WATERFURNACE
RENEWABLE ENERGY, INC.
SECOND QUARTER 2010

WaterFurnace

Smarter from the Ground Up™

Management’s Discussion and Analysis

Completed on August 5, 2010

(Thousands of U.S. dollars unless otherwise noted)

Reference notice

This Management Discussion and Analysis should be read in conjunction with WaterFurnace Renewable Energy, Inc.’s (“the Company”) 2009 Consolidated Financial Statements and accompanying notes. These documents along with the additional information about the Company, including the Annual Information Form, are available on SEDAR at *www.sedar.com*.

Caution regarding forward-looking statements

There are comments in this report that are forward-looking statements. “Forward looking statements” include statements regarding the Company’s expectations, hopes, intentions or strategies regarding the future. These statements reflect the Company’s current expectations. They are subject to a number of risks and uncertainties, including, but not limited to, changes in the general market conditions. In light of the many risks and uncertainties, readers should understand that the Company cannot offer assurance that the forward-looking statements contained in this analysis will be realized.

Company overview

The Company is incorporated under the laws of Canada. Its subsidiary companies, WaterFurnace International, Inc. (WaterFurnace) and LoopMaster International, Inc. (LoopMaster), are Indiana corporations.

WaterFurnace manufactures and distributes geothermal water source heating and cooling systems for residential, commercial and institutional buildings.

LoopMaster installs geothermal loops for residential, institutional and commercial construction projects. LoopMaster operates as a subcontractor on large projects across the U.S. and residential projects in select markets.

Discussion of quarterly results

The Company’s second quarter performance for 2010 saw sales rise 15.5% over the second quarter of 2009. Residential sales through the dealer direct channel were up 11.9% as compared to the second quarter of 2009 along with stronger than expected commercial sales which grew 37.5% in a very depressed commercial construction industry. Adding sales people, expansion of product channels and growing market share continues to be the primary focus of the Company and sales for the quarter indicate the Company is seeing a positive effect from these efforts even though the economy has yet to show signs of any measurable recovery.

Discussion of quarterly results (continued)

Net income for the second quarter was $0.27 per share as compared to $0.30 per share in the second quarter of 2009. Operating expenses for the quarter, which included an increase in expenses associated with activities for potential acquisitions, increased proportionately with sales. However, gross profit as a percentage of sales for the quarter was 4.1% lower than the prior year primarily due to normal increases in warranty expense, increased material costs and increased margin pressure which resulted in the $0.03 decrease in earnings per share.

Management continues to be pleased with the Company's performance. Bookings for the second quarter were ahead of prior year.

Cash and short-term investments continue to rise as sales and market share continue to grow despite current economic conditions. Cash and short-term investments were $15.7 million at June 30, 2010 compared to $10.2 million at June 30, 2009. Accounts receivable collections remain strong, while bad debts continue to run below historical performance. Inventory at the end of the second quarter was $7.6 million compared with $7.3 million for the end of the second quarter last year. Payables and accruals ended the quarter at $8.4 million compared with $6.9 million at the end of the second quarter last year.

Outlook

Management is optimistic about the third quarter and the remainder of the year due to the successful launch of new commercial products earlier in the year and the Company's ability to penetrate the residential replacement sector, the most lucrative portion of the market. Both the geothermal and boiler/tower industries have been running significantly lower than 2009, but despite this industry decline the Company has been able to achieve gains in market share. However, the decline in the industry has caused pressure on margins in order to compete, which is expected to continue unless there is significant growth in the industry in the latter portion of the year. Seasonal sales lift is anticipated to continue to occur in the third quarter and should result in a favorable comparison to the third quarter of 2009 due to increased market share.

The Canadian federal program, ecoENERGY Retrofit for residential is no longer being funded. While some provinces have chosen to carry on with this program independent of the federal government, which offered $4.4 thousand per new system, others have not. Therefore, it is expected that the Canadian market will decrease 10% to 15% due to lack of government support. It is anticipated that a new Canadian federal program will be announced sometime in 2011 which will focus exclusively on incentives for wind, solar and geothermal.

In the United States the largest geothermal incentive, a 30% uncapped federal tax credit, is scheduled to be in place until 2016. There are several other pieces of federal legislation, including the Rural Electric Savings Bill, Home Star and the Energy Bill, that are working their way through Congress which could positively impact and strongly encourage geothermal installations.

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Summary of quarterly results (unaudited)

2010 Quarters ended	March 31	June 30		
Sales	$ 25,794	$ 34,384		
Net income	557	3,205		
Basic and diluted earnings per share	0.05	0.27		

2009 Quarters ended	March 31	June 30	September 30	December 31
Sales	$ 23,674	$ 29,772	$ 36,209	$ 39,410
Net income	830	3,648	4,947	6,051
Basic and diluted earnings per share	0.07	0.30	0.41	0.50

2008 Quarters ended	March 31	June 30	September 30	December 31
Sales	$ 23,813	$ 31,330	$ 39,964	$ 42,708
Net income	1,582	3,425	5,248	5,119
Basic and diluted earnings per share	0.13	0.28	0.43	0.42

Capital resources and liquidity

The Company expects to fund capital expenditures from available cash. The Company has $15.7 million in cash and cash equivalents and short-term investments after paying $5.2 million in dividends during the first half of 2010. In the first quarter of 2010, the Company set up access to an unsecured $3.0 million bank line of credit which was unused at August 5, 2010. Accounts receivable days sales outstanding are at levels normal for the Company's industry. Accounts payable are paid within terms and discounts are taken when available. The Company is not aware of any legal proceedings or other issues that would have a significant impact on the financial condition of the Company.

Financial instruments and credit risk

The Company's estimate of the fair value of cash and cash equivalents, short-term investments, receivables, and payables and accruals approximates the carrying value due to the short-term nature of these instruments. The carrying value of capital lease obligations approximates their fair value as their interest rates approximate current market interest rates. The Company's exposure to credit risk is limited to accounts receivable. The Company makes provisions for any doubtful accounts as required. The Company is not currently exposed to interest rate risks from bank loans and long-term debt. The Company is only exposed to interest rate risks from investment of cash and cash equivalents and short-term investments.

The Company has a policy regarding the investment of surplus cash. The policy calls for investments to have maturities of less than one year, slight or no risk of losing the invested principal and access to the principal amount prior to maturity. All investments made must have a high-grade rating and no investments outside the U.S. are allowed without approval from the Board of Directors. Currently, the Board has decided that excess cash may only be invested in U.S. Treasury bills, money market funds or similar accounts until the Board is satisfied that the banking and credit markets have strengthened.

(Thousands of U.S. dollars except share data unless otherwise noted)

Contractual obligations

	Operating leases	Capital leases	Total
2010	$ 112	$ 20	$ 132
2011	88	40	128
2012	70	40	110
2013	43	40	83
2014	30	36	66
	$ 343	$ 176	$ 519

The Company's minimum contractual obligations consist of agreements to lease certain facilities, operational and administrative equipment and other services for various periods through 2014.

In addition, the Company has a deferred compensation plan, detailed in Note 11 of the financial statements, with amounts that are subject to vesting over three to five years or upon normal retirement age, defined in the deferred compensation plan as age 60.

Critical accounting estimates

The largest accounting estimate is the Provision for Warranty Claims on products sold by the Company. The actual future costs to fulfill warranty expenses are unknown. The method used to establish the provision is to track the actual historical costs per unit covered and multiply it by the number of units still covered under the warranty policy to establish the total estimated liability, which is then reduced to its present value with a discount rate. The cost of labor on outstanding warranties is fixed, but the price of components can increase. A major assumption underlying the estimate is that failure rates will remain relatively the same in the future as they have in the past. The provision increased $2.0 million during the first half of 2010.

The other important estimate is the determination of the provision for doubtful accounts. This includes reviewing all accounts receivable for payment history and any current events that may have an impact on collection.

Off-balance sheet arrangements

The Company has no off-balance sheet arrangements.

Share capital

Unlimited common shares without par value are authorized. On June 24, 2010, the Company issued 3,235 shares to the Company's deferred compensation plan trust. The non-cash transaction increased the assets of the plan and increased share capital. The amount booked was $83 thousand. As of August 5, 2010, there were 12,095,667 common shares issued and outstanding. As of August 5, 2010, no stock options were outstanding.

Transactions with related parties

The Company did not have any related party transactions during the first half of 2010 or during the 2009 fiscal year.

Internal controls over financial reporting

It is the opinion of the Company's Chief Executive Officer and Chief Financial Officer that the Company's internal controls over financial reporting provide a reasonable level of assurance that fiscal reporting will be free of material errors or misstatements. The Company maintains a system of internal controls that are monitored by senior management and tested on a quarterly basis. As of the end of the most recent quarter, internal control monitoring and testing has not produced any areas of concern for management. A set of control systems, no matter how well conceived or operated, can only provide reasonable, not absolute, assurance that the objectives of the control system are met.

Future adoption of International Financial Reporting Standards (IFRS)

The Accounting Standards Board requires Canadian publicly accountable enterprises to adopt International Financial Reporting Standards for fiscal years beginning on or after January 1, 2011. The Company's first IFRS compliant financial statements will be for the first quarter of 2011.

The Company commissioned a scoping of convergence to IFRS which has now been completed. The study identified additional data, new information and areas where specialized accounting principles will be required to comply with IFRS. The study also summarized relevant IFRS initial adoption requirements and options and strategy for its application.

The Company has been assessing and evaluating the effects of changes required under IFRS upon its operations, internal controls and financial reporting. The Company is defining each of the IFRS sections that are applicable and has begun making changes to how particular items are being tracked in anticipation of the new disclosure requirements.

At this time management believes that the transition to IFRS will have minimal impact, with most of the changes being primarily in disclosures and valuation of assets and depreciation under IAS 16 – Property, Plant and Equipment.

Consolidated Statements of Income & Retained Earnings

(Unaudited—Thousands of U.S. dollars except share data unless otherwise noted)

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Sales	$ 34,384	$ 29,772	$ 60,178	$ 53,446
Cost of sales	23,083	18,776	41,879	35,389
Gross profit	11,301	10,996	18,299	18,057
Operating expenses	5,633	4,902	11,307	10,315
Research and development expenses (Note 18)	590	552	1,190	1,215
Income before interest and income taxes	5,078	5,542	5,802	6,527
Interest income	21	2	21	8
Interest expense	(20)	(5)	(28)	(8)
Income before income taxes	5,079	5,539	5,795	6,527
Income taxes (Note 19)	1,874	1,891	2,033	2,049
Net income	$ 3,205	$ 3,648	$ 3,762	$ 4,478
Earnings per share (Note 20)				
Basic and diluted	$ 0.27	$ 0.30	$ 0.31	$ 0.37
Weighted average number of shares (Note 20)				
Basic and diluted	12,092,648	12,092,432	12,092,539	12,092,432
Retained earnings, beginning of period	$ 15,910	$ 10,381	$ 17,771	$ 11,842
Net income	3,205	3,648	3,762	4,478
Dividends (Note 21)	(2,764)	(2,419)	(5,182)	(4,710)
Retained earnings, end of period	$ 16,351	$ 11,610	$ 16,351	$ 11,610

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

Consolidated Balance Sheets

(Unaudited—Thousands of U.S. dollars unless otherwise noted)

Assets	June 30, 2010	December 31, 2009
Current assets		
Cash and cash equivalents	$ 5,647	$ 4,785
Short-term investments	10,026	13,368
Receivables (Note 2)	16,935	16,794
Inventory (Note 4)	7,599	5,653
Other current assets (Note 5)	3,204	2,859
Total current assets	43,411	43,459
Capital assets (Note 6)	5,705	5,345
Other assets (Note 7)	3,552	3,015
Total Assets	$ 52,668	$ 51,819
Liabilities		
Current liabilities		
Payables and accruals	$ 8,432	$ 7,398
Income taxes payable	142	880
Provision for warranty claims - current portion (Note 10)	2,465	2,215
Total current liabilities	11,039	10,493
Capital leases (Note 9)	129	146
Deferred compensation (Note 11)	125	264
Provision for warranty claims (Note 10)	10,076	8,280
Total Liabilities	21,369	19,183
Shareholders' Equity		
Share capital (Note 14)	14,948	14,865
Retained earnings	16,351	17,771
Total Shareholders' Equity	31,299	32,636
Total Liabilities & Shareholders' Equity	$ 52,668	$ 51,819

Commitments and contingencies, respectively (Notes 12 and 13)

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

Consolidated Statements of Cash Flows

(Unaudited—Thousands of U.S. dollars unless otherwise noted)

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Increase (decrease) in cash and cash equivalents				
Operating				
Net income	$ 3,205	$ 3,648	$ 3,762	$ 4,478
Add back non-cash items:				
Depreciation (Note 6)	189	169	360	335
Gain on disposal of capital assets	(9)	(1)	(9)	(18)
Change in provision for warranty claims	693	423	2,046	1,400
Change in deferred compensation	163	336	261	1,229
Change in future income taxes	268	(425)	(679)	(901)
Net cash before working capital adjustments	4,509	4,150	5,741	6,523
Net change in non-cash working capital (Note 15)	(2,686)	(1,495)	(1,995)	(117)
	1,823	2,655	3,746	6,406
Financing				
Funding of deferred compensation plan	—	(2,630)	(317)	(2,630)
Principal payments for capital leases	(8)	—	(17)	—
Payment of dividends	(2,764)	(2,419)	(5,182)	(4,710)
	(2,772)	(5,049)	(5,516)	(7,340)
Investing				
Change in short-term investments	2,842	(1)	3,342	(1,052)
Purchase of capital assets	(234)	(88)	(722)	(293)
Proceeds on disposal of capital assets	12	12	12	52
Change in other assets	—	3	—	6
	2,620	(74)	2,632	(1,287)
Net increase (decrease) in cash and cash equivalents	1,671	(2,468)	862	(2,221)
Cash and cash equivalents, beginning of period	3,976	6,276	4,785	6,029
Cash and cash equivalents, end of period	$ 5,647	$ 3,808	$ 5,647	$ 3,808

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

Notes to the Consolidated Financial Statements

(Unaudited—Thousands of U.S. dollars unless otherwise noted)

1. Summary of significant accounting policies

WaterFurnace Renewable Energy, Inc. is a public company incorporated under the laws of Canada and listed on the Toronto Stock Exchange. The Company operates in the geothermal water source heating and cooling industry, mainly in the United States.

These interim consolidated financial statements do not include all disclosures normally provided in annual consolidated financial statements and should be read in conjunction with the annual audited consolidated financial statements for the year ended December 31, 2009.

(a) Generally accepted accounting principles

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles.

(b) Reporting and functional currency

The functional currency is the U.S. dollar which is the unit of measurement for the majority of the Company's business transactions and accordingly, the U.S. dollar is used for reporting.

(c) Basis of consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary companies, WaterFurnace International, Inc. and LoopMaster International, Inc., both of which are U.S. corporations. All significant inter-company balances are eliminated on consolidation.

(d) Use of estimates

In preparing the Company's consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and reported revenues and expenses during the reporting period. Actual results could differ from those estimates.

The largest accounting estimate is the Provision for Warranty Claims on products sold by the Company. The actual future costs to fulfill warranty expenses are unknown. The method used to establish the provision is to track the actual historical costs per unit covered and multiply it by the number of units still covered under the warranty policy to establish the total estimated liability, which is then reduced to its present value with a discount rate. The cost of labor on outstanding warranties is fixed, but the price of components can increase. A major assumption underlying the estimate is that failure rates will remain relatively the same in the future as they have in the past.

The other important estimate is the determination of the provision for doubtful accounts. This includes reviewing all accounts receivable for payment history and any current events that may have an impact on collection.

(e) Cash and cash equivalents

Cash and cash equivalents include cash on hand, cash balances with banks and short-term investments with original maturity of 90 days or less which are classified as held for trading.

(f) Short-term investments

Short-term investments are classified as held for trading and are carried at fair value. Short-term investments include taxable and tax-exempt money market funds with floating interest rates. The change in fair value is included in interest income.

1. Summary of significant accounting policies (continued)

(g) Financial instruments

The financial instrument standards require that all financial instruments be classified into one of the following categories:

Financial assets	Financial liabilities
Held for trading	Held for trading
Held to maturity	Other financial liabilities
Available for sale	
Loans and receivables	

Financial assets and liabilities are initially recognized at fair value with subsequent measurement based on classification. The classification depends on the purpose for which the financial instruments were acquired, their characteristics and choice where applicable.

The Company manages financial instruments according to changes in business and economic conditions and classifies them as follows:

Type of financial instruments	Category	Measurement
Cash and cash equivalents	Held for trading	Fair value
Short-term investments	Held for trading	Fair value
Receivables	Loans and receivables	Amortized cost using the effective interest method
Payables and accruals	Other financial liabilities	Amortized cost using the effective interest method

Changes in the fair value of held for trading instruments are recognized in the statement of income. Transaction costs related to held for trading instruments are expensed as incurred. Transaction costs related to loans and receivables and other financial liabilities are capitalized and amortized using the effective interest method.

The Company's estimate of the fair value of cash and cash equivalents, short-term investments, receivables and payables and accruals approximates the carrying value due to the short-term nature of these instruments. The carrying value of capital lease obligations approximates their fair value as their interest rates approximate current market interest rates.

The Company assesses the fair value of its financial instruments using the following three-level hierarchy of measurements which reflects the significance of the inputs:

- Level 1 fair value measurements are derived from quoted prices in active markets for identical assets or liabilities;
- Level 2 fair value measurements are derived from inputs other than quoted prices included within 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 fair value measurements are derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The Company assesses the fair value of cash and cash equivalents and short-term investments from Level 1 measurements.

1. Summary of significant accounting policies (continued)

(h) Inventory

Inventory, calculated substantially on a first-in, first-out basis, is recorded at the lower of cost and net realizable value. The cost of finished goods inventory is comprised of material, labor and manufacturing overhead. Excess or obsolete inventory is reserved for as required. Due to the high level of inventory turns and short-term nature of inventory holdings, the Company has not needed to write inventory up or down due to changes in the market value of commodities.

(i) Capital assets

Capital assets are recorded at net book value which is original cost less accumulated depreciation and any writedowns for impairment. The Company assesses the carrying value of capital assets whenever events or changes in business circumstances indicate the carrying value of the asset may not be fully recoverable. This assessment of recoverability is based on management's estimate of undiscounted future operating cash flow. If the sum of the undiscounted cash flows is less than the carrying value of the related asset, then the Company will record a write-down of the asset to the extent that the carrying value exceeds the fair value of the asset.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets. The estimated useful life for the building is 40 years and other components range from 7 to 15 years. The estimated useful lives for equipment and equipment under capital lease generally run 3 to 7 years. Construction in progress is not depreciated as it is not available for use.

(j) Income taxes

The Company provides for income taxes using the liability method of tax allocation. Under this method, future income tax assets and liabilities are determined based on deductible or taxable temporary differences between financial statement values and tax values of assets and liabilities using substantively enacted income tax rates expected to be in effect for the year in which the differences are expected to reverse. Future tax benefits, such as loss carry forwards, are recognized only to the extent that such benefits are more likely than not to be realized during the carry forward period.

Research tax credits relating to capital asset purchases and research and development expenditures are accounted for as reductions of the cost of such assets and expenses, respectively. Research tax credits are recorded when there is reasonable assurance they will be realized.

(k) Foreign currency translation

Monetary assets and liabilities are translated at the exchange rate in effect at the balance sheet date. Nonmonetary assets and liabilities are translated at historical exchange rates. Operating revenues and expenses are translated at the average exchange rates prevailing during the year, except for amortization, which is translated at the same rates as those used in the translation of the corresponding assets. Translation gains or losses are included in net income. The functional and reporting currency of both the parent company and its self sustaining foreign subsidiaries is the U.S. dollar.

(l) Warranty

A provision for potential warranty claims is provided at the time sales are recognized and adjusted periodically based on warranty terms and costs incurred compared to total expected costs. The method used to establish the provision is to track the actual historical costs per unit covered and multiply it by the number of units still covered under the warranty policy to establish the total estimated liability, which is then reduced to its present value with a discount rate. The cost of labor on outstanding warranties is fixed, but the price of components can increase. A major assumption underlying the estimate is that failure rates will remain relatively the same in the future as they have in the past.

Notes to the Consolidated Financial Statements

(Unaudited—Thousands of U.S. dollars unless otherwise noted)

1. Summary of significant accounting policies (continued)

(m) Revenue recognition

The Company records equipment sales at time of shipment. Residential installation sales are recorded on the completed contract method. Commercial installation sales are recorded on the percentage of completion basis, based on costs incurred compared to total expected costs. The Company manages its credit and collection policies and procedures such that it is reasonably assured of collecting receivables.

(n) Comprehensive income

A statement of comprehensive income has not been included as the Company did not have any other comprehensive income or loss.

(o) Earnings per share

Earnings per share is calculated using the weighted average number of shares outstanding during the year. Diluted earnings per share is calculated using the treasury stock method. This method recognizes the use of proceeds that could be obtained upon the exercise of options and assumes that any proceeds would be used to purchase common shares at the average market price during the period. The incremental shares, or the difference between the number of shares assumed issued and the number of shares assumed purchased are included in the denominator of the diluted earnings per share computation. Options have a dilutive effect only when the average market price of the common shares during the period exceeds the exercise price of the options.

(p) Research and development

The Company expenses all research and development activities in accordance with Section 3064 of the CICA Handbook.

(q) Future adoption of International Financial Reporting Standards (IFRS)

The Accounting Standards Board requires Canadian publicly accountable enterprises to adopt International Financial Reporting Standards for fiscal years beginning on or after January 1, 2011. The Company's first IFRS compliant financial statements will be for the first quarter of 2011.

The Company commissioned a scoping of convergence to IFRS which has now been completed. The study identified additional data, new information and areas where specialized accounting principles will be required to comply with IFRS. The study also summarized relevant IFRS initial adoption requirements and options and strategy for its application.

The Company has been assessing and evaluating the effects of changes required under IFRS upon its operations, internal controls and financial reporting. The Company is defining each of the IFRS sections that are applicable and has begun making changes to how particular items are being tracked in anticipation of the new disclosure requirements.

At this time management believes that the transition to IFRS will have minimal impact, with most of the changes being primarily in disclosures and valuation of assets and depreciation under IAS 16 – Property, Plant and Equipment.

(Unaudited—Thousands of U.S. dollars unless otherwise noted)

2. Financial instruments disclosure and presentation

Financial risk management

Risks that arise from financial instruments include liquidity risk, credit risk and market risk.

Liquidity risk

Liquidity risk is the risk that the Company will have difficulty meeting obligations associated with its financial liabilities. The Company manages liquidity risk through cash generated from operations in excess of dividends paid on an annual basis. Management does not foresee material or significant risk of the Company not meeting its financial obligations.

The Company is able to generate sufficient cash to fund expected growth and development needs. At June 30, 2010, the Company had $5.6 million ($4.8 million at December 31, 2009) in cash and cash equivalents and $10.0 million ($13.4 million at December 31, 2009) in short-term investments remaining after paying $5.2 million in dividends during the first half of 2010 ($9.5 million for the year 2009). Accounts payable are paid within terms and discounts are taken when available.

The Company's policy regarding the investment of surplus cash calls for investments to have maturities of less than one year, slight or no risk of losing the invested principal and access to the principal amount prior to maturity with little or no penalty for liquidation. All investments must have a high-grade rating and no investments outside the U.S. are allowed without approval from the Board of Directors. Currently, the Board has decided that excess cash may only be invested in U.S. Treasury bills, money market funds or similar accounts until the Board is satisfied that the banking and credit markets have strengthened.

Credit risk

The risk with the Company's short-term investments is minimal as they are all in money market funds. The Company's financial instruments that are exposed to credit risk are primarily accounts receivable. To minimize this credit risk, the Company has established policies for evaluating customers and extending credit. Accounts receivable days sales outstanding are at levels normal for the Company's industry.

The Company makes provisions for any doubtful accounts as required. Management considers the reasons and history for each overdue account as well as economic conditions. When appropriate, the Company requires letters of credit, liens, bonds or personal guarantees from customers.

Receivables

	June 30, 2010	December 31, 2009
Trade receivables - current	$ 13,869	$ 13,315
Trade receivables - 1 to 89 days past current	2,696	3,006
Trade receivables - 90 plus days past current	472	493
Other receivables	55	71
Allowance for doubtful accounts	(157)	(91)
	$ 16,935	$ 16,794

(Unaudited—Thousands of U.S. dollars unless otherwise noted)

2. Financial instruments disclosure and presentation (continued)

Allowance for doubtful accounts

	Three months ended June 30, 2010	Six months ended June 30, 2010	Year ended December 31, 2009
Balance, beginning of period	$ 138	$ 91	$ 464
Change in provision	64	129	(12)
Net adjustment for finance charges, write-offs and recoveries	(45)	(63)	(361)
Balance, end of period	$ 157	$ 157	$ 91

Market risk

Market risk includes interest rate risk and foreign exchange risk.

Interest rate risk

Interest rate risk is the risk that the value or future cash flows of financial instruments will fluctuate due to changes in market interest rates. The Company currently is only exposed to interest rate risks from investment of its surplus cash.

The Company does not expect fluctuations in market interest rates to have a material impact on its results of operations and does not use derivative instruments to reduce its exposure to interest rate risk.

Foreign exchange risk

Sales and purchases are primarily denominated in U.S. dollars including sales outside of the United States. Foreign currency adjustments resulted in net losses of $4 thousand and $21 thousand for the quarters ended June 30, 2010 and 2009, respectively. Foreign currency adjustments resulted in net losses of $13 thousand and $30 thousand for the six months ended June 30, 2010 and 2009, respectively.

3. Capital disclosures

Capital includes shareholders' equity. At June 30, 2010, the Company had no bank loans or long-term debt other than $163 thousand under capital leases. The Company's objective when managing capital is to safeguard the entity's ability to continue as a going concern and make the Company prosper so that it can provide a fair return for shareholders and benefits for other stakeholders. The Company sets the amount of capital required and manages the capital structure and makes adjustments to it in the light of changes in business and economic conditions.

The Company uses forecasted cash flow, projected investment in the growth of the business and capital expenditure needs to determine the level of dividend payments and cash needs. The Company targets a minimum value of cash and cash equivalents and short-term investments that is equal to or greater than two times the next estimated dividend payment which is calculated using the current number of outstanding shares times the rate paid for the most recently paid regular dividend. This ratio was approximately six to one at June 30, 2010.

Notes to the Consolidated Financial Statements

(Unaudited—Thousands of U.S. dollars unless otherwise noted)

4. Inventory

	June 30, 2010	December 31, 2009
Raw material	$ 5,201	$ 4,093
Finished goods	2,398	1,560
	$ 7,599	$ 5,653

5. Other current assets

	June 30, 2010	December 31, 2009
Future income taxes	$ 2,633	$ 2,492
Prepaids and deposits	571	367
	$ 3,204	$ 2,859

6. Capital assets

	June 30, 2010	December 31, 2009
Cost		
Land	$ 450	$ 450
Building and improvements	3,924	3,924
Equipment	6,325	5,025
Equipment under capital lease	221	221
Construction in progress	289	886
	11,209	10,506
Accumulated depreciation		
Building and improvements	2,011	1,959
Equipment	3,438	3,165
Equipment under capital lease	55	37
	5,504	5,161
Net book value		
Land	450	450
Building and improvements	1,913	1,965
Equipment	2,887	1,860
Equipment under capital lease	166	184
Construction in progress	289	886
	$ 5,705	$ 5,345

Notes to the Consolidated Financial Statements

(Unaudited—Thousands of U.S. dollars unless otherwise noted)

6. Capital assets (continued)

Depreciation

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Depreciation in cost of sales	$ 85	$ 81	$ 167	$ 167
Depreciation in operating expenses	104	88	193	168
Total depreciation	$ 189	$ 169	$ 360	$ 335

7. Other assets

	June 30, 2010	December 31, 2009
Future income taxes	$ 3,550	$ 3,013
Deposits and other	2	2
	$ 3,552	$ 3,015

8. Bank arrangements

During the first quarter of 2010, the Company set up access to an unsecured $3.0 million bank line of credit. It was unused as of June 30, 2010.

9. Capital leases

The Company leases certain equipment under capital leases.

	June 30, 2010	December 31, 2009
Current portion in “Payables and accruals”	$ 34	$ 34
Long-term portion as a separate line item	129	146
	$ 163	$ 180

Minimum lease payments due under capital leases

2010	$ 20
2011	40
2012	40
2013	40
2014	36
Total minimum lease payments	176
Less: imputed interest	(13)
Total minimum principal lease payments	$ 163

Notes to the Consolidated Financial Statements

(Unaudited—Thousands of U.S. dollars unless otherwise noted)

10. Warranty reserve

	June 30, 2010	December 31, 2009
Current portion	$ 2,465	$ 2,215
Long-term portion	10,076	8,280
	$ 12,541	$ 10,495

11. Deferred compensation plan

	June 30, 2010	December 31, 2009
Plan assets		
Mutual funds	$ 2,763	$ 2,573
Life insurance policies	1,344	1,387
Company stock	83	—
	4,190	3,960
Plan liabilities	(4,315)	(4,224)
Plan net liability	$ (125)	$ (264)
Unvested additional awards balances not reflected in plan liabilities	$ 1,137	$ 819

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Deferred compensation plan expenses	$ 147	$ 260	$ 229	$ 509
Deferred compensation awarded during the period	$ 390	$ 259	$ 480	$ 1,262

The Company has established an executive nonqualified "excess" deferred compensation plan for certain management employees. These employees can elect to defer a portion of their earnings, and these amounts vest immediately. At the Company's discretion, additional amounts may be awarded to the employees' accounts. These additional amounts are subject to vesting over three to five years or upon normal retirement age, defined in the deferred compensation plan as age 60.

The plan, approved by the Board of Directors, allows participants to choose from a number of selected mutual funds as "notional investments" for participants and Company contributions prior to June 8, 2009. Effective June 8, 2009, the plan was amended by the Board to require that all future Company contributions are to be notionally invested in WaterFurnace Renewable Energy, Inc. stock. The participants continue to have the choice of a number of selected mutual funds for their notional investments.

(Unaudited—Thousands of U.S. dollars unless otherwise noted)

11. Deferred compensation plan (continued)

The earnings deferred by the participants plus amounts to be contributed by the Company are then tracked by the plan's financial institution sponsor as if those amounts were actually invested in the "notional" fund options. The liability is adjusted based on changes to the value of the offsetting "notional investments" with the changes in the market value of the calculated liability charged or credited to deferred compensation plan expense.

The plan is a contractual obligation by the Company to pay the plan participants in the future and is comprised primarily of amounts to be paid post employment, but also includes amounts designated by the participants as in-service and education amounts that can be distributed during the participant's term of employment according to payment terms designated by the participant.

The plan is not required to be funded, but the Company has established a trust to which the Company may contribute funds to satisfy the liability which can only be used to satisfy the compensation liability. The plan assets consist of mutual funds whose value is tied to the market performance of the investment options and flexible premium variable life insurance policies. As of the second quarter 2010, plan assets also include WaterFurnace Renewable Energy, Inc. stock. These assets are recorded at market value and have been netted with the offsetting liability on the basis that the investments are payable to the trust and only available for funding of the plan liability.

On June 24, 2010, the Company issued 3,235 shares to the trust. The non-cash transaction increased the assets of the plan and increased share capital. The amount booked was $83 thousand. The shareholders have approved the issuance of up to 250,000 common shares from treasury to the Company's deferred compensation plan.

12. Commitments

Contractual obligations due

	Operating leases
2010	$ 112
2011	88
2012	70
2013	43
2014	30
	$ 343

The Company has entered into agreements to lease certain facilities, operational and administrative equipment and other services for various periods through 2014.

13. Contingencies

The Company and its consolidated subsidiaries are defendants in actions brought against them from time to time in connection with their operations. While it is not possible to estimate the outcome of the various proceedings at this time, the Company does not believe that it will incur any significant loss or expense.

Notes to the Consolidated Financial Statements

(Unaudited—Thousands of U.S. dollars except share data unless otherwise noted)

14. Share capital

	Six months ended June 30, 2010	Year ended December 31, 2009
Share capital		
Balance, beginning of period	$ 14,865	$ 14,865
Shares issued to fund deferred compensation plan	83	—
Balance, end of period	$ 14,948	$ 14,865
Shares outstanding		
Balance, beginning of period	12,092,432	12,092,432
Shares issued to fund deferred compensation plan	3,235	—
Balance, end of period	12,095,667	12,092,432

Unlimited common shares without par value are authorized.

15. Supplementary cash flow information

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Net change in non-cash working capital				
Receivables	$ (2,588)	$ (1,377)	$ (141)	$ 3,404
Inventory	(682)	(51)	(1,946)	1,368
Other current assets	255	(17)	(204)	(21)
Payables and accruals other than deferred compensation and capital lease liabilities	415	439	1,034	(3,188)
Income taxes payable	(86)	(489)	(738)	(1,680)
	$ (2,686)	$ (1,495)	$ (1,995)	$ (117)
Cash paid for interest and income taxes				
Interest paid	$ —	$ 1	$ 6	$ 3
Income taxes paid	$ 2,045	$ 2,801	$ 3,806	$ 4,619
Non-cash transactions				
Shares issued to fund deferred compensation plan	$ 83	$ —	$ 83	$ —

(Unaudited—Thousands of U.S. dollars unless otherwise noted)

16. Geographical information

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Sales				
United States	$ 29,323	$ 25,019	$ 51,288	$ 44,558
Canada	4,683	4,626	8,306	7,981
Other	378	127	584	907
	$ 34,384	$ 29,772	$ 60,178	$ 53,446

All capital assets are located in the United States. Sales are attributed based on the location of the customer.

17. 401(k) pension plan

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
401(k) pension plan expenses	$ 109	$ 100	$ 223	$ 242

The Company provides a 401(k) pension plan for employees. Employees can elect to contribute up to 80% of their gross earnings. The Company matches 100% of the first 4% of compensation contributed by employees. All Company matches vest immediately.

18. Research and development expenses

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Research and development expenses	$ 652	$ 600	$ 1,314	$ 1,317
Research tax credits	(62)	(48)	(124)	(102)
	$ 590	$ 552	$ 1,190	$ 1,215

(Unaudited—Thousands of U.S. dollars unless otherwise noted)

19. Income taxes

	Three months ended June 30, 2010	Three months ended June 30, 2009	Six months ended June 30, 2010	Six months ended June 30, 2009
Income tax provision				
Current	$ 1,606	$ 2,316	$ 2,712	$ 2,950
Future	268	(425)	(679)	(901)
	$ 1,874	$ 1,891	$ 2,033	$ 2,049

	June 30, 2010	December 31, 2009
Significant components of future income taxes		
Warranty reserve	$ 4,858	$ 4,066
Deferred compensation and other compensation amounts	1,958	1,972
Inventory reserve	(372)	(372)
Tax value of assets in excess of book value	48	48
Book value of assets in excess of tax value	(381)	(223)
Other	72	14
	$ 6,183	$ 5,505
Future income taxes		
Current portion in "Other current assets"	$ 2,633	$ 2,492
Long-term portion in "Other assets"	3,550	3,013
	$ 6,183	$ 5,505

The income tax expense for the second quarter of 2010 included a reversal of an over-accrual of income taxes at December 31, 2009, in the amount of $186 thousand.

(Unaudited—Thousands of U.S. dollars except share data unless otherwise noted)

20. Earnings per share

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Shares outstanding at beginning of period	12,092,432	12,092,432	12,092,432	12,092,432
Weighted average dilution for shares issued to deferred compensation plan	216	—	107	—
Basic and diluted weighted average shares outstanding	12,092,648	12,092,432	12,092,539	12,092,432
Net income	$ 3,205	$ 3,648	$ 3,762	$ 4,478
Basic and diluted earnings per share	$ 0.27	$ 0.30	$ 0.31	$ 0.37

As of June 30, 2010, no stock options were outstanding.

21. Dividends

Dividends paid per share (U.S.$)

		Six months ended June 30,	
Date of payment	Date of record	2010	2009
March 1 (March 2)	February 17 (February 20)	$ 0.19	$ 0.18
June 1 (June 1)	May 21 (May 15)	0.22	0.19
		$ 0.41	$ 0.37

Total dividend

	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Dividend payment to shareholders	$ 2,661	$ 2,297	$ 4,958	$ 4,474
Withholding tax payment to the IRS on intercorporate dividend	103	122	224	236
	$ 2,764	$ 2,419	$ 5,182	$ 4,710

22. Comparative figures

Comparative figures have been reclassified to conform to the current period presentation and classifications.

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For quarter and annual reports by mail go to
www.computershare.com/mailinglist

Trading Information

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ISIN CA9415EQ1089
Toronto Stock Exchange
WFI for trading in Canadian dollars
WFI.U for trading in U.S. dollars

Directors

Thomas F. Huntington
President and CEO
WaterFurnace Renewable Energy, Inc.

James R. Shields [1]
Chairman Emeritus
WaterFurnace Renewable Energy, Inc.

Timothy E. Shields [1]
Chairman
WaterFurnace Renewable Energy, Inc.

Thomas C. Dawson, CA [1, 2]
Corporate Director

J. David Day, LLB [1, 3, 4]
Corporate Director

Charles R. Diltz [2, 3, 4]
Sr. Vice President
Comfort Systems USA

Dr. Geoffrey W.J. Pottow [2, 3, 4]
President and CEO
The Becker Milk Co. Ltd.

1 Member of the Executive Committee
2 Member of the Audit Committee
3 Member of the Compensation Committee
4 Member of the Governance Committee

Officers

Thomas F. Huntington
President and
Chief Executive Officer

Timothy E. Shields
Chairman

Fred Andriano
Secretary, Treasurer and
Chief Financial Officer