



2012 annual report

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following management's discussion and analysis ("MD&A") dated March 5, 2013 is intended to assist the readers in understanding EcoSynthetix Inc. ("EcoSynthetix" or the "Company"), its business environment, strategies and performance and risk factors. It should be read in conjunction with the audited annual consolidated financial statements. Financial data has been prepared in conformity with International Financial Reporting Standards ("IFRS").

The Company directly or indirectly owns a majority of the equity interest in each of EcoSynthetix Ltd. ("EcoSynthetix U.S."), EcoSynthetix B.V., EcoSynthetix Technologies Inc. and EcoSynthetix Corporation. The Company, together with its consolidated subsidiaries, is referred to as the "Company", "we", "us", or "our". All references to "Fiscal 2010" are to EcoSynthetix U.S.' year ended December 31, 2010. Our functional currency and reporting currency is the U.S. dollar. Unless otherwise indicated, all references to "\$" and "dollars" in this discussion and analysis mean U.S. dollars.

Certain measures used in this MD&A do not have any standardized meaning under IFRS. When used, these measures are defined in such terms as to allow the reconciliation to the closest IFRS measure. It is unlikely that these measures could be compared to similar measures presented by other companies. See "IFRS and non-IFRS Measures".

Forward-looking statements are included in this MD&A. See "Forward-Looking Statements" below for a discussion of risks, uncertainties and assumptions relating to these statements. For a description of the risks relating to the Company, refer to the "Risk Factors" section of this MD&A and the "Risk Factors" section of the Company's Annual Information Form for the fiscal year ended December 31, 2012.

Forward-looking Statements

Certain statements contained in this MD&A constitute forward-looking statements. All statements other than statements of historical fact may be forward-looking statements. These statements relate to, but are not limited to, future events or future performance, our expectations regarding the Company's growth, results of operations, estimated future revenues, requirements for additional capital, production costs, future demand for latex-based products, business prospects and opportunities. Forward-looking statements are often, but not always, identified by use of words such as "may", "will", "should", "could", "seek", "anticipate", "contemplate", "continue", "expect", "intend", "plan", "potential", "budget", "target", "believe", "estimate" and similar expressions. Such statements reflect our current views and beliefs with respect to future events, are subject to risks and uncertainties, and are based upon a number of estimates and assumptions that, while considered reasonable by us, are inherently subject to significant business, economic, competitive, political and social uncertainties and contingencies. Many factors could cause actual results, performance or achievements to be materially different from any future results, performance, or achievements that may be expressed or implied by such forward-looking statements.

We have made material assumptions regarding, among other things: that our intellectual property rights are adequately protected; our ability to obtain the materials necessary for the production of our products; our ability to market products successfully to our customers; that we will continue to face no direct competition; changes in demand for and prices of our products or the materials required to produce those products; labour and material costs remaining consistent with our current expectations; and that we do not and will not infringe third party intellectual property rights. Some of our assumptions are based upon internal estimates and analyses of current market conditions and trends, management plans and strategies, economic conditions and other factors and are necessarily subject to risks and uncertainties inherent in projecting future conditions and results.

Some of the risks that could affect our future results and could cause those results to differ materially from those expressed in the forward-looking information include, among other things: an inability to protect, defend, enforce or use our intellectual property and/or infringement of third-party intellectual property; dependence on certain customers and changes in customer demand; the availability and price of natural feedstocks used in the production of our products; the inability to effectively expand our production facilities; variations in our financial results; increase in industry competition; the risk of volatility in global financial conditions, as well as significant decline in general economic conditions; our ability to effectively commercially market and sell our products; our

ability to protect our know-how and trade secrets; Company growth and the impact of significant operating and capital cost increases; changes in the current political and regulatory environment in which we operate; the inability to retain key personnel; changes to regulatory requirements, both regionally and internationally, governing development, production, exports, taxes, labour standards, waste disposal, and use, environmental protection, project safety and other matters; enforcement of intellectual property rights; a significant decrease in the market price of petroleum; a shortage of supplies, equipment and parts; the inability to secure additional government grants; a deterioration in our cash balances or liquidity; the inability to obtain equity or debt financing; the ability to acquire intellectual property; the risk of litigation; changes in government regulations and policies relating to our business; losses from hedging activities and changes in hedging strategy; insufficient insurance coverage; the inability to expand technology; the impact of issuance of additional equity securities on the trading price of the Common Shares; the impact of ethical, legal and social concerns relating to genetically modified organisms and the food versus fuel debate; the risk of business interruptions; the impact of changes in interest rates; the impact of changes in foreign currency exchange; and credit risk, as well as the factors identified in the "Risk Factors" section of the Company's Annual Information Form for the fiscal year ended December 31, 2012. Such factors are not intended to represent a complete list of the factors that could affect us. These factors should be considered carefully and prospective investors should not place undue reliance on forward-looking information.

Should one or more of these risks or uncertainties materialize, or should assumptions underlying those forward-looking statements prove incorrect, actual results may vary materially from those anticipated in such forward-looking statements. Although the forward-looking statements contained in this MD&A are based upon what we believe to be reasonable assumptions, there can be no assurance that such forward-looking information will prove to be accurate and we cannot assure that actual results will be consistent with these forward looking statements. Accordingly, readers should not place undue reliance on forward-looking statements. The information contained in this document, including the information provided under the heading "Risk Factors", identifies additional factors that could affect the Company's operating results and performance. Forward-looking information contained in this MD&A is made as of March 5, 2012 and we disclaim any obligation to update any forward-looking information, whether as a result of new information, future events or results, except as may be required by applicable securities laws. Accordingly, potential investors should not place undue reliance on forward-looking information.

IFRS and Non-IFRS Measures

This MD&A makes reference to certain non-IFRS measures. These non-IFRS measures are not recognized measures under IFRS, do not have a standardized meaning prescribed by IFRS and are therefore unlikely to be comparable to similar measures presented by other companies. Rather, these measures are provided as additional information to complement those IFRS measures by providing a further understanding of results of operations of the Company from management's perspective. Accordingly, they should not be considered in isolation or as a substitute for analysis of the financial information of the Company reported under IFRS. We use non-IFRS measures such as Adjusted EBITDA to provide investors with a supplemental measure of operating performance and thus highlight trends in our core business that may not otherwise be apparent when relying solely on IFRS financial measures. We also believe that securities analysts, investors and other interested parties frequently use non-IFRS measures in the evaluation of issuers. Our management also use non-IFRS measures in order to facilitate operating performance comparisons from period to period, prepare annual operating budgets and assess its ability to meet its capital expenditure and working capital requirements. Adjusted EBITDA is defined as consolidated net income (loss) before interest, income taxes, depreciation, amortization, accretion, other non-cash charges deducted in determining consolidated net income (loss), including the movement of unrealized gains and losses on the Company's redeemable preferred shares and warrants that were designated as financial liabilities prior to the initial public offering and share based compensation expense.

Initial Public Offering

On August 4, 2011, the Company completed an initial public offering of 11,150,000 common shares issued from treasury at a price of Cdn\$9.00 per share for gross proceeds of Cdn\$100,350,000. During the fiscal year-ended December 31, 2011, the Company recognized approximately \$10.8 million of share issuance costs in equity related to the initial public offering.

The Company granted to the underwriters an over-allotment option, exercisable, in whole or in part, at the sole discretion of the underwriters, for a period of 30 days from the closing of the offering to purchase up to an additional 1,672,500 common shares at a price of Cdn\$9.00 per share. On September 12, 2011 the Company

announced that the underwriters had purchased an additional 300,000 common shares of the Company at a price of Cdn\$9.00 per share. The Company did not receive any proceeds from the sale of these additional shares.

In connection with the offering, EcoSynthetix U.S., which previously owned, either directly or indirectly, through its subsidiaries, all of the asset and operations relating to the EcoSynthetix business, was acquired by EcoSynthetix Inc. (Ontario) through an acquisition of 77% of the outstanding shares of common stock of EcoSynthetix U.S. from certain of the existing shareholders in exchange for approximately 33,640,663 Common Shares assuming no exercise of the over-allotment option. As at December 31, 2012, the remaining approximately 15% of the outstanding shares of common stock of EcoSynthetix U.S. continue to be held by retained interest holders (the "Retained Interest Holders").

On August 4, 2011, in connection with the initial public offering, the Retained Interest Holders and the Company entered into a put/call agreement. Pursuant to the put/call agreement, the Retained Interest Holders will be entitled to sell their shares of common stock of EcoSynthetix U.S. and shares of common stock of EcoSynthetix U.S. issued upon exercise of warrants (the "**Covered Shares**") to the Company at any time prior to the date that is five years following the Closing (the "**Put Expiry Date**") in exchange for common shares of the Company on the basis of seven common shares for one Covered Share, subject to adjustment. In addition, the Company will be entitled to purchase the Covered Shares held by the Retained Interest Holders at any time from the period commencing one year following the Put Expiry Date to the date that is two years following the Put Expiry Date in exchange for seven common shares for one Covered Share, subject to adjustment. In addition, the Company will be entitled to exercise its right to purchase the Covered Shares in the event of a change of control of the Company or a bankruptcy event of the Company or EcoSynthetix U.S. that occurs prior to the Put Expiry Date. As at December 31, 2012, assuming all the Retained Interest Holders exchanged their shares of common stock of EcoSynthetix U.S. for Common Shares, an additional approximately 8,144,395 common shares will be issued by the Company.

In conjunction with the initial public offering, the Company's preferred shares were automatically converted to common shares. As a result, the Company's liability relating to its preferred shares were re-classified into common shares on August 4, 2011. Furthermore, warrants to acquire preferred shares will be automatically converted to warrants to acquire common shares. As a result, the Company's liability relating to warrants to acquire preferred shares was re-classified into a separate component of shareholders' equity on August 4, 2011.

On August 4, 2011 the Company completed a share exchange of its issued and outstanding common shares in conjunction with its initial public offering resulting in a ratio of seven post-exchange shares for every 1 pre-exchange share. The Company has amended the disclosures in the consolidated financial statements to reflect the share exchange as if it had occurred on December 31, 2009.

On August 4, 2011 the Company, in connection with the initial public offering mentioned above, provided certain retained interest shareholders an indemnity that covers potential shareholder tax liabilities. The potential liability related to this indemnity is approximately \$4 million. The indemnity is terminated on the date that is five years following the closing date. The Company has assessed the likelihood of incurring a liability as remote and accordingly has not recorded a provision as at December 31, 2012.

Overview

We are a renewable chemicals company specializing in biomaterials. Biomaterials are commonly used as inputs in industrial manufacturing for a wide range of end products. We have commercial bio-based products that have equal or superior performance and significant cost advantages compared to currently available petroleum-based products. Our strategy is to commercialize a broad range of bio-based polymer and monomer products across a wide range of industries. We have developed processes that leverage "green" technology to produce bio-based materials from natural feedstock, such as corn, tapioca and dextrose from cornstarch as an alternative to petroleum-derived feedstocks. To date, we have developed the following two bio-based technology platforms that support broad application across industries: (i) a biopolymer nanosphere technology that has been fully scaled and validated; and (ii) a bio-based sugar macromer technology that has been validated on a pilot scale and is being developed for the pre-commercialization plant stage. Our two bio-based technology platforms have generated three product families to date, namely ECOSPHERE BIOLATEX polymers, ECOMER and ECOSTIX. Our lead product, ECOSPHERE BIOLATEX binders, has achieved commercialization in the coated paper, paperboard and personal care industries. While our technology platform offers a significantly reduced carbon

footprint, we market our products to customers on the basis of reduced cost, stable pricing and superior product performance.

Factors Affecting the Results of Operation

Commercialization

A major source of our revenue has resulted from the conversion of customer evaluations of our products into commercial sales. Generally, the adoption of our products by customers is evaluated in three stages prior to acceptance of the product on a commercial basis: (i) laboratory evaluation; (ii) pilot scale production testing; and (iii) mill trials representing full scale production.

Following a period of evaluations, we first achieved commercial sales in the first quarter of 2008. We are currently operating on a commercial scale in the coated paper and paperboard industry. Manufacturers generating greater than 60% in SB latex demand in the global paper and paperboard market are either evaluating or commercial with our ECOSPHERE BIOLATEX binders. Due to the low capital expenditure required to switch to our products, reduced cost, improved performance and a significantly reduced carbon footprint, our experience suggests volume demand can be relatively steady post-conversion, which creates the potential for continuous recurring revenue. Despite certain customer mills having unique material handling requirements, we have the capability of rapidly designing and delivering state-of-the art dry material handling solutions for our customers resulting in a seamless integration of our ECOSPHERE BIOLATEX binders.

Our performance will be influenced by our success in converting prospects from the mill trial phase into full commercial clients. The mill trial stage is an important part of the sales cycle; it requires potential customers to invest significant resources, including labour and operating expenditures, and the product must meet or surpass rigorous qualification procedures. Successfully reaching the mill trial stage with a potential customer reflects substantial interest and commitment with which the potential customer is evaluating the product.

Since entering commercial production, we have achieved significant sales growth. Our lead product, ECOSPHERE BIOLATEX binders, is used commercially by 6 of the global top 20 manufacturers in the coated paper and paperboard industry and an additional 9 of the global top 20 manufacturers are currently in the process of evaluating the Company's products. Given our past record of successfully converting a high number of evaluations into commercial clients, we expect that the conversion of current and future product evaluations into recurring commercial sales will be a continuous source of growth for us.

Our objective is to achieve significant growth across multiple industries through continuous innovation of new bio-based polymer and monomer products using widely available raw materials and our scalable production techniques. In addition, we will continue to expand the functionalities and applications of our existing products, which are readily applicable across numerous markets where petroleum-based polymers and monomers currently dominate.

Net Sales

Our sales are primarily derived from the sale of our products to our customers. Net sales are measured based on the price specified in the sales contract net of any discounts and estimated returns at the time of sale. Sales are recorded when significant risks and rewards of ownership have passed on to the buyer, which generally occurs at the time of shipment.

Cost of sales and gross profit

Our gross profit is derived from our net sales less our cost of sales. Cost of sales includes raw material costs, contract manufacturing costs, freight costs and depreciation related to manufacturing equipment. Direct materials consist of the costs of cornstarch feedstock and process chemicals. Cost of sales is mainly affected by the cost of cornstarch and contract manufacturing costs. Cornstarch is the most significant raw material cost.

Selling, general and administrative

Selling, general and administrative expense primarily relates to personnel costs, including salaries & benefits, share-based compensation, recruitment and training costs, professional fees, marketing costs, corporate insurance costs, occupancy-related costs, depreciation on property, plant and equipment not utilized in our production process, amortization of intangible assets, and travel expenses. We anticipate increases in selling and general and administrative expenses as we make additional investments to further develop our marketing and sales organizations.

Research and development

Expenditures during the research phase are expensed as incurred. Expenditures during the development phase are expensed as incurred, unless they meet certain capitalization criteria. No development costs have been capitalized to date.

Our research and development expenses consist of expenses incurred to develop and test our products, and include personnel and related costs, share-based compensation, consultants, facility costs, supplies and other associated product development expenses. These costs are partially offset by government grants recorded related to such expenditures. We expect our research and development expense to grow as we focus on enhancing and expanding our product lines.

Other Factors Affecting the Results of Operations and Financial Conditions

Our financial condition and results of operations are influenced by a variety of factors, including:

- Optimizing the formulation of existing products to allow higher substitution rates by current and new customers and the ability to effectively develop products for new markets which could be a significant source of revenue growth in the future. As a result, we made a significant investment in a new research and development facility located in Burlington, Ontario, Canada. This facility has a laboratory and pilot production line for use in the advanced development of new or significantly enhanced products and to support sales activities.
- Pricing of petroleum substitutes for our products.
- Feedstock, other input and production costs. Cost of sales is mainly affected by the cost of cornstarch and contract manufacturing costs. Cornstarch is generally the most significant raw material cost. During fiscal 2012 we experienced lower contract manufacturing costs that were partly offset by higher cornstarch costs compared to fiscal 2011.

Results of operations

The following is a summary of selected consolidated annual information extracted from the Company's audited consolidated financial statements over the latest three year period.

	Fiscal year-ended December 31		
	2012	2011	2010
Net sales	19,552,345	20,769,851	15,879,080
Gross Profit	3,857,858	4,973,021	3,951,995
Operating expenses	15,649,372	11,034,659	5,893,328
Loss from operations	(11,791,514)	(6,061,638)	(1,941,333)
Net loss	(11,430,735)	(252,708,148)	(49,194,031)
Basic and diluted loss per share	(0.21)	(10.93)	(61.78)
Total current assets	104,730,880	119,896,087	40,977,830
Total assets	118,068,797	130,662,211	42,712,214
Total current liabilities	4,509,216	6,142,668	5,096,128
Total non-current financial liabilities	-	-	136,697,726

Fiscal year ended December 31, 2012 compared to fiscal year ended December 31, 2011

Net Sales – Net sales in fiscal 2012 were \$19.6M compared to \$20.8 million in fiscal 2011, a decrease of \$1.2 million or 5.9%. From a geographic perspective, sales increased \$1.7 million each in North America and EMEA which was more than offset by lower sales of \$4.3 million in Asia Pacific and \$0.4 million in Latin America. Lower sales volume in Asia Pacific was primarily due to lower purchases from one customer for which we recorded significant sales in 2011. Excluding the impact of this, sales increased in Asia Pacific by \$3.0 million while sales on a consolidated basis increased \$6.1 million or 45% which consists of a 13% increase in sales to existing customers and 32% from sales to new customers. The decrease in Latin American sales was principally due to the timing of inventory purchases in the fourth quarter of fiscal 2011 while higher sales in North America and EMEA were principally due to increased volumes to existing customers.

We commercialized twelve new customers during calendar 2012 which accounted for 22% of fiscal 2012 revenue. We commercialized seven customers in Asia Pacific, two of which are considered part of the top 20 manufacturers in the global coated paper and paperboard industry, three customers in North America and one customer each in Latin America and EMEA. Subsequent to December 31, 2012 we commercialized two paper mills in North America and one paper mill in Asia Pacific.

Gross profit – Gross profit in fiscal 2012 was \$3.9 million or 19.7% of sales compared to \$5.0 million or 23.9% of sales in fiscal 2011, a decrease of \$1.1 million or 22.4%. The decrease in gross profit was primarily due to higher manufacturing depreciation costs, lower selling prices, decreased sales volume and increased corn starch prices. These items were partially offset by favorable foreign exchange related to European manufacturing costs and lower manufacturing production costs. Manufacturing depreciation costs increased due to the expansion of our production facilities in the Netherlands and Tennessee, USA which was commissioned in the fourth quarter of fiscal 2011 and first quarter of fiscal 2012, respectively. Gross profit adjusted for non-cash items (manufacturing depreciation) as a percentage of sales decreased slightly from 25.5% in fiscal 2011 to 24.9% in fiscal 2012 principally due to lower selling prices and increased corn starch costs partially offset by lower manufacturing production costs.

Operating Expenses

The following table sets forth the breakdown of our operating expenses by category in fiscal 2012 compared to fiscal 2011:

	Fiscal year-ended December 31	Change	
	2012	2011	\$
Selling, general and administrative ¹	10,179,128	7,320,603	2,858,525
Research and development	4,382,854	2,516,360	1,866,494
Share-based compensation	847,104	984,325	(137,221)
Depreciation and amortization	198,220	249,872	(51,652)
Foreign exchange loss (gain)	42,066	(36,501)	78,567
Total operating expenses	15,649,372	11,034,659	4,614,713
			42%

¹ For the purposes of this MD&A, selling, general and administrative expenses excludes share-based compensation, depreciation and amortization and foreign exchange loss (gain)

Total operating expenses in fiscal 2012 were \$15.6 million compared to \$11.0 million in fiscal 2011, an increase of \$4.6 million or 42%. The increase in total operating expenses was principally due to higher selling, general and administrative costs and increased research and development activities. The increase in operating expenses is consistent with our growth strategy as we continue to invest in developing our sales, marketing and R&D capabilities.

Selling, general and administrative¹ – Selling, general and administrative costs increased \$2.9 million or 39% to \$10.2 million from \$7.3 million in fiscal 2011. The increase was principally due to higher salaries and benefits, travel expenses and office administration costs associated with increased headcount compared to the prior year. Our headcount increased 50% in fiscal 2012 compared to fiscal 2011. In addition, we incurred increased costs as a result of being listed as a public company for a full year in fiscal 2012 compared to six months during fiscal 2011 following the IPO on August 4, 2011.

Research and development – Research and development costs were \$4.4 million in fiscal 2012 compared to \$2.5 million in fiscal 2011, an increase of \$1.9 million or 74%. The increase represents continued investment in research and development net of government assistance. In fiscal 2012, we recognized \$0.1 million of government incentives compared to \$0.7 million in fiscal 2011, a decrease of \$0.6 million. Product development is a key focus of EcoSynthetix as we pursue the enhancement of ECOSPHERE BIOLATEX, as well as the development of ECOMER and ECOSTIX to support our on-going effort to displace petrochemical polymers with our low cost, bio-based alternative.

Share-based compensation - Share-based compensation was \$0.8 million in fiscal 2012 compared to \$1.0 million in the prior year, a decrease of \$0.1 million. The decrease was principally due to a lower number of stock options issued in fiscal 2012 compared to fiscal 2011.

Depreciation and Amortization - Depreciation of property, plant and equipment and amortization of intangible assets in fiscal 2012 was \$0.2 million compared to \$0.25 million in fiscal 2011, a decrease of \$0.05 million or 21%. The decrease was primarily related to lower amortization of intangible assets partly offset by higher

depreciation related to equipment located at the Company's Center of Innovation (COI) which was commissioned in the fourth quarter of 2011.

Foreign currency exchange loss (gain) - Foreign exchange represents the revaluation of monetary assets and liabilities denominated in foreign currencies. In fiscal 2012 foreign exchange revaluation losses were \$0.04 million compared to foreign exchange revaluation gains of \$0.04 million in the prior year. The change in foreign exchange revaluation gains are primarily related to foreign exchange rate fluctuations between the U.S. dollar (our functional currency) and the Canadian dollar on our net monetary position in Canadian dollars.

Loss from operations – Our loss from operations in fiscal 2012 was \$11.8 million compared to \$6.1 million in fiscal 2011, an increase of \$5.7 million or 95%. The increase in loss from operations was due to increased operating expenses and lower gross profit.

Interest income – Interest income increased \$0.2 million from \$0.2 million in fiscal 2011 to \$0.4 million in fiscal 2012. The increase in interest income was principally due to the full year effect of higher cash balances resulting from the initial public offering on August 4, 2011.

Loss related to change in fair value of warrants and redeemable preferred shares - In conjunction with the initial public offering on August 4, 2011, the Company's preferred shares were automatically converted to common shares on a one to one basis. As a result, the Company's liability relating to its preferred shares were reclassified into common shares on August 4, 2011. Furthermore, warrants to acquire preferred shares were automatically converted to warrants to acquire common shares. Accordingly, the Company's previous liability relating to warrants to acquire preferred shares are included as a separate component of shareholders' equity as at December 31, 2012 and December 31, 2011. Prior to the initial public offering on August 4, 2011, the redeemable preferred shares and warrants were designated as financial liabilities. They were measured at fair value with the changes in fair value recognized directly in earnings. In fiscal 2012, our loss related to warrants and preferred shares was nil compared to a loss of \$246.8 million in fiscal 2011.

Net Loss - We incurred a net loss of \$11.4 million or \$0.21 per common share in fiscal 2012 compared to a net loss of \$252.7 million or \$10.93 per common share in fiscal 2011. The decrease in net loss during this period is principally due to the loss related to warrants and preferred shares in fiscal 2011 partly offset by an increase in loss from operations in fiscal 2012.

Fiscal year ended December 31, 2011 compared to fiscal year ended December 31, 2010

Net Sales – In fiscal 2011 net sales were \$20.8 million compared to \$15.9 million in fiscal 2010, an increase of \$4.9 million or 31%. 25% of this sales increase was generated from the commercialization of nine new mills in 2011. From a geographic perspective, sales increased \$3.6 million in North America, \$1.0 million in Latin America and \$0.6 million in EMEA. These increases were partially offset by lower sales in Asia Pacific of \$0.3 million. Price increases and higher sales volume in North America, Latin America and EMEA offset lower sales volume experienced in Asia Pacific in fiscal 2011 compared to the prior year.

Gross profit – Gross profit in fiscal 2011 was \$5.0 million or 23.9% of sales compared to \$4.0 million or 24.9% of sales in fiscal 2010, an increase of \$1.0 million or 25.8%. The increase in gross profit was primarily due to sales price increases and higher sales volume partially offset by an increase in raw material input costs principally related to cornstarch. The decrease in gross profit as a percentage of sales was primarily due to sales price increases, which were more than offset by higher raw material input costs and depreciation expenses related to manufacturing equipment. Gross profit adjusted for non-cash items (manufacturing depreciation) as a percentage of sales was 25.5% in fiscal 2011 compared to 26.3% in fiscal 2010.

Operating Expenses

The following table sets forth the breakdown of our operating expenses by category in fiscal 2011 compared to fiscal 2010:

	Fiscal year-ended December 31		Change	
	2011	2010	\$	%
Selling, general and administrative ¹	7,320,603	3,689,095	3,631,508	98%
Research and development	2,516,360	1,051,810	1,464,550	139%
Share-based compensation	984,325	1,095,911	(111,586)	-10%
Depreciation and amortization	249,872	122,460	127,412	104%
Foreign exchange loss (gain)	(36,501)	(65,948)	29,447	-45%
Total operating expenses	11,034,659	5,893,328	5,141,331	87%

¹ For the purposes of this MD&A, selling, general and administrative expenses excludes share-based compensation, depreciation and amortization and foreign exchange loss (gain)

Total operating expenses in fiscal 2011 were \$11.0 million compared to \$5.9 million in fiscal 2010, an increase of \$5.1 million or 87%. The increase in total operating expenses was principally due to an increase in selling, general and administrative expenses and research and development costs. The increase in total operating expenses is consistent with the growth in the business and reflects our continued investment in developing sales, marketing and research and development capabilities.

Selling, general and administrative¹ - Selling, general and administrative costs increased \$3.6 million or 98% from \$3.7 million in fiscal 2010 to \$7.3 million in fiscal 2011. The increase was principally due to higher salaries and benefits and office administration costs associated with increased headcount compared to the prior year. Our headcount increased 80% in fiscal 2011 compared to fiscal 2010. In addition, we incurred increased professional costs associated with operating as a public company.

Research and development – Research and development costs were \$2.5 million in fiscal 2011 compared to \$1.1 million in fiscal 2010, an increase of \$1.5 million or 139%. The increase represents continued investment in research and development net of higher levels of government assistance.

Share-based compensation - Share-based compensation was \$1.0 million in fiscal 2011 compared to \$1.1 million in the prior year, a slight decrease of \$0.1 million. In 2010 we incurred \$0.8 million of share-based compensation expense related to stock options provided to the guarantors of a liability to purchase an annuity related to a key employee. This expense did not recur in fiscal 2011. This was partially offset by an increase in share-based compensation expense related to stock options issued in the current fiscal year.

Depreciation and Amortization - Depreciation of property, plant and equipment and amortization of intangible assets in fiscal 2011 was \$0.2 million compared to \$0.1 million in fiscal 2010, an increase of \$0.1 million or 104%. The increase was primarily related to higher amortization of intangible assets in addition to depreciation related to equipment located at the Company's Center of Innovation (COI) which was commissioned in the fourth quarter of 2011.

Foreign currency exchange loss (gain) - Foreign exchange represents the revaluation of monetary assets and liabilities denominated in foreign currencies. In fiscal 2011 foreign exchange revaluation gains were \$0.04 million compared to foreign exchange revaluation gains of \$0.07 million in the prior year. The change in foreign exchange revaluation gains are primarily related to foreign exchange rate fluctuations between the U.S. dollar (our functional currency) and the Canadian dollar on our net monetary position in Canadian dollars.

Loss from operations – Our loss from operations in fiscal 2011 was \$6.1 million compared to \$1.9 million in fiscal 2010, an increase of \$4.1 million. The increase in loss from operations was due to increased operating expenses, partially offset by higher gross profit.

Interest income – Interest income increased \$0.17 million from \$0.01 million in fiscal 2010 to \$0.18 million in fiscal 2011. The increase in interest income was principally due to higher cash balances during 2011 resulting from the initial public offering on August 4, 2011 compared to our cash balances during fiscal 2010.

Loss related to change in fair value of warrants and redeemable preferred shares - In conjunction with the initial public offering on August 4, 2011, the Company's preferred shares were automatically converted to common shares on a one to one basis. As a result, the Company's liability relating to its preferred shares were reclassified into common shares on August 4, 2011. Furthermore, warrants to acquire preferred shares were automatically converted to warrants to acquire common shares. Accordingly, the Company's previous liability relating to warrants to acquire preferred shares are included as a separate component of shareholders' equity as at December 31, 2011. Prior to the initial public offering on August 4, 2011, the redeemable preferred shares and warrants were designated as financial liabilities. They were measured at fair value with the changes in fair value recognized directly in earnings. In fiscal 2011, our loss related to warrants and preferred shares was \$246.8 million compared to \$47.3 million in the prior year.

Net Loss - We incurred a net loss of \$252.7 million or \$10.93 per common share in fiscal 2011 compared to a net loss of \$49.2 million or \$61.78 per common share in fiscal 2010. The increase in net loss is principally due to a higher loss related to the change in fair value of warrants and redeemable preferred shares and increased operating expenses partly offset by higher gross profit.

Financial condition

	December 31		Change	
	2012	2011	\$	%
Total current assets	104,730,880	119,896,087	(15,165,207)	-13%
Total assets	118,068,797	130,662,211	(12,593,414)	-10%
Total current liabilities	4,509,216	6,142,668	(1,633,452)	-27%
Total long-term liabilities	-	-	-	-

Fiscal year ended December 31, 2012 compared to fiscal year ended December 31, 2011

Total current assets – Total current assets as at December 31, 2012 were \$104.7 million compared to \$119.9 million as at December 31, 2011, a decrease of \$15.2 million or 13%. The decrease is principally due to lower cash as a result of cash flows utilized in operations and lower inventories partly offset by an increase in accounts receivable.

Total assets – Total assets as at December 31, 2012 were \$118.1 million compared to \$130.7 million as at December 31, 2011, a decrease of \$12.6 million or 10%. The decrease was primarily due to lower current assets partly offset by an increase in property, plant & equipment during the year due to equipment purchases related to the commissioning of our new production line in Tennessee, USA.

Total current liabilities – Total current liabilities as at December 31, 2012 were \$4.5 million compared to \$6.1 million as at December 31, 2011, a decrease of \$1.6 million or 27%. The decrease was principally due to lower trade payables and accruals related to purchases of property, plant & equipment.

Fiscal year ended December 31, 2011 compared to fiscal year ended December 31, 2010

Total current assets – Total current assets increased \$78.9 million from \$41.0 million at December 31, 2010 to \$119.9 million at December 31, 2011. The increase was mainly due to an increase in cash of \$70.5 million principally due to the proceeds received from the IPO on August 4, 2011 and an increase in inventories of \$8.3 million.

Total assets – Total assets at December 31, 2011 were \$130.7 million compared to \$42.7 million at December 31, 2010, an increase of \$88.0 million. The increase was primarily due to higher current assets of \$78.9 million and an increase in property, plant and equipment as we continued to invest in our COI facility in Burlington, Ontario and additional production lines in Tennessee and The Netherlands. These investments are further described under the 'liquidity and capital resources' section.

Total current liabilities – Total current liabilities increased from \$5.1 million at December 31, 2010 to \$6.1 million at December 31, 2011, an increase of \$1.0 million. The increase is primarily due to increased trade payables related to equipment purchases, partly offset by lower liabilities related to deferred government grants and accrued compensation. As at December 31, 2010, we were required to purchase an annuity of \$1.0 million which was settled during 2011.

Total long-term liabilities – Long-term liabilities as at December 31, 2011 were nil compared to long-term liabilities of \$136.7 million as at December 31, 2010. As noted earlier, in conjunction with the IPO, our redeemable preferred shares were converted to common shares and our warrants exercisable for preferred shares were converted to warrants exercisable for common shares. Accordingly, the liability with respect to the redeemable preferred shares were reclassified to common shares and the warrants exercisable for common shares (previously for preferred shares) were reclassified to a component of shareholders' equity.

Liquidity and Capital Resources

Our growth is financed through a combination of the cash flows from operations and the issuance of equity. We believe that ongoing operations, working capital and associated cash flow in addition to our cash resources provide sufficient liquidity to support our ongoing business operations for at least the next 12 months.

Below is a summary of our cash flows used in operating activities, financing activities and investing activities for the fiscal year ended December 31, 2012 and 2011:

	Fiscal year-ended December 31		Change	
	2012	2011	\$	%
Cash used in operating activities	(6,566,015)	(13,776,207)	7,210,192	-52%
Cash used in investing activities	(5,748,063)	(10,012,325)	4,264,262	-43%
Cash provided by (used in) financing activities	(139,331)	94,309,200	(94,448,531)	-100%
Net increase (decrease) in cash	(12,453,409)	70,520,668	(82,974,077)	-118%
Beginning cash	105,713,705	35,193,037	70,520,668	200%
Ending cash	93,260,296	105,713,705	(12,453,409)	-12%

Cash used in operating activities – In fiscal 2012 cash utilized in operating activities was \$6.6 million compared to \$13.8 million in fiscal 2011, a decrease of \$7.2 million or 52%. The decrease was principally due to lower investments in non-cash working capital partly offset by an increased in loss from operations.

During fiscal 2012, non-cash working capital decreased \$2.8 million compared to an increase in non-cash working capital of \$9.5 million during fiscal 2011. The decrease in non-working capital in fiscal 2012 was principally due to lower inventory which decreased from \$10.2 million at December 31, 2011 to \$6.8 million at December 31, 2012. In fiscal 2011, the non-cash working capital increase was primarily related to higher inventory levels and the settlement of accrued compensation.

Cash used in investing activities – Cash used in investing activities during fiscal 2012 was \$5.7 million compared to \$10.0 million in fiscal 2011, a decrease of \$4.3 million or 43%. In fiscal 2011 we made investments in our Centre of Innovation (COI) facility and expanded our production capacity.

Cash provided by (used in) financing activities – Cash flows used in financing activities in fiscal 2012 were \$0.1 million compared to cash flows provided by financing activities of \$94.3 in fiscal 2011. The decrease is primarily due to proceeds received on the issuance of common shares, net of share issuance costs, through the initial public offering (IPO) in fiscal 2011 and lower government grants in association with our COI in fiscal 2012 compared to fiscal 2011.

Capital Management

Our objective in managing capital is to ensure sufficient liquidity to pursue our growth strategy and fund research and product development, while at the same time taking a conservative approach towards managing financial risk. Our capital is composed of common shares and the net proceeds from the issuance of common shares redeemable preferred shares. Our primary uses of capital are financing operations, increasing non-cash working capital and capital expenditures. We currently fund these requirements from existing cash resources and cash raised through share issuances. Our objectives when managing capital are to ensure that we will continue to have enough liquidity so that we can provide our products and services to our customers and a return to our shareholders. We monitor our capital on the basis of the adequacy of our cash resources to fund our business plan. In order to maximize the capacity to finance our ongoing growth, we do not currently pay a dividend to holders of our common shares.

Contractual Obligations

Our contractual obligations include operating leases for premises. The following table summarizes our cash commitments as of December 31, 2012 for operating leases.

2013	\$7,843,944
2014	\$378,504
2015	\$378,318
2016	\$378,318
Thereafter	\$1,087,976

In addition, as at December 31, 2012, we are committed to equipment purchases in the approximate amount of \$0.1 million over the next twelve months. This commitment is primarily due to purchases of equipment as we continue to make additional investments in our production facilities.

During the normal course of operations, the company may enter into feedstock contracts to secure raw material availability over a twelve month period based on market pricing at the time of purchase. As at December 31, 2012, the Company was committed to purchases of feedstock prior to September 30, 2013 in the approximate amount of \$6.0 million.

Summary of Quarterly Results

The following table sets out selected financial information for each of the eight most recent quarters, the latest of which ended December 31, 2012. This information has been prepared on the same basis as the annual financial statements and all necessary adjustments have been included in the amounts stated below to present fairly the unaudited quarterly results when read in conjunction with the quarterly financial statements of the Company and the related notes to those statements.

Historically, our quarterly operating results have fluctuated significantly and may continue to fluctuate significantly in the future. Therefore, we believe that past operating results and period-to-period comparisons should not be relied upon as an indication of our future performance. See "Risk Factors" outlined elsewhere in this document.

	Three months ended (unaudited)							
	December 31, 2012	September 30, 2012	June 30, 2012	March 31, 2012	December 31, 2011	September 30, 2011	June 30, 2011	March 31, 2011
Net sales	5,923,661	5,915,571	3,734,766	3,978,347	3,719,129	5,282,495	5,609,095	6,159,132
Gross profit	1,192,753	1,280,527	624,764	759,814	796,474	1,331,328	1,354,593	1,490,626
Loss from operations	(3,480,133)	(2,410,005)	(2,868,263)	(3,033,113)	(2,421,212)	(2,350,475)	(1,121,679)	(168,272)
Net loss	(3,394,357)	(2,324,278)	(2,772,608)	(2,939,492)	(2,345,937)	(2,288,612)	(192,018,852)	(56,054,747)
Weighted average number of shares outstanding	55,297,736	55,324,997	55,248,933	55,248,203	55,239,412	34,406,703	1,079,036	796,278
Basic and diluted loss per share	(0.06)	(0.04)	(0.05)	(0.05)	(0.04)	(0.07)	(177.95)	(70.40)
Adjusted EBITDA ⁽¹⁾	(2,950,364)	(1,804,122)	(2,428,644)	(2,553,696)	(1,886,654)	(2,020,697)	(758,038)	171,456

The following table reconciles net income (loss) to Adjusted EBITDA for the three months ended:

	Three months ended (unaudited)							
	December 31, 2012	September 30, 2012	June 30, 2012	March 31, 2012	December 31, 2011	September 30, 2011	June 30, 2011	March 31, 2011
Net loss	(3,394,357)	(2,324,278)	(2,772,608)	(2,939,492)	(2,345,937)	(2,288,612)	(192,018,852)	(56,054,747)
Depreciation and amortization	384,769	320,883	262,515	239,417	258,341	33,005	145,974	146,060
Share-based compensation	145,000	285,000	177,104	240,000	276,217	296,773	217,667	193,668
Change in value of warrants and preferred shares	-	-	-	-	-	-	190,925,114	55,904,423
Interest expense (income)	(85,776)	(85,727)	(95,655)	(93,621)	(75,275)	(61,863)	(27,941)	(17,948)
Adjusted EBITDA ⁽²⁾	(2,950,364)	(1,804,122)	(2,428,644)	(2,553,696)	(1,886,654)	(2,020,697)	(758,038)	171,456

Notes:

- (1) The common shares issued and outstanding reported prior to the initial public offering completed on August 4, 2011 have been adjusted to reflect the exchange ratio applied, being seven common shares of EcoSynthetix for one share of common share of EcoSynthetix U.S.
- (2) Adjusted EBITDA is not a measure recognized under IFRS and does not have a standardized meaning prescribed by IFRS. See "IFRS and Non-IFRS Measures." The Company presents Adjusted EBITDA because the Company believes it facilitates investors' use of operating performance comparisons from period to period and company to company by backing out potential differences caused by variations in capital structures (affecting relative interest expense), the book amortization of intangibles (affecting relative amortization expense) and the age and book value of property and equipment (affecting relative depreciation expense). The Company also presents Adjusted EBITDA because it believes it is frequently used by securities analysts, investors and other interested parties as a measure of financial performance. Adjusted EBITDA as presented herein are not recognized measures under IFRS and should not be considered as an alternative to operating income or net income as measures of operating results or an alternative to cash flows as measures of liquidity. Adjusted EBITDA is defined as consolidated net income (loss) before net interest expense, income taxes, depreciation, amortization, other non-cash expenses and charges deducted in determining consolidated net income (loss), including both the movement in the unrealized gains and losses on the Company's redeemable preferred shares and warrants and share-based compensation.

Key factors that account for the fluctuations in quarterly results include the growth in the Company's revenue and the pace at which the Company's sales and administrative personnel are expanding.

Fourth Quarter Results

	Three months ended December 31,		Change	
	2012	2011	\$	%
Net sales	5,923,661	3,719,129	2,204,532	59%
Gross profit	1,192,753	796,474	396,279	50%
Loss from operations	(3,480,133)	(2,421,212)	(1,058,921)	44%
Net loss	(3,394,357)	(2,345,937)	(1,048,420)	45%
Weighted average number of shares outstanding	55,297,736	55,239,412	58,324	0%
Basic and diluted loss per share	(0.06)	(0.04)	(0.02)	41%
Adjusted EBITDA	(2,950,364)	(1,886,654)	(1,063,710)	56%

Net sales – Sales in the fourth quarter of fiscal 2012 increased \$2.2 million or 59% from \$3.7 million during the same period in fiscal 2011 to \$5.9 million. The increase in sales was principally due to higher sales volume partly offset by lower selling prices during the fourth quarter of fiscal 2012 compared to 2011. Three new paper mills were commercialized during the fourth quarter accounting for 9% of revenue while the twelve new paper mills commercialized on a year-to-date basis accounted for 23% of fourth quarter revenues. From a geographic perspective, sales increased in Asia Pacific, EMEA and North America principally due to increased volumes to existing customers as a result of higher substitution rates. These increases were partly offset by lower sales in Latin America which decreased principally due to the timing of inventory purchases in the fourth quarter of fiscal 2011.

Gross profit – Gross profit increased from \$0.8 million during the fourth quarter of fiscal 2011 to \$1.2 million during the fourth quarter of 2012, an increase of \$0.4 million or 50%. The increase was principally due to higher volume and lower contract manufacturing production costs partly offset by lower selling price and increased depreciation expense related to manufacturing equipment. Manufacturing depreciation costs increased due to the expansion of our production facilities in the Netherlands and Tennessee, USA which was completed in the fourth quarter of fiscal 2011 and first quarter of fiscal 2012, respectively. Gross profit as a percentage of sales adjusted for non-cash items (manufacturing depreciation) remained consistent at 25.2% compared to prior year as lower contract manufacturing costs offset lower selling prices.

Operating Expenses

The following table sets forth the breakdown of our operating expenses by category for the fourth quarter of 2012 compared to the fourth quarter of 2011:

	Three months ended December 31,		Change	
	2012	2011	\$	%
Selling, general and administrative ¹	2,906,458	1,843,284	1,063,174	58%
Research and development	1,518,916	1,088,845	430,071	39%
Share-based compensation	145,000	276,217	(131,217)	-48%
Depreciation and amortization	81,913	117,872	(35,959)	-31%
Foreign exchange loss (gain)	20,599	(108,532)	129,131	-119%
Total operating expenses	4,672,886	3,217,686	1,455,200	45%

¹ For the purposes of this MD&A, selling, general and administrative expenses excludes share-based compensation, depreciation and amortization and foreign exchange loss (gain).

Total operating expenses in the fourth quarter of fiscal 2012 were \$4.7 million compared to operating expenses in the comparable period in prior year of \$3.2 million, an increase of \$1.5 million or 45%. The increase was principally due to higher selling, general and administration costs and research and development costs partly

offset by decreased share-based compensation expense. The increase in total operating expenses is consistent with the growth in the business and reflects our continued investment in sales, marketing and research and development.

*Selling, general and administrative*¹ – Selling, general and administration expenses increased \$1.1 million or 58% from \$1.8 million in the fourth quarter of fiscal 2011 to \$2.9 million in the fourth quarter of fiscal 2012. The increase was principally due to higher salaries and benefits, travel costs and other administration costs directly related to the increase in headcount.

Research and development – Research and development costs were \$1.5 million in the fourth quarter of fiscal 2012 compared to \$1.1 million in the comparable period in prior year, an increase of \$0.4 million or 39%. The increase in research and development costs represents our ongoing investment in product development and innovation which will allow for further market penetration in the paper and paperboard industry in addition to other key markets as we continue to displace petrochemical polymers with our low cost, bio-based alternative.

Share-based compensation – Share-based compensation expense in the fourth quarter of fiscal 2012 was \$0.1 million compared to \$0.3 million in the comparable period of fiscal 2011, a decrease of \$0.1 million or 48%. The decrease is primarily due to reduced stock option issuances in the current fiscal year compared to prior year.

Foreign currency exchange loss (gain) – Foreign exchange represents the revaluation of monetary assets and liabilities denominated in foreign currencies. In the fourth quarter of 2012 foreign exchange revaluation losses were \$0.02 million compared to foreign exchange revaluation gains of \$0.1 million. The change in foreign exchange revaluation loss in the fourth quarter of 2012 compared to a foreign exchange revaluation gain in the same period in prior year was primarily related to foreign exchange rate fluctuations between the U.S. dollar (our functional currency) and the Canadian dollar on our Canadian dollar net monetary position.

Loss from operations – Our loss from operations in the fourth quarter of fiscal 2012 was \$3.5 million compared to a loss from operations of \$2.4 million in the comparable period of prior year, an increase of \$1.1 million or 44%. The increase was due to increased operating expenses partly offset by higher gross profit.

Interest income – Interest income in the fourth quarter of 2012 was \$0.1 million which was comparable to the fourth quarter of fiscal 2011.

Net Loss – We incurred a net loss of \$3.4 million or \$0.06 per common share in the fourth quarter of fiscal 2012 compared to a net loss of \$2.3 million or \$0.04 per common share in the comparable period of prior year. The increase in net loss of \$1.1 is due to an increase in operating expenses partly offset by higher gross profit

Liquidity

Below is a summary of our cash flows provided by (used in) operating activities, financing activities and investing activities for the three months ended December 31, 2012 and 2011:

	Three months ended December 31		Change	
	2012	2011	\$	%
Cash used in operating activities	(1,191,478)	(2,782,135)	1,590,657	-57%
Cash used in investing activities	(403,264)	(3,766,427)	3,363,163	-89%
Cash provided by financing activities	240,614	15,454	225,160	1457%
Net decrease in cash	(1,354,128)	(6,533,108)	5,178,980	-79%
Beginning cash	94,614,424	112,246,813	(17,632,389)	-16%
Ending cash	93,260,296	105,713,705	(12,453,409)	-12%

Cash used in operating activities – Cash used in operations in the fourth quarter of 2012 was \$1.2 million compared to \$2.8 million for the comparable period in prior year, a decrease in cash utilized for operating activities of \$1.6 million. The decrease was principally due to a lower investment in non-cash working capital of \$1.7 million in the fourth quarter of fiscal 2012 compared to a higher investment in non-cash working capital of

\$1.0 million in the fourth quarter of fiscal 2011. This was partly offset by an increase in loss from operations of \$1.1 million during this period.

For the three months ended December 31, 2012, the decrease in non-cash working capital was principally due to lower inventories, increased accounts payable and accrued liabilities and lower accounts receivable.

For the three months ended December 31, 2011, the increase in non-cash working capital was due to increased inventory partially offset by lower accounts receivable.

Cash used in investing activities – Cash used in investing activities during the fourth quarter of fiscal 2012 was \$0.4 million compared to \$3.8 million in the comparable period of fiscal 2011, a decrease of to \$3.4. The decrease was due to purchases of capital equipment in fiscal 2011 related to investments in our Center of Innovation research facility and in the expansion of our production capacity in the Netherlands and in Tennessee, USA which were completed in the fourth quarter of fiscal 2011 and the first quarter of fiscal 2012, respectively.

Cash provided by financing activities – Cash provided by financing activities in the fourth quarter of 2012 was \$0.2 million compared to nil for the same period in fiscal 2011. The increase was principally due to government grants received during the current quarter.

Adjusted EBITDA

Adjusted EBITDA in the fourth quarter of 2012 was a loss of \$3.0 million compared to a loss of \$1.9 million in the same period of the prior year. The increase in adjusted EBITDA loss is principally due to higher operating expenses partly offset by higher gross profit.

Critical Accounting Policies and Estimates

The preparation of the financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities. These estimates and assumptions are affected by management's application of accounting policies and historical experience, and are believed by management to be reasonable under the circumstances. Such estimates and assumptions are evaluated on an ongoing basis and form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ significantly from these estimates.

Management believes the following critical accounting policies reflect the more significant estimates and assumptions used in the preparation of our financial statements. We believe that there have been no significant changes in our critical accounting estimates for the time periods presented in our interim financial statements.

Inventory

Inventory valuation assessments are performed periodically or when indicators of impairment are present. These assessments may involve significant uncertainty and are subject to change in that they could require the use of forward looking assumptions such as estimating the amount and timing of revenues as well as projecting the likelihood of an item becoming obsolete or unusable in the future. Recognition of inventory valuation provisions may have a material impact on our net income and the value of our inventory.

Impairment of long-lived assets

Long-lived assets (including property, plant and equipment and intangible assets with definite lives) are reviewed for impairment at each reporting date to determine whether there is an indication that an asset may be impaired. If any indication exists we estimate the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating units (CGU) fair value less costs to sell and its value in use and is determined for individual assets unless the asset does not generate cash inflows that are largely independent of those from other assets or group of assets. Where the carrying amount of an asset or CGU exceeds its recoverable amount, the asset is considered impaired and it is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Asset impairment

assessments involve significant uncertainty and are susceptible to change they require the use of forward looking assumptions such as sales, costs, foreign exchange rates and market growth rates. Recognition of impairment may have a material impact on our net income and the value of our long-lived assets. Whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable, a long-lived asset or asset group is required to be tested for possible impairment.

Redeemable Preferred Shares and Warrants

Upon completion of our IPO on August 4, 2011, all of the redeemable preferred shares were automatically converted into common shares and warrants to acquire redeemable preferred shares were automatically converted to warrants to acquire common shares . As a result the Company's liability relating to redeemable preferred shares were reclassified into common shares and warrants were reclassified to a separate component of shareholders' equity (deficiency). Prior to the conversion on August 4, 2011, our redeemable preferred shares had a liability component that was designated a financial liability, and outstanding warrants that were convertible into such shares that were also designated as financial liabilities. They were measured at fair value, with changes in fair value recognized directly in earnings.

Share-based compensation

We have a share-based compensation plan which is described in note 13 to the consolidated financial statements. We account for all share-based payments using the fair value-based method.

We use a Black-Scholes option pricing model to determine fair value of share options at the grant date, electing to use the minimum value valuation model. This pricing model requires management to make highly subjective assumptions with respect to volatility, dividend yield, expected life and risk free interest rate. Changes in the input assumptions can materially affect the fair value estimate and, therefore, the existing models do not necessarily provide a reliable measure of the fair value of our share options. Share-based compensation is charged to operations over the vesting period and the offset is credited to contributed surplus. On exercise of share options, the related amount in contributed surplus is transferred to common shares.

Valuation of Future Income Tax Assets

Significant management judgment is required in determining the valuation allowance recorded against our net income tax assets. We record a valuation allowance to reduce our future income tax assets recorded on our consolidated balance sheet to the amount of future income tax benefit that is more likely than not to be realized. We have recorded a full valuation allowance to reflect the uncertainties associated with the realization of our future income tax assets based on management's best estimates as to the certainty of realization.

Internal control over financial reporting

Management is responsible for establishing and maintaining a system of disclosure controls and procedures to provide reasonable assurance that all material information relating to the Company and its subsidiaries is gathered and reported to senior management on a timely basis so that appropriate decisions can be made regarding public disclosures. Management is also responsible for establishing and maintaining adequate internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial reports for external purposes in accordance with IFRS.

As required by National Instrument 52-109 (Certification of Disclosure in Issuer's Annual and Interim Filings), the Executive Chairman, as Chief Executive Officer and the Chief Financial Officer have caused to be evaluated under their supervision the effectiveness of such internal controls over financial reporting using the framework as established by The Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on the evaluation, they have concluded that the design and operation of the Company's internal controls over financial reporting were effective as at December 31, 2012.

In designing such controls, it should be noted that due to inherent limitations, any controls, no matter how well designed and operated can provide reasonable assurance of achieving the desired control objectives and may not prevent or detect misstatements. Additionally management is necessarily required to use judgment in evaluating controls and procedures.

There were no changes in the Company's internal control over financial reporting during the fourth quarter of 2012 that have materially affected, or are reasonable likely to materially affect, the Company's internal control over financial reporting.

Outlook

The world needs to reduce its dependence on oil. The global economy is predicated on cheap oil and many of the consumer goods we rely on are manufactured using petroleum-based synthetic polymers. While the bio-based product industry is still in its infancy today, it is growing, and we believe it will be a significant part of the petrochemicals industry that exceeds \$2 trillion today. As society becomes more sustainable in its use of natural resources, our aim is to be a global leader in bio-materials by investing in product development across a range of applications.

In 2012, we completed a number of strategic initiatives that position our bio-based products for robust growth in the approximately \$6 billion coated paper and coated paperboard for packaging markets. The demand for these products is growing as paper and paperboard mills continue to migrate from petroleum-based binders to the renewable biolatex® binders we offer. The decision to build out a direct sales force and technical service team in Asia is now paying dividends with new customers and a robust sales pipeline. Similarly, the decision to invest in six new dispersion centers in North America, Europe and Asia has allowed us to provide liquid product to mills. Our ability to supply liquid product has helped to accelerate the sales cycle after the successful completion of a production trial.

We are seeing a growing interest from the building products industry for renewable polymers and resins that can replace products containing formaldehyde binders, which are increasingly under pressure due to the potential risk they pose to consumer health. The stringent requirement of LEED certification in new buildings and a change in government regulation in many countries is already underway and is expected to create a growing demand for the products we have in our development pipeline.

We have a unique and differentiated value proposition, a solid corporate and go-to market strategy, innovative product development, outstanding talent and the financial resources to become one of the world's leading technology and market developers of bio-based materials.

Risk Factors

For a detailed description of the risk factors associated with the Company, refer to the "Risk Factors" section of the Company's Annual Information Form for the fiscal year ended December 31, 2012. The Company is not aware of any significant changes to the Company's risk factors from those disclosed at that time.

Additional Information

Additional information relating to EcoSynthetix Inc., including continuous disclosure documents, is available on SEDAR at www.sedar.com.

Common Share Trading Information

The Company's common shares trade on the Toronto Stock Exchange under the symbol "ECO" and commenced trading on August 4, 2011. As at March 5, 2013, the Company had the equivalent of 55,924,371 common shares issued and outstanding assuming conversion of all rights pursuant to the put/call agreement. In addition, if all outstanding warrants and share options were exercised, there would be the equivalent of 61,395,599 common shares issued and outstanding on a fully diluted basis as at March 5, 2013.

EcoSynthetix Inc.

Consolidated Financial Statements

December 31, 2012 and December 31, 2011

(expressed in US dollars)

March 5, 2013

Independent Auditor's Report

To the Shareholders of EcoSynthetix Inc.

We have audited the accompanying consolidated financial statements of and its subsidiaries, which comprise the consolidated balance sheets as at December 31, 2012 and December 31, 2011 and the consolidated statements of operations and comprehensive loss, shareholders' equity (deficiency) and cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of EcoSynthetix Inc. and its subsidiaries as at December 31, 2012 and December 31, 2011 and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards.

(Signed) “PricewaterhouseCoopers LLP”

**Chartered Accountants, Licensed Public Accountants
Toronto, Ontario**

EcoSynthetix Inc.

Consolidated Balance Sheets At December 31

(expressed in US dollars)

	2012	2011
Assets		
Current assets		
Cash	93,260,296	105,713,705
Accounts receivable (note 5)	4,309,355	3,116,445
Inventory (note 6)	6,822,619	10,243,410
Government grants receivable (note 7)	184,118	639,685
Prepaid expenses	<u>154,492</u>	<u>182,842</u>
	104,730,880	119,896,087
Non-current assets		
Intangible assets (note 8)	163,501	-
Property, plant and equipment (note 9)	<u>13,174,416</u>	<u>10,766,124</u>
Total assets	<u>118,068,797</u>	<u>130,662,211</u>
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities (note 10)	4,282,296	6,142,668
Deferred government grant (note 7)	<u>226,920</u>	-
Total liabilities	<u>4,509,216</u>	<u>6,142,668</u>
Shareholders' Equity		
Common shares (note 14)	492,065,820	492,353,321
Contributed surplus	6,831,354	6,073,080
Accumulated deficit	<u>(385,337,593)</u>	<u>(373,906,858)</u>
Total shareholders' equity	<u>113,559,581</u>	<u>124,519,543</u>
Total shareholders' equity and liabilities	<u>118,068,797</u>	<u>130,662,211</u>

Approved by the Board of Directors

(Signed) John van Leeuwen, Director

(Signed) John E. Barker, Director

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

EcoSynthetix Inc.

Consolidated Statements Operations and Comprehensive Loss For the years ended December 31

(expressed in US dollars, unless otherwise noted)

	2012	2011
Net sales	19,552,345	20,769,851
Cost of sales	15,694,487	15,796,830
Gross profit on sales	<u>3,857,858</u>	<u>4,973,021</u>
Expenses		
Selling, general and administrative	11,266,518	8,518,299
Research and development	4,382,854	2,516,360
	<u>15,649,372</u>	<u>11,034,659</u>
Loss from operations	(11,791,514)	(6,061,638)
Interest income	360,779	183,027
Loss related to change in value of warrants and redeemable preferred shares (note 11)	-	<u>(246,829,537)</u>
Net loss and comprehensive loss	<u>(11,430,735)</u>	<u>(252,708,148)</u>
Basic and diluted loss per common share (note 19)	(0.21)	(10.93)
Weighted average number of common shares outstanding (note 19)	55,288,432	23,125,647

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

EcoSynthetix Inc.

Consolidated Statements of Shareholders' Equity (Deficiency)

For the years ended December 31

(expressed in US dollars)

	Common shares	Equity component of redeemable preferred shares	Contributed surplus	Accumulated deficit	Total
Balance - January 1, 2011	143,213	19,793,287	2,180,570	(121,198,710)	(99,081,640)
Issuance of common shares - net of share issuance costs	91,658,551	-	-	-	91,658,551
Conversion of preferred shares and warrants	400,055,391	(19,793,287)	3,265,161	-	383,527,265
Warrants exercised	334,649	-	(305,155)	-	29,494
Common share options exercised	161,517	-	(51,821)	-	109,696
Share-based compensation	-	-	984,325	-	984,325
Net loss and comprehensive loss	-	-	-	(252,708,148)	(252,708,148)
Balance - December 31, 2011	<u>492,353,321</u>	-	<u>6,073,080</u>	<u>(373,906,858)</u>	<u>124,519,543</u>
Balance - January 1, 2012	<u>492,353,321</u>	-	<u>6,073,080</u>	<u>(373,906,858)</u>	<u>124,519,543</u>
Common share options exercised	234,228	-	(88,830)	-	145,398
Common shares repurchased	(521,729)	-	-	-	(521,729)
Share-based compensation	-	-	847,104	-	847,104
Net loss and comprehensive loss	-	-	-	(11,430,735)	(11,430,735)
Balance - December 31, 2012	<u>492,065,820</u>	-	<u>6,831,354</u>	<u>(385,337,593)</u>	<u>113,559,581</u>

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

EcoSynthetix Inc.

Consolidated Statements of Cash Flows **For the years ended December 31**

(expressed in US dollars)

	2012	2011
Cash provided by (used in)		
Operating activities		
Net loss	(11,430,735)	(252,708,148)
Items not affecting cash		
Depreciation and amortization	1,207,584	583,380
Share-based compensation (note 13)	847,104	984,325
Change in value of warrants and redeemable preferred shares	-	246,829,537
Changes in non-cash working capital		
Accounts receivable	(1,192,910)	(376,875)
Inventory	3,535,225	(8,055,027)
Government grants receivable (note 7)	455,567	334,066
Prepaid expenses	28,350	(101,753)
Accounts payable and accrued liabilities	(6,120)	226,620
Accrued compensation	-	(1,005,371)
Deferred government assistance	(10,080)	(486,961)
	<hr/>	<hr/>
	(6,566,015)	(13,776,207)
Investing activities		
Purchase of intangible assets and property and equipment (notes 8 and 9)	<hr/>	<hr/>
	(5,748,063)	(10,012,325)
Financing activities		
Common share issuance costs (note 14)	-	(10,792,531)
Issuance of common shares (note 14)	-	102,451,082
Repurchase of common shares	(521,729)	-
Exercise of share options	145,398	109,696
Exercise of common share warrants	-	29,494
Increase in government grant (note 7)	237,000	2,511,459
	<hr/>	<hr/>
	(139,331)	94,309,200
(Decrease) increase in cash during the year	<hr/>	<hr/>
Cash - Beginning of year	<hr/>	<hr/>
Cash - End of year	<hr/>	<hr/>
Non-cash financing activities		
Conversion of redeemable preferred shares and related warrants to common shares (note 14)	-	383,527,263

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

EcoSynthetix Inc.

Notes to Consolidated Financial Statements **December 31, 2012 and December 31, 2011**

(expressed in US dollars, unless otherwise noted)

1 Business operations

EcoSynthetix Inc. (EcoSynthetix or the company) is engaged in the development and commercialization of ecologically friendly, bio-based technologies as replacement solutions for synthetic, petrochemical-based adhesives and other related products in North America, Latin America, Europe, Middle East and Africa (EMEA), and Asia Pacific. EcoSynthetix is incorporated and domiciled in Canada. The address of its registered office is 3365 Mainway, Burlington, Ontario, Canada.

2 Summary of significant accounting policies

Statement of compliance

These consolidated financial statements have been authorized for issuance by the board of directors of the company on March 5, 2013.

Basis of preparation

The consolidated financial statements have been prepared under International Financial Reporting Standards (IFRS), using the historical cost convention, except that financial instruments at fair value through profit or loss (FVTPL) are measured at fair value, and liabilities for share-based payment arrangements are measured at fair value.

Use of estimates and judgments

The preparation of consolidated financial statements in accordance with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. These estimates are based on management's best knowledge of current events and actions that the company may undertake in the future. Actual results may differ from those estimates.

Significant estimates made by the company include estimates of share-based compensation, potentially uncollectible accounts receivable, provisions for inventory that are carried in excess of net realizable value, and the realizability of deferred income tax assets.

Basis of consolidation

The financial statements of the company consolidate the accounts of EcoSynthetix and all of its subsidiaries. All intercompany transactions, balances and unrealized gains and losses from intercompany transactions are eliminated on consolidation.

Subsidiaries are all entities controlled by the company.

EcoSynthetix Inc.

Notes to Consolidated Financial Statements **December 31, 2012 and December 31, 2011**

(expressed in US dollars, unless otherwise noted)

Foreign currency translation

i) Functional and presentation currency

Items included in the financial statements of each consolidated entity in the company's consolidated financial statements are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The consolidated financial statements are presented in US dollars, which is the company's reporting currency. The functional currency of all entities is US dollars.

ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign currency exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in currencies other than an organization's functional currency are recognized in the consolidated statements of operations and comprehensive loss.

Cash

Cash consists of cash on hand and deposits held with banks.

Trade receivables

Trade receivables are amounts due from customers for products sold in the ordinary course of business. If collection is expected in one year or less, they are classified as current assets.

Trade receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less a provision for impairment.

Financial instruments

Financial assets and financial liabilities are recognized when the company becomes a party to the contractual provisions of the financial instrument. Financial assets are derecognized when the rights to receive cash flows from the financial assets have expired or have been transferred and the company has transferred substantially all risks and rewards of ownership.

Financial assets and financial liabilities are offset and the net amount reported in the consolidated balance sheets when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the financial asset and settle the financial liability simultaneously.

EcoSynthetix Inc.

Notes to Consolidated Financial Statements **December 31, 2012 and December 31, 2011**

(expressed in US dollars, unless otherwise noted)

At initial recognition, the company classifies its financial instruments in the following categories, depending on the purpose for which the financial instruments were acquired:

i) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The company's loans and receivables comprise account receivables, government grants and cash and cash equivalents and are classified as current, except for the portion expected to be realized or paid beyond 12 months of the consolidated balance sheet dates, which is classified as non-current. Loans and receivables are initially recognized at the amount expected to be received less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest method, less a provision for impairment.

ii) Financial liabilities at amortized cost

Financial liabilities at amortized cost include trade payables and accrued liabilities. Trade and accrued liabilities are initially recognized at the amount required to be paid less, when material, a discount to reduce the payables to fair value. Subsequently, trade and accrued liabilities are measured at amortized cost, using the effective interest method.

Financial liabilities are classified as current liabilities if payment is due within 12 months. Otherwise, they are presented as non-current liabilities.

Impairment of financial assets

At each reporting date, the company assesses whether there is objective evidence that a financial asset is impaired. If such evidence exists, the company recognizes an impairment loss on financial assets carried at amortized cost as follows. The loss is the difference between the amortized cost of the receivable and the present value of the estimated future cash flows, discounted using the financial instrument's original effective interest rate. The carrying amount of the asset is reduced by this amount either directly or indirectly through the use of an allowance account.

Impairment losses on financial assets carried at amortized cost are reversed in subsequent years if the amount of the loss decreases and the decrease can be related objectively to an event's occurring after the impairment was recognized.

Inventory

Raw materials, work-in-process and finished goods are valued at the lower of cost, determined on a first-in, first-out basis, and net realizable value. Inventory costs include the costs of material, labour, variable overhead and an allocation of fixed manufacturing overhead, including depreciation based on normal production volumes. Net realizable value is the estimated selling price less applicable selling expenses.

EcoSynthetix Inc.

Notes to Consolidated Financial Statements **December 31, 2012 and December 31, 2011**

(expressed in US dollars, unless otherwise noted)

Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the company and the cost can be measured reliably. The carrying amount of a replaced asset is derecognized when replaced. Repairs and maintenance costs are charged to the consolidated statements of operations and comprehensive loss during the year in which they are incurred.

Depreciation is calculated on a straight-line method to reduce the cost of the asset to its residual value over its estimated useful life. The depreciation rates applicable to each category of property, plant and equipment are as follows:

Leasehold improvements	remaining lease term
Computer hardware	3 years
Machinery and equipment	2 to 15 years

Useful lives and residual values are reviewed and adjusted, if appropriate, at the end of each reporting period.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. Gains and losses on disposals of property and equipment are determined by comparing the proceeds with the carrying amount of the asset and are included as part of other gains and losses in the consolidated statements of operations and comprehensive loss.

Intangible assets

Computer software costs are amortized on a straight-line basis over their estimated useful lives, which are approximately three years.

Impairment of non-financial assets

Property and equipment and intangible assets are tested for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units or CGUs). The recoverable amount is the higher of an asset's fair value less costs to sell and value in use (being the present value of the expected future cash flows of the relevant asset or CGU). An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. Non-financial assets that have been impaired previously are reviewed for possible reversal of impairment at each reporting date.

Provisions

Provisions are recognized when the company has a present legal or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation, and the

EcoSynthetix Inc.

Notes to Consolidated Financial Statements **December 31, 2012 and December 31, 2011**

(expressed in US dollars, unless otherwise noted)

amount can be reliably estimated. Provisions are measured at management's best estimate of the expenditure required to settle the obligation at the end of the reporting period and are discounted to present value where the effect is material. The company performs evaluations to identify onerous contracts and, where applicable, records provisions for such contracts.

Redeemable preferred shares

The company's redeemable preferred shares are compound financial instruments. The liability component of the redeemable preferred shares is recognized initially at the fair value of a similar liability. The equity conversion option is recognized initially at the difference between the fair value of the compound financial instrument as a whole and the fair value of the liability component. Any directly attributable transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts. In conjunction with the initial public offering (the offering) on August 4, 2011, the redeemable preferred shares and related warrants were automatically converted to common shares.

Research and product development costs

Expenditures during the research phase are expensed as incurred. Expenditures during the development phase are expensed as incurred, unless they meet the capitalization criteria of International Accounting Standard (IAS) 38, Intangible Assets. No development costs have been capitalized to date.

Government grants

Government grants include funding for government research and product development support. Research and product development funding is recognized when there is reasonable assurance that the company has complied with the conditions attached to the funding arrangement and is recognized as the applicable costs are incurred. Research and product development funding is presented as a reduction in research and product development expenses, unless it is for reimbursement of an asset, in which case, it is accounted for as a reduction in the carrying amount of the applicable asset.

Revenue recognition

Revenue is recognized when the company has transferred the significant risk and rewards of ownership of the goods to the buyer, it is probable that the economic benefits will flow to the company, delivery has occurred, and the amount of revenue and costs incurred or to be incurred can be measured reliably. These criteria are generally met at the time the product is shipped and risk and rewards have passed to the customer. Revenue is measured based on the price specified in the sales contract, net of discounts and estimated returns at the time of sale. Historical experience is used to estimate and provide for discounts and returns.

Cost of sales and gross profit

Our gross profit is derived from our net sales, less our cost of sales. Cost of sales includes raw material costs, contract manufacturing costs, freight costs and depreciation related to manufacturing equipment. Direct materials consist of the costs of cornstarch feedstock and process chemicals. Cost of sales is mainly affected by the cost of cornstarch and contract manufacturing costs. Cornstarch is the most significant raw material cost.

EcoSynthetix Inc.

Notes to Consolidated Financial Statements **December 31, 2012 and December 31, 2011**

(expressed in US dollars, unless otherwise noted)

Share capital

Common shares are classified as equity. Incremental costs directly attributable to the issuance of common shares are recognized as a deduction from shareholders' equity (deficiency). The company has classified all outstanding exchangeable shares of its subsidiaries as issued and outstanding of the parent company.

Share-based compensation

The company grants share options to certain employees, advisers and consultants. Each tranche in an award is considered a separate award with its own vesting period and grant date fair value. The fair value of each tranche is measured at the date of grant using the Black-Scholes option pricing model. Compensation expense is recognized over the tranche's vesting period, based on the number of awards expected to vest, by increasing contributed surplus. The number of awards expected to vest is reviewed at least annually, with any impact being recognized immediately. Any contribution paid by an employee or director on the exercise of share options is credited to common stocks with any previously recognized compensation expense.

Income taxes

Income taxes comprise current and deferred income taxes. Income taxes are recognized in the consolidated statements of operations and comprehensive loss, except to the extent that they relate to items recognized directly in shareholders' equity, in which case the income taxes are also recognized directly in shareholders' equity.

Current income taxes are the expected income taxes payable on the taxable income for the year, using income tax rates enacted or substantively enacted, at the end of the reporting period, and any adjustment to income taxes payable in respect of previous years.

In general, deferred income taxes are recognized in respect of temporary differences arising between the income tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income taxes are determined on a non-discounted basis using income tax rates and laws that have been enacted or substantively enacted at the consolidated balance sheet dates and are expected to apply when the deferred income tax asset or liability is settled. Deferred income tax assets are recognized to the extent that it is probable that the assets can be recovered.

Deferred income taxes are provided on temporary differences arising on investments in subsidiaries and associates, except, in the case of subsidiaries, where the timing of the reversal of the temporary difference is controlled by the company and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets and liabilities are presented as non-current.

Loss per share

Basic loss per common share is calculated based on the weighted average number of common shares outstanding for the year. Diluted loss per common share is calculated using the weighted average number of

EcoSynthetix Inc.

Notes to Consolidated Financial Statements **December 31, 2012 and December 31, 2011**

(expressed in US dollars, unless otherwise noted)

common shares outstanding for the year for basic net loss per common share plus the weighted average number of potential dilutive common shares that would have been outstanding during the year had potentially all common shares been issued at the beginning of the year or when the underlying share options or warrants were granted, if later, unless they were anti-dilutive.

Operating lease

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments under an operating lease (net of any incentives received from the lessor) are recognized in the consolidated statements of operations and comprehensive loss on a straight-line basis over the period of the lease.

Operating segments

The company operates in one operating segment and is reported in a manner consistent with the internal reporting provided to the chief operating decision-maker (CODM). The chief executive officer has authority for resource allocation and assessment of the company's performance and is, therefore, the CODM.

3 Risk management and financial instruments

The company has classified its financial instruments into one of the following categories: loans and receivables; and other financial liabilities at amortized cost. The following table summarizes information regarding the carrying amounts of the company's financial instruments:

	2012	2011
Loans and receivables (i)	97,569,651	108,830,150
Other financial liabilities (ii) - amortized cost	4,509,216	6,142,668

- i) Includes cash and cash equivalents and accounts receivable
- ii) Includes financial liabilities included within accounts payable and accrued liabilities and deferred government grant.

Liquidity

The company has sustained losses and negative cash flows from operations since its inception. Liquidity risk is the risk that the company will encounter difficulty in meeting its financial obligations associated with financial liabilities that are settled by delivering cash or another financial asset. The company is exposed to liquidity risk as it continues to have net cash outflows to support its operations. The company's approach to managing liquidity risk is to ensure it will have sufficient liquidity to meet liabilities when due. The company achieves this by maintaining sufficient cash and cash equivalents. The company monitors its financial position on a monthly basis and updates its expected use of cash resources based on the latest available data. The company's accounts payable and accrued liabilities will be paid within the next 12 months.

EcoSynthetix Inc.

Notes to Consolidated Financial Statements **December 31, 2012 and December 31, 2011**

(expressed in US dollars, unless otherwise noted)

Credit risk

Credit risk arises from the potential that a counterparty will fail to perform its obligations. The company is exposed to credit risk from customers. At December 31, 2012, the company's three largest customers accounted for 48% (2011 - two customers at 52%) of accounts receivable. In order to minimize the risk of loss for accounts receivable, the company's extension of credit to customers involves a review and approval by senior management. The majority of the company's sales are invoiced with payment terms between 20 and 90 days. The company's objective is to minimize its exposure to credit risk from customers in order to prevent losses on financial assets by performing regular monitoring of overdue balances and to provide an allowance for potentially uncollectible accounts receivable.

The company's accounts receivable have a carrying amount of \$4,055,247 at December 31, 2012 (2011 - \$2,510,783), representing the maximum exposure to credit risk of those financial assets, exclusive of the allowance for doubtful accounts. Normal credit terms for amounts due from customers call for payment within 20 to 90 days. An insignificant number of these receivables were past due at December 31, 2012. The company's exposure to credit risk for trade receivables by geographic area at December 31 was as follows:

	2012 %	2011 %
North America	23	29
Latin America	9	21
EMEA	14	7
Asia Pacific	54	43
	<hr/>	<hr/>
	100	100

The company believes the credit quality is high for trade receivables, which are neither past due nor impaired, based on prior experience of collections of accounts within 0-90 days of billing.

The company may also have credit risk relating to cash, which it manages by dealing with large chartered Canadian and US banks. The company's objective is to minimize its exposure to credit risk in order to prevent losses on financial assets by placing its investments in lower risk deposits of these chartered banks. The company's cash carrying amount is \$93,260,296 at December 31, 2012 (2011 - \$105,713,705), representing the maximum exposure to credit risk of these financial assets. Approximately 75% (2011 - 99%) of the company's cash at December 31, 2012 was held by one financial institution. The company's exposure to credit risk relating to cash segmented by geographic area at December 31 was as follows:

	2012 %	2011 %
Canada	77.1	98.5
United States of America	22.7	1.0
The Netherlands	0.2	0.5
	<hr/>	<hr/>
	100.0	100.0

EcoSynthetix Inc.

Notes to Consolidated Financial Statements **December 31, 2012 and December 31, 2011**

(expressed in US dollars, unless otherwise noted)

Foreign currency risk

Foreign currency risk arises because of fluctuations in foreign currency exchange rates. The company conducts a portion of its business activities in currencies other than the functional currency of the parent company (US dollars). This primarily includes Canadian dollar and Euro denominated transactions. The company's objective in managing its foreign currency risk is to minimize its net exposure to foreign currency cash flows by converting foreign denominated financial assets into US dollars to the extent practical to match the obligations of its financial liabilities. Financial assets and financial liabilities denominated in foreign currencies will be affected by changes in the exchange rate between the functional currency and these foreign currencies. This primarily includes cash, accounts receivable and accounts payable and accrued liabilities, which are denominated in foreign currencies. The company recognized foreign currency exchange gains (losses) in the years ended December 31, 2012 and 2011 of (\$42,066) and \$36,501, respectively.

If a shift in the Canadian dollar relative to the US dollar of 10% were to occur, the foreign currency exchange gain or loss on the net financial assets could be plus or minus \$25,128 (2011 - \$34,084) due to exchange rate fluctuations and this amount would be recorded in the consolidated statements of operations and comprehensive loss.

If a shift in the euro relative to the US dollar of 10% were to occur, the exchange gain or loss on the net financial assets would not be significant.

Interest rate risk

Interest rate risk arises because of the fluctuation in market interest rates. The company's objective in managing interest rate risk is to maximize the return on its cash. The company is subject to interest rate risk on its cash. If a shift in interest rates of 10% were to occur, the impact on the consolidated statements of operations and comprehensive loss for the year is not significant.

Fair value

The carrying amounts of cash, accounts receivable and accounts payable and accrued liabilities approximate their fair values given their short-term nature.

Fair value measurement recognized in the consolidated balance sheets

Financial instruments that are measured at fair value are grouped into levels 1 to 3, based on the degree to which their fair value is observable.

- Level 1 - Fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical financial assets or financial liabilities.
- Level 2 - Fair value measurements are those derived from inputs other than quoted prices included within level 1 that are observable for the financial asset or financial liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

EcoSynthetix Inc.

Notes to Consolidated Financial Statements **December 31, 2012 and December 31, 2011**

(expressed in US dollars, unless otherwise noted)

- Level 3 - Fair value measurements are those derived from valuation techniques that include inputs for the financial asset or financial liability that are not based on observable market data (unobservable inputs).

The company's financial assets and liabilities at fair value as at December 31, 2012 were as follows:

	Level 1 \$	Level 2 \$	Level 3 \$	Total \$
Cash and cash equivalents	-	93,260,296	-	93,260,296
Accounts receivable	-	4,309,355	-	4,309,355
Accounts payable and accrued liabilities	-	4,282,296	-	4,282,296
Government grant receivable	-	184,118	-	184,118
	<hr/>	<hr/>	<hr/>	<hr/>
	-	102,036,065	-	102,036,065
	<hr/>	<hr/>	<hr/>	<hr/>

4 Capital management

The company's objective in managing capital is to ensure sufficient liquidity to pursue its growth strategy, fund research and product development, while at the same time, taking a conservative approach toward financial leverage and management of financial risk. The company's capital is composed of the net cash received related to common shares, warrants and shareholder option exercises. The total capital at December 31, 2012 is \$158,582,896 (2011 - \$158,959,227). The company's primary uses of capital are financing operations, increasing non-cash working capital and capital expenditures. The company currently funds these requirements from existing cash resources and cash raised through share issuances. The company's objectives when managing capital are to ensure the company will continue to have enough liquidity so that it can provide its products and services to its customers and returns to its shareholders. The company monitors its capital on the basis of the adequacy of its cash resources to fund its business plan. In order to maximize the capacity to finance the company's ongoing growth, the company does not currently pay a dividend to holders of its common shares.

5 Accounts receivable

	2012	2011
Trade accounts receivable - net	4,055,247	2,510,783
Commodity taxes receivable and other	254,108	605,662
	<hr/>	<hr/>
	4,309,355	3,116,445
	<hr/>	<hr/>

The company has recorded no provision for bad debts at December 31, 2012 (2011 - \$82,126).

EcoSynthetix Inc.

Notes to Consolidated Financial Statements **December 31, 2012 and December 31, 2011**

(expressed in US dollars, unless otherwise noted)

The aging of accounts receivable at each reporting date was as follows:

	2012	2011
Current	3,180,662	2,671,616
Past due 1-30 days	981,031	357,782
Past due 31-60 days	1,035	34,309
Past due 61-90 days	138	6,498
Past due greater than 91 days	<u>146,489</u>	<u>46,240</u>
Balance at December 31	<u>4,309,355</u>	<u>3,116,445</u>

6 Inventory

	2012	2011
Raw materials	1,118,460	994,440
Finished goods	<u>5,704,159</u>	<u>9,248,970</u>
	<u>6,822,619</u>	<u>10,243,410</u>

7 Government grants

The company has a forgivable loan agreement with the Province of Ontario under its Innovation Demonstration Fund Program (Ontario) (IDF), pursuant to which, Ontario will provide a forgivable loan up to a maximum of approximately \$3.1 million for a specific technology demonstration project. This loan is forgivable in the event no conditions of default have occurred, the technology is not commercialized outside the Province of Ontario and various other documentation requirements. Management has determined that there is reasonable assurance that the company will comply with these conditions and, therefore, has recognized this forgivable loan as a government grant receivable at December 31, 2012. The loan is collateralized by a general security agreement over all of the assets of EcoSynthetix Corporation, a subsidiary company, and by the company's guarantee. In the event that the company is required to repay this funding, the company will be obligated to repay the funding plus interest charged at a rate of 4.55% per annum.

During the year ended December 31, 2011, the company had recognized the full amount of this grant and received all cash related to claims made during the year. No further claims were recognized during the year ended December 31, 2012.

In addition to the above, the company also has a non-repayable government grant agreement, Grant 1, with the Canadian federal government's Sustainability Development Technology Fund (the Fund or SDTF), which was formally granted in 2010 to the company. Grant 1 provides up to a maximum of approximately \$1.7 million for a special research and development project. During the year ended December 31, 2011, the company had recognized the full amount of this grant and, therefore, no further claims were recognized during the year ended December 31, 2012. The company collected \$0.5 million (2011 - \$1.0 million) from the SDTF during the year ended December 31, 2012 and expects to collect the remaining balance of \$0.2 million within the next 12 months.

EcoSynthetix Inc.

Notes to Consolidated Financial Statements **December 31, 2012 and December 31, 2011**

(expressed in US dollars, unless otherwise noted)

During 2011, the company recognized \$2.5 million and \$0.7 million against capital expenditures and operating expenditures, respectively, for the IDF and SDTF Grant 1 programs.

In 2012, the company was formally granted an additional SDTF non-repayable government grant, Grant 2, securing \$2.1 million funding on completion of project milestones. For the year ended December 31, 2012, in accordance with the provisions of Grant 2, the company recognized \$0.2 million primarily related to operating expenditures and received \$0.5 million in cash.

8 Intangible assets

The composition of the net carrying amount of the company's intangible assets is presented in the following table:

	Computer software
Cost	
December 31, 2011	194,841
Additions	<u>186,679</u>
December 31, 2012	<u>381,520</u>
Accumulated amortization	
December 31, 2011	194,841
Amortization	<u>23,178</u>
	<u>218,019</u>
Carrying amount	
December 31, 2011	-
December 31, 2012	<u>163,501</u>

Amortization expense has been charged to selling, general and administrative.

EcoSynthetix Inc.

Notes to Consolidated Financial Statements December 31, 2012 and December 31, 2011

(expressed in US dollars, unless otherwise noted)

9 Property, plant and equipment

The composition of the net carrying amount of the company's property, plant and equipment is presented in the following table:

	Machinery and equipment	Leasehold improvements	Computer hardware	Construction- in-process and deposits placed on property and equipment	Total
Cost					
January 1, 2011	2,031,796	-	75,749	225,757	2,333,302
Additions	(865,220)	91,009	67,366	10,454,808	9,747,963
Transfers	6,653,237	680,783	-	(7,334,020)	-
 December 31, 2011	 7,819,813	 771,792	 143,115	 3,346,545	 12,081,265
Additions	3,520,390	19,566	66,592	101,949	3,708,497
Transfers	3,208,545	-	-	(3,208,545)	-
 December 31, 2012	 14,548,748	 791,358	 209,707	 239,949	 15,789,762
 Accumulated depreciation					
January 1, 2011	(610,733)	-	(32,500)	-	(643,233)
Depreciation expense	(560,083)	(75,547)	(36,278)	-	(671,908)
 December 31, 2011	 (1,170,816)	 (75,547)	 (68,778)	 -	 (1,315,141)
Depreciation expense	(1,171,368)	(78,191)	(50,646)	-	(1,300,205)
 December 31, 2012	 (2,342,184)	 (153,738)	 (119,424)	 -	 (2,615,346)
 Net carrying amount					
December 31, 2011	6,648,997	696,245	74,337	3,346,545	10,766,124
December 31, 2012	12,206,564	637,620	90,283	239,949	13,174,416

The company incurred \$3.7 million (2011 - \$9.7 million) in capital asset additions for the year ended December 31, 2012, net of \$0.1 million (2011 - \$2.5 million) in government grants. The additions primarily relate to both the manufacturing equipment required for the company's production expansion and the company's research and development facility in Burlington, Ontario. Approximately \$0.5 million (2011 - \$2.3 million) of capital asset additions were included in accounts payable and accrued liabilities at December 31, 2012.

10 Trade payables and accrued liabilities

	2012	2011
Trade payables	2,093,659	4,335,632
Accrued liabilities	2,188,637	1,807,036
	4,282,296	6,142,668

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(expressed in US dollars, unless otherwise noted)

11 Redeemable preferred shares

The movement of redeemable preferred shares for the years ended December 31, 2011 and 2010 are as follows:

	Series A-3-C preferred shares	Series A-3-B preferred shares	Series A-3-A preferred shares	Series A-2 preferred shares	Series A-1 preferred shares	Total
Opening balance - January 1, 2011	26,854,800	10,460,686	14,080,679	31,700,734	52,099,532	135,196,431
Issuances	-	2,464,560	-	-	-	2,464,560
Charges	24,324,893	14,568,254	24,598,765	67,448,022	111,661,177	242,601,111
Conversion to equity	(51,179,693)	(27,493,500)	(38,679,444)	(99,148,756)	(163,760,709)	(380,262,102)
Closing balance - December 31, 2011	-	-	-	-	-	-

On June 30, 2011, the company issued 273,841 Series A-3-B preferred shares to certain holders of the company's preferred shares for \$nil. The preferred shares were issued pursuant to the original A-3-B preferred share agreement, whereby if the company did not complete a qualified event by June 30, 2011, the Series A-3-B preferred shares would be issued. The company has expensed \$2,464,560 in the year ended December 31, 2011 related to this issuance. The expense is included in the consolidated statements of operations and comprehensive loss, loss related to warrants and redeemable preferred shares.

Charges related to the warrants for the years ended December 31, 2012 and 2011 were \$nil and \$1,763,865, respectively.

On August 4, 2011, the company's redeemable preferred shares were automatically converted into common shares in connection with the offering. Further, warrants to acquire redeemable preferred shares were automatically converted to warrants to acquire common shares. As a result, the company's liability relating to redeemable preferred shares was reclassified into common shares and warrants were reclassified to a separate component of shareholders' equity (deficiency).

12 Related party transactions

Key management personnel includes those individuals having authority and responsibility for planning, directing and controlling the activities of the company directly or indirectly. Key management personnel includes the directors, chief executive officer, chief financial officer and other key members of the executive team. The compensation paid or payable to key management personnel for employee services is shown below:

	2012	2011
Salaries and other short-term employee benefits	2,028,605	1,797,249
Share-based payments	490,775	666,873
	<u>2,519,380</u>	<u>2,464,122</u>

EcoSynthetix Inc.

Notes to Consolidated Financial Statements December 31, 2012 and December 31, 2011

(expressed in US dollars, unless otherwise noted)

13 Common share options

The company has issued share options to employees, directors, officers, advisers and consultants under its two share option plans. The 2001 plan is an incentive share option plan, which provides for granting incentive share options, as defined under current income tax laws for common shares. The share options are exercisable at fixed prices established at the date of the grant. The 2003 plan provides for granting both incentive share options and non-statutory stock options, as determined by the administrator, at the date of the grant. Employees and officers become vested in their share option rights at a rate of 25% per year, following the date of the grant of the share options. Certain share option agreements also have accelerated vesting periods in the event of a sale of the company or change of control. Vested share options may be exercised at any time before the expiration date. These share options expire ten years from the date of the grant or later if extended further by the board of directors in accordance with the terms of the plans.

At December 31, 2012, the company had outstanding share options to purchase 5,775,285 common shares of the company. The share options expire at various dates through August 31, 2020.

	Number of share options outstanding	Weighted average exercise price
Outstanding - December 31, 2010	5,741,484	0.36
Share options cancelled	-	-
Share options granted	981,453	3.00
Share options exercised	<u>(885,297)</u>	<u>(0.12)</u>
Outstanding - December 31, 2011	5,837,640	0.80
Share options cancelled	-	-
Share options granted	99,471	4.04
Share options exercised	<u>(161,826)</u>	<u>0.92</u>
Outstanding - December 31, 2012	<u>5,775,285</u>	<u>0.85</u>

The weighted average contractual life of the outstanding share options at December 31, 2012 is 2.18 years (2011 - 3.02 years). The total number of share options exercisable at December 31, 2012 is 4,826,715 (2011 - 4,158,257), which have a weighted average exercise price of \$0.55 (2011 - \$0.31) per share.

	Number	
	2012	2011
Range of exercise prices		
\$0.01 - \$0.50	2,897,097	2,897,097
\$0.51 - \$1.00	1,562,717	1,702,717
\$1.01 - \$10.00	1,315,471	1,237,875
	5,775,285	5,837,640

EcoSynthetix Inc.

Notes to Consolidated Financial Statements **December 31, 2012 and December 31, 2011**

(expressed in US dollars, unless otherwise noted)

For the years ended December 31, the company determined the fair values of share options using the Black-Scholes option pricing model with the following assumptions for share option grants:

	2012	2011
Expected dividend yield	-	-
Risk-free interest rate	1.0% to 2.0%	1.2% to 2.2%
Expected share option life (in years)	5	5
Volatility	70%	50% - 70%

The aggregate fair value of share options granted during the year is \$215,082 (2011 - \$1,681,376). The weighted average fair value of the share options is \$2.16 (2011 - \$1.72) per share.

For the year ended December 31, 2012, expected volatility is based on a review of historical volatilities for the company and similar publicly listed companies.

The expected share option life is based on the employees' historical exercise behaviour.

The risk-free interest rate used for each grant is equal to the US Treasury's yield curve and Canadian treasury bill rates in effect at the date of grant for instruments with a term similar to the expected life of the related share option.

14 Common shares

	2012	2011
Common shares (unlimited number of shares authorized, 55,259,085 (2011 - 55,242,741) shares issued and outstanding)	492,065,820	492,353,321

Share exchange

On August 17, 2012, the company received regulatory approval for a normal course issuer bid (the Bid) to repurchase a certain number of its outstanding common shares through the facilities of the Toronto Stock Exchange (TSX). The number of shares to be purchased will not exceed 2,348,261 common shares. The period of the Bid will occur from August 20, 2012 to August 19, 2013. During the year ended December 31, 2012, the company repurchased 145,800 common shares for total consideration of \$521,729.

Outstanding warrants

During the year ended December 31, 2012 (2011 - 37,240), no warrants were exercised into common shares, generating proceeds of \$nil (2011 - \$29,494). At December 31, 2012, the company had outstanding warrants for the purchase of 361,228 common shares of the company, exercisable at \$0.81 per share. These shares are exercisable up to February 28, 2014.

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Notes to Consolidated Financial Statements **December 31, 2012 and December 31, 2011**

(expressed in US dollars, unless otherwise noted)

15 Income taxes

The difference between income tax expense and the income taxes, as computed, based on the statutory rate, is as follows:

	2012	2011
Net loss before income taxes	<u>(11,430,735)</u>	<u>(252,708,148)</u>
Income tax benefit at statutory rate	(3,029,144)	(66,335,889)
Cost (benefit) resulting from		
Redeemable preferred share losses, net of foreign tax rate differential	-	65,277,327
Research and development credit	(439,603)	(212,000)
Income tax assets expired	89,348	100,000
Valuation allowance and other	<u>3,379,399</u>	<u>1,170,562</u>
Income tax expense	<u>-</u>	<u>-</u>

Estimated temporary differences in the timing of recognition of expenses for accounting and income tax purposes at December 31 result in deferred income taxes as follows:

	2012	2011
Estimated deferred income tax assets attributable to		
Net operating loss carry-forwards	14,851,129	11,583,331
Research and development credits	1,147,998	934,869
Deferred compensation and other	<u>2,437,490</u>	<u>2,575,614</u>
Deferred income tax assets	<u>18,436,617</u>	<u>15,093,814</u>
Valuation allowance	<u>(18,436,617)</u>	<u>(15,093,814)</u>
Net deferred income tax assets	<u>-</u>	<u>-</u>

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Notes to Consolidated Financial Statements December 31, 2012 and December 31, 2011

(expressed in US dollars, unless otherwise noted)

The estimated net operating loss carry-forwards and estimated research and development credits expire as follows:

	United States of America	Canada and the Netherlands	Canada	
	Net operating loss carry-forwards	Research and development credits	Net operating loss carry-forwards	Research and development credits
Year ending December 31,				
2013	-	-	102,869	-
2014	-	-	17,766	-
2015	-	-	410,651	-
2016	252,561	-	8,389	-
2017	317,961	-	9,094	-
2018	1,009,888	-	11,850	-
2019	1,561,172	25,236	13,162	-
2020	2,063,163	42,132	50,259	-
2021	2,564,511	55,822	-	-
2022	1,338,594	52,731	-	-
2023	1,321,285	44,965	-	-
2024	1,532,264	46,333	-	-
2025	1,629,456	47,245	-	-
2026	1,562,856	41,905	397,347	-
2027	2,011,361	35,351	-	-
2028	2,717,038	69,118	1,512,105	-
2029	2,854,334	63,226	-	-
2030	1,207,399	96,302	-	54,600
2031	3,927,982	-	6,114,577	474,525
2032	1,243,610	-	9,100,304	177,078
	29,115,435	620,366	17,748,373	706,203

16 Commitments

- a) The company has entered into the following financial commitments:

	\$
Year ending December 31, 2013	7,843,944
2014	378,504
2015	378,318
2016	378,318
Thereafter	<u>1,087,976</u>
	<u>10,067,060</u>

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(expressed in US dollars, unless otherwise noted)

During the normal course of operations, the company may enter into feedstock contracts to secure raw material availability over a 12-month period based on market pricing at the time of purchase. As at December 31, 2012, the company was committed to purchases of feedstock of approximately \$6.0 million prior to September 30, 2013.

At December 31, 2012, the company is committed to property, plant and equipment purchases or equipment rental commitments in the approximate amount of \$0.1 million.

17 Segmented information and enterprise-wide disclosures

Segmented reporting

The company operates in one reportable segment and generated revenue primarily from the sale of its Ecosphere Biolatex (r) Binders.

Sales by geographic location

The company is domiciled in Canada. During the year ended December 31, 2012, revenue from external customers located in Canada was \$65,606 (2011 - \$nil). The total revenue from external customers in the following regions is as follows:

	2012	2011
North America	5,938,119	4,193,156
Latin America	1,685,437	2,063,238
EMEA	2,315,804	599,493
Asia Pacific	9,612,985	13,913,964
	<hr/> 19,552,345	<hr/> 20,769,851

The revenue has been assigned to each jurisdiction, based on the location of the customer. In situations where a sale is made through a reseller, revenue associated with that sale is attributed to the geographic region of the end customer. During the year ended December 31, 2012, revenue attributable to the individual countries representing greater than 10% of total revenues included Japan, United States, China and Germany which represented 33%, 30%, 10%, and 10% respectively. During the year ended December 31, 2011, revenue attributable to individual countries representing greater than 10% of total revenue included Indonesia, Japan, United States and China which represented 26%, 23%, 20% and 17%, respectively.

Sales to major customers

The company derives a significant portion of its revenues from certain customers. Three customers represented 33%, 12% and 10% of total revenue for the year ended December 31, 2012 (2011 two customers represented 26% and 23%, respectively). The concentrations listed do not necessarily apply to the same customer year over year.

EcoSynthetix Inc.

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(expressed in US dollars, unless otherwise noted)

Property, plant and equipment and intangible assets

The company's property, plant and equipment and intangible assets, reported at net carrying amount, are located in the following countries:

	2012	2011
Canada	2,727,975	1,971,731
United States of America	6,087,898	4,277,777
The Netherlands	<u>4,522,044</u>	<u>4,516,616</u>
	<u>13,337,917</u>	<u>10,766,124</u>

18 Expenses by nature

Additional information on the nature of amounts included in cost of sales, selling, general and administrative and research and development is as follows:

	2012	2011
Wages and salaries	6,793,528	5,624,771
Share-based compensation	847,104	984,325
Depreciation and amortization	1,207,584	583,980

19 Loss per share

Basic loss per share is calculated by dividing the profit attributable to equityholders of the company by the weighted average number of common shares in issue during the year.

Diluted loss per share is equivalent to basic loss per share, as the consideration of potentially dilutive securities would be anti-dilutive.

20 Contingencies and guarantees

In connection with the company's initial public offering on August 4, 2011, the company agreed to provide an indemnity to each of the retained interest holders for any (i) loss of deferral of US income taxes attributable to the execution of the put/call agreement that are incurred by a retained interest holder before the third anniversary of the closing of the offering; (ii) interest and penalties paid that are attributable to any US federal, state or local income tax liability of a retained interest holder that arises as a result of a final determination by any US taxing authority relating to the execution of the put/call agreement (taxes); and (iii) certain reasonable fees, costs and expenses paid by a retained interest holder to defend any demand, claim or notice from a US taxing authority with respect to taxes. The company's liability under the indemnity will not exceed the indemnity cap, which is determined based on \$2.72 per covered share (which equates to \$0.3885 per common share into which each covered share may be exchanged), representing a maximum liability to the company under the indemnity of approximately \$4 million. The indemnity will terminate on the fifth anniversary of the

EcoSynthetix Inc.

Notes to Consolidated Financial Statements **December 31, 2012 and December 31, 2011**

(expressed in US dollars, unless otherwise noted)

closing. The company has assessed the likelihood of incurring the liability as remote and, accordingly, has not recorded a provision at December 31, 2012.

21 Comparative balances

Certain comparative balances have been reclassified to conform to the consolidated financial statement presentation adopted in the current year.

Board of Directors

David W. Colcleugh

Chairman

John van Leeuwen

John E. Barker

Dr. Arthur Carty

John Varghese

Management

John van Leeuwen

Chief Executive Officer and Director

Dr. Steven Bloembergen

Executive Vice President, Technology

Robert Haire

Chief Financial Officer and Corporate Secretary

Ted van Egdom

Senior Vice President, Market Realization and Product Manufacturing

Diane Richard

Senior Vice President, Product Innovation and Market Development

Pierre Lebel

Vice President, Human Resources

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Transfer Agent

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Exchange Listing

EcoSynthetix Inc. is listed on the Toronto Stock Exchange under the symbol "ECO"

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Annual General & Special Meeting

May 8th, 2013, at 1:30 pm ET

The Ron Joyce Centre

DeGroote School of Business

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