this method, monetary assets and liabilities denominated in foreign currencies are translated at the exchange rates in effect at the balance sheet date. Non-monetary assets are translated at the historical rate of exchange. Revenue and expenses are translated at the rates of exchange prevailing on the transaction date. Gains and losses on translation are reflected in the consolidated statement of operations, comprehensive loss and deficit.

Financial Instruments

The Company classifies financial assets and liabilities according to their characteristics and management's choices and intentions related thereto for the purposes of ongoing measurements. Classification choices for financial assets include: a) held for trading - measured at fair value with changes in fair value recorded in net operations; b) held to maturity - measured initially at fair value and carried at amortized cost with gains and losses recognized in net operations in the period that the asset is derecognized or impaired; c) available for sale - measured at fair value with changes in fair value recognized in other comprehensive loss for the current period until realized through disposal or impairment; and d) loans and receivables - measured initially at fair value and carried at amortized cost with gains and losses recognized in operations in the period that the asset is no longer recognized or impaired. Classification choices for financial liabilities include: a) held for trading - measured at fair value with changes in fair value recorded in operations and b) other - measured initially at fair value and carried at amortized cost. Any financial asset or liability can be classified as held for trading as long as its fair value is reliably determinable.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

The Company's financial assets and liabilities are classified and measured as follows:

Asset/Liability	Classification	Measurement
Cash	Held for trading	Fair value
Accounts receivable	Loans and receivables	Amortized cost
Operating lines of credit	Other liabilities	Amortized cost
Accounts payable and accrued liabilities	Other liabilities	Amortized cost
Long-term debt	Other liabilities	Amortized cost

Transaction costs other than those related to financial instruments classified as held for trading, which are expensed as incurred, are added to the fair value of the financial asset or financial liability on initial recognition and amortized using the effective interest method.

Cash Flow

The Company uses the direct method of reporting cash flow from operating activities.

Measurement Uncertainty

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. Actual results could differ from these estimates.

The amounts accrued to recognize investment tax credits and future income tax assets are based on the Company's estimate that it will likely have sufficient future taxable income to utilize these losses. Management assesses intangible assets, property and equipment and product development costs for impairment. Management also assesses the useful lives of these assets.

By their nature, these estimates are subject to measurement uncertainty and the effects of changes in estimates and judgments will be recorded in the period such changes are made.

Stock-Based Compensation

The Company has a stock option plan which is described in note 13. The Company accounts for stock options granted to employees using the fair value method. Under this method, compensation expense for stock options granted is measured at the fair value at the grant date, using the Black-Scholes option valuation model. In accordance with the fair value method, the Company recognizes estimated compensation expense related to stock options over the vesting period of the options granted, with the related credit being charged to contributed surplus.

3. CHANGE IN ACCOUNTING POLICY

The Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3064, "Goodwill and Intangible Assets" that supercedes Section 3062, "Goodwill and Other Intangible Assets" and Section 3450, "Research and Development Costs" was effective July 1, 2009 for the Company. This Section provides additional guidance on when expenditures qualify for recognition as intangible assets and requires total costs be deferred only when relating to an item meeting the definition of an asset. The new accounting standard was adopted by the Company and did not have a significant impact on the Company's consolidated financial statements.

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4. FUTURE ACCOUNTING STANDARDS

In January 2009, the CICA issued three new accounting standards. Section 1582, "Business Combinations", which replaces Section 1581 with the same title, aims to improve the relevance, reliability and comparability of the information provided in financial statements about business combinations. This Section is to be applied prospectively to business combinations for which the acquisition date is on or after January 1, 2011 and assets and liabilities that arose from business combinations that preceded the adoption of this standard should not be adjusted upon adoption. Section 1601, "Consolidated Financial Statements", and Section 1602, "Non-controlling Interests", replace Section 1600, "Consolidated Financial Statements", and establish standards for the preparation of consolidated financial statements and accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards apply to interim and annual consolidated financial statements beginning on or after January 1, 2011. Earlier adoption of all three standards is permitted as of the beginning of a fiscal year; however, if an entity chooses to early adopt, all three standards must be adopted concurrently. The Company is currently evaluating the impact of these new standards.

5. ASSETS HELD FOR SALE

On June 15, 2010, the Company announced its intent to sell its headborne system assets to Revision Eyewear Inc. ("Revision"). The Company developed the headborne assets in order to pursue future market opportunities; however, significant further investment was required in order to capitalize on these anticipated market opportunities. Given the state of the industry and the current economic conditions, the Company did not have the required capital to fund the program and Revision's offer provided the Company with the opportunity to monetize the asset.

On August 18, 2010, the Company sold certain of PSP's headborne system assets, in particular, the helmet liner capability, to Revision for \$275,000 and a 4% royalty on gross sales over a five-year period. On September 14, 2010, Revision exercised an option to purchase the remainder of the headborne systems for an additional \$100,000 and a 2.5% royalty on gross sales over a five-year period. The Company recorded a loss of \$609,422 related to this transaction in the current year based on the fair value of the assets, less estimated costs to complete the sale.

6. INVENTORY

	2010	2009
Raw materials	\$ 1,885,897	\$ 3,059,028
Work-in-process	13,507	180,288
Finished goods and samples	1,119,254	1,347,875
	3,018,658	4,587,191
Less provision	(759,784)	(394,288)
	\$ 2,258,874	\$ 4,192,903

Write-down of inventories recognized as an expense and recorded in cost of sales during the year ended June 30, 2010 was \$1,079,308 (June 30, 2009 - \$105,893).

The following table sets forth details of cost of sales:

	2010	2009
Inventory expensed	\$ 17,584,421	\$ 19,237,259
Labour costs	3,182,252	4,506,617
Other costs	3,166,387	2,836,782
	\$ 23,933,060	\$ 26,580,658

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7. INCOME TAXES

	2010	2009
Future tax asset		
Loss carryforwards	\$ 1,967,836	\$ 1,564,852
Financing costs	6,352	61,199
Reserves	292,797	80,871
Harmonization tax credit	10,818	12,957
Scientific research and development	12,928	-
Intangibles and other assets	905,823	1,074,568
Total gross future tax asset	3,196,554	2,794,447
Less valuation allowance	(3,023,915)	(2,289,656)
Net future tax asset	172,639	504,791
Future tax liability		
Property and equipment	(161,773)	(244,595)
Investment tax credits	(10,866)	(160,883)
Scientific research and development	-	(145,685)
Net future tax asset / (liability)	\$ -	\$ (46,372)
Financial statement disclosure		
Future income taxes - current	\$ -	\$ 13,120
Future income taxes liability	-	(59,492)
Net future tax asset / (liability)	\$ -	\$ (46,372)

The effective rate of income tax varies from the statutory rate as follows:

For the years ended June 30	2010	2009
Statutory income tax rate	32%	33%
Expected Canadian income tax recovery	\$ (996,453)	\$ (2,952,630)
(Increase) decrease resulting from:		
Change in valuation allowance	734,259	2,005,737
Change in foreign exchange rate	144,602	(83,057)
Change in Canadian statutory rate	86,975	(67,914)
Difference between Canadian and U.S. statutory income tax rates	(50,821)	(26,313)
Reinstatement of investment tax credits	-	(329,158)
Income tax effect of items not deductible for income tax purposes	7,638	1,514,326
Income tax effect of items not taxable for income tax purposes	(151,348)	-
Adjustment for prior years income tax matters	146,437	98,226
Other	11,056	21,995
Actual income tax expense / (recovery)	\$ (67,655)	\$ 181,212

At June 30, 2010, the Company had approximately \$3.0 million in Canadian non-capital tax loss carryforwards and \$2.8 million USD of U.S. net operating loss carryforwards available. These unused losses will expire between 2026 and 2030.

As at June 30, 2010, management determined that there was no reasonable assurance that its non-refundable investment tax credits could be utilized. As a result, the Company wrote down these investment tax credits by \$0.6 million. Therefore, together with non-refundable tax credits expected to be filed for the current year, the Company has \$0.6 million of non-refundable investment tax credits for tax purposes, which expire between 2025 and 2030.

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8. PROPERTY AND EQUIPMENT

	2010			2009		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Office equipment	\$ 321,027	\$ 187,406	\$ 133,621	\$ 310,545	\$ 154,062	\$ 156,483
Manufacturing equipment	2,406,403	1,559,949	846,454	2,289,077	1,347,180	941,897
Computer equipment	1,307,045	1,048,520	258,525	1,307,310	935,657	371,653
Test and design equipment	86,757	82,838	3,919	119,257	93,492	25,765
Leasehold improvements	308,059	123,911	184,148	280,829	65,980	214,849
	\$ 4,429,291	\$ 3,002,624	\$ 1,426,667	\$ 4,307,018	\$ 2,596,371	\$ 1,710,647

Of the total amortization expense of \$439,601 for the year ended June 30, 2010 (June 30, 2009 - \$419,609) there is \$233,672 (June 30, 2009 - \$222,193) recorded in cost of sales.

9. PRODUCT DEVELOPMENT COSTS

	2010			2009		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Product development costs	\$ 1,668,232	\$ 618,809	\$ 1,049,423	\$ 1,795,847	\$ 417,809	\$ 1,378,038

10. INTANGIBLE ASSETS

	2010			2009		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Patents	\$ 92,242	\$ 60,722	\$ 31,520	\$ 87,096	\$ 47,238	\$ 39,858
Trademarks	46,724	36,731	9,993	38,609	34,214	4,395
Customer relationships	3,179,128	899,839	2,279,289	3,179,127	653,582	2,525,545
Non-compete agreements	171,273	170,327	946	171,273	134,411	36,862
Tradenames	550,531	115,952	434,579	550,531	79,242	471,289
	\$ 4,039,898	\$ 1,283,571	\$ 2,756,327	\$ 4,026,636	\$ 948,687	\$ 3,077,949

11. OPERATING LINES OF CREDIT

PSP has an agreement with the Bank to provide advances repayable on demand with interest payable monthly calculated at the bank prime lending rate plus 3.50% per annum. The loan is secured by a first priority general security agreement over Canadian accounts receivable and inventory. The maximum operating line is \$3.0 million and is subject to margin requirements and covenants set by the Bank. At June 30, 2010, the amount drawn on the line of credit was \$1,875,094 (June 30, 2009 - \$2,965,659).

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11. OPERATING LINES OF CREDIT (continued)

PSP is required to meet certain covenants as outlined in its credit facility agreement with the Bank. At September 30, 2009, December 31, 2009, March 31, 2010 and June 30, 2010, the Company did not meet certain covenants as stipulated in its credit facility. The Bank has agreed, pursuant to a letter agreement dated August 17, 2010 (the "Forbearance Agreement"), not to take steps to realize under the facility prior to February 28, 2011 (the "Forbearance Period") unless a terminating event as defined in the Forbearance Agreement occurs. During this Forbearance Period, the Company will be subject to amended financial covenants.

Sentry has 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 is secured by a first priority general security agreement over U.S. accounts receivable, inventory and an assignment of insurance. The maximum operating line is \$1.4 million USD and is subject to margin requirements and covenants set by the lenders. At June 30, 2010, the amount drawn on the line of credit was \$535,296 (June 30, 2009 - \$Nil).

12. LONG-TERM DEBT

	2010	2009
Secured term loan with interest payable monthly calculated at the Lender's floating base rate of 5.25% at June 30, 2010 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 line of credit.		
A condition of the Company's Forbearance Agreement with its Canadian Chartered bank, required the Company to request from its Lender a six-month postponement of principal payments related to its long-term debt. The Lender has agreed, pursuant to a letter agreement dated August 4, 2010, to this request. All other terms and conditions of the debt facility remain unchanged.	\$ 1,160,900	\$ 1,375,220
Less current portion	(214,320)	(214,320)
	\$ 946,580	\$ 1,160,900

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

2011	\$ 214,320
2012	214,320
2013	214,320
2014	214,320
2015	214,320
Thereafter	89,300
	\$ 1,160,900

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13. EQUITY INSTRUMENTS

Authorized

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

	2010		2009	
	Number of Shares	Amount	Number of Shares	Amount
Beginning balance	25,654,605	\$ 17,600,017	25,467,694	\$ 17,504,223
Employee Ownership Plan (a)	86,548	14,714	—	—
Employee Ownership Plan (b)	—	—	24,705	15,564
Restricted Shares (c)	—	—	162,206	80,230
Balance, June 30	25,741,153	\$ 17,614,731	25,654,605	\$ 17,600,017

(a) In fiscal 2010, the Company issued 86,548 common shares under the employee ownership plan for proceeds of \$14,714.

(b) In fiscal 2009, the Company issued 24,705 common shares under the employee ownership plan for proceeds of \$15,564.

(c) In June 2009, the Company issued 162,206 restricted shares to an employee of the Company.

Restricted Shares

Effective March 13, 2007, the Company entered into a Restricted Share Agreement with an Employee. Subject to the terms and conditions of this Agreement, the Company agreed to grant Restricted Shares to the Employee on each of November 26, 2007, 2008 and 2009. The Restricted Shares granted in any year vest one year after the grant date and will be issued to the Employee on the second anniversary of the vesting date. The Company granted 62,206 and 100,000 Restricted Shares on November 26, 2007 and November 26, 2008, respectively, and issued the shares on June 16, 2009. The restricted shares related to 2010 are expected to be issued in fiscal 2011.

Stock Options

The Company has 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. At June 30, 2010, the Company had 987,800 stock options outstanding with exercise prices ranging from \$0.14 to \$1.95.

	Senior Management	Executive Officers	Board of Directors	Total	Weighted Average Exercise Price
Balance, June 30, 2008	50,000	504,330	561,500	1,115,830	\$ 0.77
Issued	—	150,000	200,000	350,000	0.36
Forfeited	—	(20,000)	(15,000)	(35,000)	0.28
Expired	(34,700)	(404,330)	(144,000)	(583,030)	0.66
Balance, June 30, 2009	15,300	230,000	602,500	847,800	\$ 0.70
Issued	—	125,000	30,000	155,000	0.14
Expired	—	—	(15,000)	(15,000)	1.95
Balance, June 30, 2010	15,300	355,000	617,500	987,800	\$ 0.59

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13. EQUITY INSTRUMENTS (continued)

	Senior Management	Executive Officers	Board of Directors	Weighted Average Exercise Price	Total
Weighted Average Exercise Price	\$ 0.74	\$ 0.31	\$ 0.76	\$ 0.59	
Weighted Average Remaining Contractual Life (years)	0.97	3.71	1.58	2.34	
Total Stock Option Pool Authorized					3,000,000
Total Stock Option Pool Remaining					510,170

The fair value of stock options issued in fiscal 2009 was estimated using the Black-Scholes option-pricing model with the following assumptions: dividend yield (nil), expected volatility ranged from (0.73 to 0.74), risk-free interest rate of (4%), and expected option life of five years with a fair value ranging from (\$0.21 - \$0.69). The fair value of stock options issued during the current year was estimated using the Black-Scholes option-pricing model with the following assumptions: dividend yield (nil), expected volatility ranging from (0.71 to 0.73), risk-free interest rate (4%), expected option life of five years with a fair value ranging from (\$0.11 to \$0.14).

The following table summarizes information regarding the Company's outstanding stock options at June 30, 2010:

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
\$0.14 to \$0.43	530,000	3.33	\$ 0.31	530,000	\$ 0.31
\$0.46 to \$0.68	112,800	0.62	0.63	112,800	0.63
\$0.71 to \$1.03	315,000	1.46	0.93	315,000	0.93
\$1.49 to \$1.95	30,000	0.42	1.95	30,000	1.95
	987,800		\$ 0.59	987,800	\$ 0.59

14. CONTRIBUTED SURPLUS

Balance, June 30, 2008	\$ 1,126,643
Stock-based compensation expense	130,578
Release to share capital on reclassification of restricted shares	(80,230)
Balance, June 30, 2009	1,176,991
Stock-based compensation expense	17,185
Balance, June 30, 2010	\$ 1,194,176

15. FINANCIAL RISK MANAGEMENT

In the normal course of business, the Company is exposed to a variety of financial risks related to credit, interest rate, currency fluctuations and liquidity.

(a) Credit Risk

The Company sells its products to a variety of customers under various payment terms in the normal course of its operations and therefore is exposed to credit risk. The Company's exposure to credit risk is influenced by general economic conditions, the default risk of the industry and the relative concentration of business. A significant amount of the Company's trade receivables are derived from the Canadian Federal Government. At June 30, 2010, the Company had \$1.3 million (June 30, 2009 - \$1.3 million) in accounts receivable with the Canadian Federal Government.

In monitoring credit risk, the Company considers industry, sales volume and aging trends, maturity, and other relevant factors. The Company performs ongoing credit evaluations of its customers' financial condition and limits the amount of credit extended when deemed necessary. Purchase limits established for certain accounts represent the maximum open balance permitted without approval from management. The Company maintains reserves for potential credit losses relating to specific exposures.

The maximum exposure to credit risk is the carrying value of accounts receivable.

The movement in the allowance for doubtful accounts receivable in respect of trade accounts receivable during the period was not significant. The amount of impairment loss recorded against accounts receivable in the year ended June 30, 2010 was \$51,925 (June 30, 2009 - \$9,913).

The following table sets forth details of accounts receivable:

	2010	2009
Not past due	\$ 3,006,823	\$ 2,907,895
Past due for more than one day but not more than 30 days	556,426	700,133
Past due for more than 31 days but not more than 60 days	292,798	229,630
Past due for more than 61 days	359,326	144,699
	4,215,373	3,982,357
Less: allowance for doubtful accounts	(60,938)	(12,791)
	\$ 4,154,435	\$ 3,969,566

As at June 30, 2010, the Company's accounts receivable consist of balances due from customers in different jurisdictions including Canada amounting to \$2,981,805 (June 30, 2009 - \$2,953,954), the United States amounting to \$1,172,630 (June 30, 2009 - \$974,173), and other countries amounting to \$Nil (June 30, 2009 - \$41,439).

(b) Interest Rate Risk

The Company is exposed to interest rate risk with regard to short-term variable rate operating lines of credit and a long-term variable rate secured loan. For the year ended June 30, 2010, if interest rates on the operating lines and long-term debt were to fluctuate by 1%, and all other variables were held constant, the impact on the Company's operations before income taxes would be \$39,000.

(c) Foreign Exchange Risk

The Company operates primarily in North America and as a result, fluctuations in the rate of exchange between the U.S. and Canadian dollar can have an effect on the Company's reported results.

A significant portion of the Company's raw material used in production and products purchased for resale are denominated in U.S. dollars. Therefore, a decrease in the value of the Canadian dollar relative to the U.S. dollar increases the Company's costs, which reduces operating margin and the cash flow available to fund operations. The Company also has an investment in a U.S. integrated operation.

For the year ended June 30, 2010, if the rate of exchange between the U.S. and Canadian dollar were to fluctuate by 10%, and all other variables were held constant, the impact on the Company's operations before income taxes would be \$512,000.

15. FINANCIAL RISK MANAGEMENT (continued)

(c) Foreign Exchange Risk (continued)

The Company's foreign exchange risk management includes the use of foreign currency forward contracts to fix the exchange rates on certain foreign currency exposures. The Company's objective is to manage and control exposures and secure the Company's profitability on existing contracts. The Company does not utilize derivative financial instruments for trading or speculative purposes.

The Company does not designate its foreign exchange contracts as a hedge of underlying assets, liabilities, firm commitments or anticipated transactions, and accordingly, does not use hedge accounting. As a result of this, the foreign exchange forward contracts are recorded on the consolidated balance sheets at fair value in accounts receivable when contracts are in a gain position and in accounts payable and accrued liabilities when the contracts are in a loss position. The Company did not have any foreign exchange contracts outstanding as at June 30, 2010.

(d) Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under normal and stressed conditions. The Company manages liquidity by having appropriate lines of credit available and monitoring cash requirements to meet expected operational expenses including debt service and capital requirements.

The Company has a \$3.0 million operating line of credit with a Canadian chartered bank and \$1.4 million USD operating line of credit with a U.S. chartered bank (note 11).

The following table summarizes the carrying amount and contractual maturities of significant financial liabilities over the next 5 years, on an undiscounted basis as at June 30, 2010.

	2011	2012	2013	2014	2015	Total
Accounts payable and accrued liabilities	\$ 3,841,698	\$ —	\$ —	\$ —	\$ —	\$ 3,841,698
Operating leases	748,778	696,198	655,512	646,045	646,788	3,393,321
Operating lines of credit	2,410,390	—	—	—	—	2,410,390
Long-term debt	214,320	214,320	214,320	214,320	214,320	1,071,600

(e) Fair Value of Financial Instruments

The Company's financial instruments consist of cash, accounts receivable, operating lines of credit, accounts payable and accrued liabilities and long-term debt. The fair values of accounts receivable, operating lines of credit, and accounts payable and accrued liabilities, as recorded in the consolidated balance sheets approximate their carrying amounts due to the short-term maturities of these instruments. The long-term debt reflects current market interest rates and therefore the carrying amount approximate fair value.

Financial instruments recorded at fair value on the consolidated balance sheet are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

Level 1 – valuation based on quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2 – valuation techniques based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices);

Level 3 – valuation techniques using inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value.

There are no financial instruments measured at fair value other than cash which is classified as Level 1. During the year, there have been no transfers of amounts between any categories. There are no items classified as Level 2 or Level 3 as at June 30, 2010.

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16. CAPITAL DISCLOSURES

The Company's objectives when managing capital are: i) to ensure sufficient liquidity to support its financial obligations and execute its operating and strategic plans, ii) to minimize the cost of capital while taking into consideration current and future industry, market and economic risks and conditions, and iii) to maintain an optimal capital structure that provides necessary financial flexibility while also ensuring compliance with financial covenants.

The Company monitors its capital structure, when necessary, in light of changes in economic conditions, the objectives of its shareholders, the cash requirements of the business and the condition of capital markets.

The Company considers its total capitalization to include all interest-bearing debt, including operating lines of credit, long-term debt (including the current portion thereof) and shareholders' equity, net of cash. The calculation is set out in the following table:

	2010	2009
Operating lines of credit	\$ 2,410,390	\$ 2,965,659
Current portion of long-term debt	214,320	214,320
Long-term debt	946,580	1,160,900
Funded debt	3,571,290	4,340,879
Less: cash	-	219,982
Net funded debt	3,571,290	4,120,897
Shareholders' equity	4,634,541	7,651,824
Capital under management	\$ 8,205,831	\$ 11,772,721

There have been no changes in the Company's approach to capital management during fiscal 2010.

17. SEGMENTED INFORMATION

The Company's principal business activity is the manufacture, distribution and sale of a complete line of protective products and accessories for the defence and security market. The Company operates in Canada through its PSP and APS Distributors segments with operations based in Arnprior, Ontario and Bedford, Nova Scotia respectively, and in the U.S. through its Sentry subsidiary located in Dover, Tennessee.

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.

	Canadian Operations	U.S. Operations	Consolidated Total
<i>For the year ended June 30, 2010</i>			
Revenue	\$ 21,183,817	\$ 9,410,570	\$ 30,594,387
Elimination of inter-segment revenue	(27,034)	(724,273)	(751,307)
Total revenue	21,156,783	8,686,297	29,843,080
Gross margin	4,490,450	1,419,570	5,910,020
Expenses	4,938,162	1,963,342	6,901,504
Amortization	341,965	395,495	737,460
Other items	1,387,893	-	1,387,893
Income tax expense (recovery)	(88,205)	20,550	(67,655)
Net loss after taxes	\$ (2,089,365)	\$ (959,817)	\$ (3,049,182)

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17. SEGMENTED INFORMATION (continued)

	Canadian Operations	U.S. Operations	Consolidated Total
<i>For the year ended June 30, 2009</i>			
Revenue	\$ 25,238,794	\$ 10,693,425	\$ 35,932,219
Elimination of inter-segment revenue	(172,291)	(724,442)	(896,733)
Total revenue	25,066,503	9,968,983	35,035,486
Gross margin	6,040,322	2,414,506	8,454,828
Expenses	5,354,480	2,461,113	7,815,593
Amortization	505,957	291,088	797,045
Other items	5,876,436	2,995,204	8,871,640
Income tax expense (recovery)	(102,707)	283,919	181,212
Net loss after taxes	\$ (5,593,844)	\$ (3,616,818)	\$ (9,210,662)

	Canadian Operations	U.S. Operations	Consolidated Total
AS AT JUNE 30, 2010			
Assets			
Current assets	\$ 5,309,408	\$ 1,598,793	\$ 6,908,201
Property and equipment	880,079	546,588	1,426,667
Intangible, other assets	2,442,789	1,362,961	3,805,750
	\$ 8,632,276	\$ 3,508,342	\$ 12,140,618

<i>AS AT JUNE 30, 2009</i>			
<i>Assets</i>			
Current assets	\$ 6,731,687	\$ 2,067,525	\$ 8,799,212
Property and equipment	1,126,808	583,839	1,710,647
Intangible, other assets	3,825,212	1,165,269	4,990,481
	\$ 11,683,707	\$ 3,816,633	\$ 15,500,340

Sales for the year ended June 30	2010	2009
Domestic	\$ 19,891,977	\$ 27,089,421
United States	8,142,028	3,069,409
International	1,809,075	4,876,656
	\$ 29,843,080	\$ 35,035,486

Included in Fiscal 2010 revenue were sales of \$6.7 million to the Canadian Federal Government (Fiscal 2009 - \$6.4 million) which represents 22.5% (Fiscal 2008 - 18.3%) of total sales. Other than 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.

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18. RESTRUCTURING CHARGE

	2010	2009
Opening balance	\$ 19,843	\$ 1,139,757
Restructuring costs incurred	188,545	417,419
Restructuring costs paid	(105,698)	(1,537,333)
Restructuring costs included in accounts payable and accrued liabilities	\$ 102,690	\$ 19,843

During the year ended June 30, 2010, the Company announced a restructuring plan directed at reducing costs. During the year ended June 30, 2009, the Company announced a restructuring plan directed at reducing costs through the reduction of staff and the integration of APS.

19. COMMITMENTS

Over the next five years, the Company is committed to operating leases in respect of its premises and equipment as follows:

2011	\$ 748,778
2012	696,198
2013	655,512
2014	646,045
2015	646,788
Thereafter	1,254,596
	\$ 4,647,917

20. ASSET IMPAIRMENT AND OTHER CHARGES

	2010	2009
Impairment of goodwill	\$ -	\$ 8,454,221

The Company performed an impairment test as at June 30, 2009, whereby the carrying amount of goodwill was compared to the discounted future cash flow expected from its use, using a current weighted average discount rate that reflects the realities of the current economic environment. Impairment tests involve a significant degree of judgment, as expectations concerning future cash flows and the selection of an appropriate discount rate are subject to considerable risks and uncertainties. Management concluded that an impairment had occurred and determined that the carrying value of goodwill of \$8.5 million was fully impaired. This resulted in a non-cash impairment charge of \$8.5 million that was recorded in the fiscal 2009 consolidated statements of operations, comprehensive loss and deficit.

21. COMPARATIVE FIGURES

In certain instances the information presented for comparative purposes have been reclassified to conform to the financial statement presentation adopted for the current year.

22. SUBSEQUENT EVENTS

(i) On August 6, 2010, the Board of Directors of the Company approved the grant of 2,100,000 stock options at \$0.10 per share to certain employees. All options granted vested prior to August 31, 2010 and will expire five years following the vesting date. However, in view of the number of options being available to be issued at the date of the grant being less than the amount of the grant, the Company is evaluating steps necessary to fulfill the purported option grant.

(ii) On August 18, 2010, the Company completed a non-brokered private placement offering of \$1.0 million (the "Offering"). The Offering consisted of 40 units (the "Units") at a purchase price of \$25 thousand per Unit. Each Unit consisted of \$25 thousand in principal amount of unsecured convertible debentures (the "Debentures") and 62,500 detachable common share purchase warrants (the "Warrants"). The Debentures are convertible into common shares of the Company from the date of issue, at the option of the holder, at a price of \$0.10 per common share. The Debentures will mature and be payable three years from the date of issuance and, subject to the conversion right, may be repaid by the Company after one year from the date of issuance. Interest will accrue on the Debentures at a rate of 10% per annum, compounded and paid annually, payable in (i) cash, or, at the election of the Company, (ii) common shares of the Company calculated based on 95% of the market weighted average closing price for the period of 20 trading days ending on the day that is 5 days immediately preceding date of payment. Any conversion which will result in a subscriber holding 20% or more of the Company's issued and outstanding common shares is subject to shareholder approval. Each Warrant will allow the subscriber to purchase one common share at a price of \$0.10 per common share for the first 6-month term and \$0.12 per common share for the second 6-month term.

(iii) On August 18, 2010, the Company sold certain of PSP's headborne system assets (note 5), in particular, the helmet liner capability, to Revision Eyewear Inc. ("Revision") for \$275,000 and a 4% royalty on gross sales over a five-year period (the "Headborne Sale"). On September 14, 2010, Revision exercised an option to purchase the remainder of the headborne systems for an additional \$100,000 and a 2.5% royalty on gross sales over a five-year period.

(iv) On October 20, 2010, the Company announced that it had signed a LOI to complete a Merger by way of a court approved plan of arrangement of Zuni Holdings Inc., an NEX listed company. Under the LOI, PSP has agreed to acquire 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. Following completion of the Merger, PSP will be owned 45.8% by current PSP shareholders and 54.2% by current Zuni shareholders, based on the current shares issued and outstanding. On a partially diluted basis, assuming exercise or conversion of all outstanding warrants and debentures of PSP, PSP will be owned 55.7% by current PSP shareholders and 44.3% by current Zuni shareholders. Subject to certain closing conditions, and non-solicitation and termination provisions, the Merger is currently expected to close in late December, 2010. PSP believes this transaction will solidify its capital position and allow it to take advantage of significant growth opportunities that are available to the Company.