

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

The following management's discussion and analysis ("MD&A") dated July 31, 2014 is intended to assist the readers in understanding of EcoSynthetix Inc. and its wholly owned subsidiaries ("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 and MD&A for the fiscal year ended December 31, 2013. Financial data has been prepared in conformity with International Financial Reporting Standards ("IFRS").

The Company, together with its consolidated subsidiaries, is referred to as the "Company", "we", "us", or "our". 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, 2013.

### 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 feedstock's 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, 2013. 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 July 31, 2014 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, and other non-cash charges deducted in determining consolidated net income (loss).

## **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 feedstock’s. 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 4 of the global top 20 manufacturers in the coated paper and paperboard industry and an additional 11 of the global top 20 manufacturers are currently in the process of evaluating the Company's products.

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 or delivery depending on the terms of the agreement.

### **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.

### **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.

## **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, consultants, facility costs, supplies and other associated product development expenses. These costs are partially offset by government grants recorded related to such expenditures.

## **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;
- Pricing of petroleum substitutes for our products;
- Feedstock, other input and production costs.

## **Results of operations**

The following is a summary of our results of operations for the three and six months ended June 30, 2014 and 2013:

	<b>Three months ended (unaudited)</b>		<b>Change</b>	
	<b>June 30, 2014</b>	<b>June 30, 2013</b>	<b>\$</b>	<b>%</b>
Net sales	4,542,648	5,533,678	(991,030)	-18%
Gross profit	952,679	820,482	132,197	16%
Loss from operations	(3,828,006)	(3,728,548)	(99,458)	3%
Net loss	(3,741,862)	(3,634,692)	(107,170)	3%
Weighted average number of shares outstanding	56,655,530	55,709,678	945,852	2%
Basic and diluted loss per share	(0.07)	(0.07)	(0.00)	1%
Adjusted EBITDA	(3,274,361)	(3,076,975)	(197,386)	6%

	<b>Six months ended (unaudited)</b>		<b>Change</b>	
	<b>June 30, 2014</b>	<b>June 30, 2013</b>	<b>\$</b>	<b>%</b>
Net sales	9,536,712	11,654,156	(2,117,444)	-18%
Gross profit	1,935,668	1,876,608	59,060	3%
Loss from operations	(7,233,361)	(7,347,406)	114,045	-2%
Net loss	(7,064,116)	(7,168,178)	104,062	-1%
Weighted average number of shares outstanding	56,754,446	55,904,023	850,423	2%
Basic and diluted loss per share	(0.12)	(0.13)	0.00	-1%
Adjusted EBITDA	(6,114,797)	(5,982,823)	(131,974)	2%

*Net Sales* – Net sales for the three months ended June 30, 2014 were \$4.5 million compared to \$5.5 million in the same period of fiscal 2013, a decrease of \$1.0 million or 18%. The decrease was due to lower sales in Asia Pacific and EMEA of \$1.1 million and \$0.7 million, respectively. These decreases were partly offset by higher sales in North America and Latin America of \$0.6 million and \$0.2 million, respectively. Net sales for the six months ended June 30, 2014 were \$9.5 million compared to \$11.7 million in the same period of fiscal 2013, a decrease of \$2.1 million or 18%. The decrease in sales was due to lower sales in Asia Pacific and EMEA of \$1.6 million and \$1.4 million, respectively. These decreases were partly offset by increased sales in North America.

For the three and six months ended June 30, 2014 sales decreased in Asia Pacific primarily due to continuing unfavourable market dynamics caused by the over-supply of butadiene and the related drop in butadiene and SB Latex prices. The decrease in sales in EMEA was due to the negative impact of the closure of a customer's coated paper production line announced in the fourth quarter of fiscal 2013. The increase in sales in North America is primarily due to increased substitution rates at existing accounts.

Two new customers have been commercialized on a year-to-date basis.

*Gross profit* – Gross profit for the three months ended June 30, 2014 was \$1.0 million compared to \$0.8 million in the same period of fiscal 2013, an increase of \$0.1 million or 16%. Gross margin as a percentage of sales increased from 14.8% to 21.0% during this same period. The increase in gross profit was principally due to lower manufacturing production costs partially offset by lower sales volume. Gross profit adjusted for manufacturing depreciation as a percentage of sales increased from 19.6% for the three months ended June 30, 2013 to 27.7% for the three months ended June 30, 2014. The increase was principally due to lower manufacturing production costs mainly due to lower feedstock costs.

Gross profit for the six months ended June 30, 2014 was comparable to the same period in fiscal 2013 at \$1.9 million as the impact of lower manufacturing product costs were offset by lower sales volume. Gross profit as a percentage of sales increased from 16.1% to 20.3% during this same period. Gross profit adjusted for manufacturing depreciation as a percentage of sales increased from 21.1% for the six months ended June 30, 2013 to 26.6% for the six months ended June 30, 2014. The increase was principally due to lower manufacturing production costs mainly due to lower feedstock costs.

## Operating Expenses

The following table sets forth the breakdown of our operating expenses by category during the three and six months ended June 30, 2014 and 2013:

	Three months ended (unaudited)		Change	
	June 30, 2014	June 30, 2013	\$	%
Selling, general and administrative <sup>1</sup>	3,339,056	2,928,287	410,769	14%
Research and development <sup>1</sup>	1,241,336	1,229,431	11,905	1%
Share-based compensation	120,000	285,876	(165,876)	-58%
Depreciation and amortization	127,991	99,030	28,961	29%
Foreign exchange (gain)/loss	(47,698)	6,406	(54,104)	-845%
<b>Total operating expenses</b>	<b>4,780,685</b>	<b>4,549,030</b>	<b>231,655</b>	<b>5%</b>

  

	Six months ended (unaudited)		Change	
	June 30, 2014	June 30, 2013	\$	%
Selling, general and administrative <sup>1</sup>	5,974,801	5,929,476	45,325	1%
Research and development <sup>1</sup>	2,718,209	2,498,953	219,256	9%
Share-based compensation	255,000	616,979	(361,979)	-59%
Depreciation and amortization	257,933	170,825	87,108	51%
Foreign exchange (gain)/loss	(36,914)	7,781	(44,695)	-574%
<b>Total operating expenses</b>	<b>9,169,029</b>	<b>9,224,014</b>	<b>(54,985)</b>	<b>-1%</b>

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

Total operating expenses for the three months ended June 30, 2014 were \$4.8 million compared to \$4.5 million in the same period of fiscal 2013, an increase of \$0.2 million or 5%. The increase in total operating expenses for the three months ended June 30, 2014 was principally due to higher selling, general and administrative costs partially offset by lower share-based compensation expense and foreign exchange gains.

Total operating expenses for the six months ended June 30, 2014 remained comparable to the same period in fiscal 2013 at \$9.2 million as higher research and development costs and higher depreciation and amortization were offset by lower share-based compensation expense.

*Selling, general and administrative*<sup>1</sup> – Selling, general and administrative costs for the three months ended June 30, 2014 were \$3.3 million compared to \$2.9 million in the same period last year, an increase of \$0.4 million or 14%. The increase during the three months ended June 30, 2014 was principally due to higher salaries & benefits related to increased headcount and a \$0.5 million charge related to a payroll tax provision and employee severance costs. These cost increases were partly offset by the favourable impact of the weakening Canadian dollar relative to the US dollar in the current year compared to the same period last year.

Selling, general and administrative costs for the six months ended June 30, 2014 remained comparable to the same period in fiscal 2013 at \$5.9 million. An increase in salaries & benefits due to increased headcount, a \$0.3 million tax provision related to a payroll audit and severance costs of \$0.2 million were offset by the favourable impact of the weakening Canadian dollar relative to the US dollar in the current year compared to the same period last year.

*Research and development*<sup>1</sup> – Research and development costs for the three months ended June 30, 2014 remained comparable to the same period in fiscal 2013 at \$1.2 million. Research and development costs for the six months ended June 30, 2014 were \$2.7 million compared to \$2.5 million during the same period last year, an increase of \$0.2 million or 9%. The increase was primarily due to increased trials related to the introduction of a new grade of Ecosphere® biolatex which was announced in the current quarter and multiple industrial scale trials with potential customers in the wood composites and insulation markets.

*Share-based compensation* – Share-based compensation expense for the three months ended June 30, 2014 was \$0.1 million compared to \$0.3 million in the same period last year, a decrease of \$0.2 million or 58%. Share-based compensation for the six months ended June 30, 2014 was \$0.3 million compared to \$0.6 million in the same period last year, a decrease of \$0.4 million or 59%. The decrease during the three and six months ended was principally due to the expense related to performance stock options (PSOs) recorded in the prior year with the expectation that the required performance hurdles would be achieved.

*Depreciation and amortization* – Depreciation and amortization for the three months ended June 30, 2014 and June 30, 2013 was consistent at \$0.1 million. Depreciation and amortization for the six months ended June 30, 2014 was \$0.3 million compared to \$0.2 million in the same period last year. The increase was principally due to increased depreciation related to equipment located at the Company's Center of Innovation (COI).

*Foreign currency exchange (gain)/loss* – Foreign exchange represents the revaluation of monetary assets and liabilities denominated in foreign currencies. The change in foreign exchange revaluation gains and losses are primarily due to foreign exchange rate fluctuations between the U.S. dollar (our functional currency) and the Canadian dollar and Euro on our net monetary position in those respective currencies.

*Loss from operations* – Our loss from operations for the three months ended June 30, 2014 was \$3.8 million compared to \$3.7 million during the same period of last year, an increase of \$0.1 million or 3%. The increase during the three months ended June 30, 2014 was primarily due to higher operating expenses partly offset by increased gross profit. Our loss from operations for the six months ended June 30, 2014 was \$7.2 million compared to \$7.3 million in the same period last year, a decrease of \$0.1 million or 2%. The decrease during the six months ended June 30, 2014 was primarily due to increased gross profit and lower operating expenses.

*Interest income* – Interest income for the three and six months ended June 30, 2014 remained comparable to the same periods in fiscal 2013 as an increase in interest rates were offset by lower cash balances.

*Net Loss* - We incurred a net loss of \$3.7 million or \$0.07 per common share during the three months ended June 30, 2014 compared to a net loss of \$3.6 million or \$0.07 per common share in the same period last year. The increase in net loss is principally due to an increase in loss from operations. For the six months ended June 30, 2014, we incurred a net loss of \$7.1 million or \$0.12 per common share compared to a net loss of \$7.2 million or \$0.13 per common share. The decrease in net loss is principally due to a decrease in loss from operations.

### **Financial Condition**

	<b>June 30, December 31,</b>		<b>Change</b>	
	<b>2014</b>	<b>2013</b>	<b>\$</b>	<b>%</b>
Total current assets	84,127,017	91,207,662	(7,080,645)	-8%
Total assets	96,593,270	104,106,859	(7,513,589)	-7%
Total current liabilities	3,529,200	3,947,385	(418,185)	-11%

*Total current assets* – Total current assets at June 30, 2014 were \$84.1 million compared to \$91.2 million at December 31, 2013, a decrease of \$7.1 million or 8%. The decrease was principally due to lower cash of \$6.6 million and lower inventory of \$0.5 million partly offset by an increase in prepaid expenses of \$0.2 million.

*Total assets* – Total assets at June 30, 2014 were \$96.6 million compared to \$104.1 million at December 31, 2013, a decrease of \$7.5 million or 7%. The decrease was principally due to lower current assets of \$7.1 million and lower property, plant and equipment of \$0.4 million due to depreciation expense.

*Total current liabilities* – Total current liabilities at June 30, 2014 were \$3.5 million compared to \$3.9 million at December 31, 2013, a decrease of \$0.4 million or 11%. The decrease was principally related to the settlement of trade payables.

## Liquidity and Capital Resources

We currently fund our business operations from existing cash which was provided through the initial public offering (IPO) in 2011. 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 provided by/ (used in) operating activities, financing activities and investing activities for the three and six months ended June 30, 2014 and 2013:

	Three months ended (unaudited)		Change	
	June 30, 2014	June 30, 2013	\$	%
Cash used in operating activities	(2,905,805)	(4,463,939)	1,558,134	-35%
Cash used in investing activities	(41,495)	(775,745)	734,250	-95%
Cash provided by/(used in) financing activities	(402,398)	7,818	(410,216)	-5247%
Net decrease in cash	(3,349,698)	(5,231,866)	1,882,168	-36%
Beginning cash	77,212,911	90,209,738	(12,996,827)	-14%
<b>Ending cash</b>	<b>73,863,213</b>	<b>84,977,872</b>	<b>(11,114,659)</b>	<b>-13%</b>

	Six months ended (unaudited)		Change	
	June 30, 2014	June 30, 2013	\$	%
Cash used in operating activities	(6,085,763)	(7,282,186)	1,196,423	-16%
Cash used in investing activities	(271,693)	(1,242,935)	971,242	-78%
Cash provided by/(used in) financing activities	(286,288)	242,697	(528,985)	-218%
Net decrease in cash	(6,643,744)	(8,282,424)	1,638,680	-20%
Beginning cash	80,506,957	93,260,296	(12,753,339)	-14%
<b>Ending cash</b>	<b>73,863,213</b>	<b>84,977,872</b>	<b>(11,114,659)</b>	<b>-13%</b>

*Cash used in operating activities* – Cash used in operating activities for the three months ended June 30, 2014 was \$2.9 million compared to \$4.5 million during the same period in the prior year, a decrease of \$1.6 million or 35%. The decrease was primarily due to a lower investment in working capital during the same period. For the three months ended June 30, 2014, working capital decreased \$0.3 million principally due to lower inventories and increased accounts payable and accrued liabilities partially offset by a higher prepaid expenses. For the three months ended June 30, 2013, working capital increased \$1.5 million principally due to lower accounts payable and accrued liabilities partially offset by lower inventories and accounts receivable.

Cash used in operating activities for the six months ended June 30, 2014 was \$6.1 million compared to \$7.3 million for the same period in prior year, a decrease of \$1.2 million or 16%. The decrease was primarily due to a lower investment in working capital during the same period. For the six months ended June 30, 2014, working capital increased \$0.1 million due to lower accounts payable and accrued liabilities, higher prepaid expenses and government grants receivable offset with lower inventories and accounts receivable. For the six months ended June 30, 2013, working capital increased \$1.5 million primarily due to higher inventories, accounts receivable, prepaid expenses and lower deferred government grants.

*Cash used in investing activities* – Cash used in investing activities for the three months ended June 30, 2014 was \$0.04 million compared to \$0.8 million for the same period in prior year, a decrease of \$0.7 million or 95%. Cash used in investing activities for the six months ended June 30, 2014 was \$0.3 million compared to \$1.2 million in the same period in last year, a decrease of \$1.0 million or 78%. The decreases were primarily due to decreased purchases of capital equipment in the first half of fiscal 2014 compared to the prior periods.

*Cash provided by/(used in) financing activities* – Cash used in financing activities during the three months ended June 30, 2014 was \$0.4 million compared to cash provided by financing activities of \$0.01 million for the same period in fiscal 2013. The increase is due to the repurchase of common shares related to the normal course issuers bids (“NCIB”) in the current quarter compared to the same period in the prior year.

Cash used in financing activities during the six months ended June 30, 2014 was \$0.3 million compared to cash provided by financing activities of \$0.2 million for the same period in fiscal 2013. The increased use of cash relates to the repurchase of common shares related to the NCIB partly offset by the exercise of warrants in the current period compared to the same period of the prior year.

**Capital Management**

The Company’s objective in managing capital is to ensure sufficient liquidity to pursue its growth strategy and fund research and product development, while at the same time taking a conservative approach towards managing financial risk. The Company’s capital is composed of the net cash received related to common shares, warrants and shareholder option exercises. 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 and purchase obligations. The following table summarizes our cash commitments as of June 30, 2014:

Less than one year .....	\$8,998,559
One – two years .....	\$1,472,685
Two – three years.....	\$ 330,671
Three – four years .....	\$ 330,671
Thereafter .....	\$ 826,678

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 June 30, 2014, the Company was committed to purchases of feedstock in the approximate amount of \$9.4 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 June 30, 2014. 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. 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 operating costs are expanding.

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

	Three months ended (unaudited)							
	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013	June 30, 2013	March 31, 2013	December 31, 2012	September 30, 2012
Net sales	4,542,648	4,994,064	5,159,069	5,416,621	5,533,678	6,120,478	5,923,661	5,915,571
Gross profit	952,679	982,989	895,594	836,873	820,482	1,056,126	1,192,753	1,280,527
Loss from operations	(3,828,006)	(3,405,355)	(3,723,691)	(4,051,221)	(3,728,548)	(3,618,858)	(3,480,133)	(2,410,005)
Net loss	(3,741,862)	(3,322,254)	(3,636,080)	(3,960,546)	(3,634,692)	(3,533,486)	(3,394,357)	(2,324,278)
Weighted average number of shares outstanding	56,655,530	56,731,241	55,802,382	55,764,273	55,709,678	55,689,778	55,297,736	55,324,997
Basic and diluted loss per share	(0.07)	(0.06)	(0.07)	(0.07)	(0.07)	(0.06)	(0.06)	(0.04)
Adjusted EBITDA <sup>(1)</sup>	(3,274,361)	(2,840,436)	(3,264,621)	(3,186,884)	(3,076,975)	(2,905,848)	(2,950,364)	(1,804,122)

	Three months ended (unaudited)							
	June 30, 2014	March 31, 2014	December 31, 2013	September 30, 2013	June 30, 2013	March 31, 2013	December 31, 2012	September 30, 2012
Net loss	(3,741,862)	(3,322,254)	(3,636,080)	(3,960,546)	(3,634,692)	(3,533,486)	(3,394,357)	(2,324,278)
Depreciation and amortization	433,645	429,919	596,824	387,337	365,697	381,907	384,769	320,883
Share-based compensation	120,000	135,000	(137,754)	477,000	285,876	331,103	145,000	285,000
Interest income	(86,144)	(83,101)	(87,611)	(90,675)	(93,856)	(85,372)	(85,776)	(85,727)
Adjusted EBITDA <sup>(1)</sup>	(3,274,361)	(2,840,436)	(3,264,621)	(3,186,884)	(3,076,975)	(2,905,848)	(2,950,364)	(1,804,122)

Notes:

- (1) 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).

## Adjusted EBITDA

Adjusted EBITDA for the three months ended June 30, 2014 was a loss of \$3.3 million compared to a loss of \$3.1 million for the same period last year. The increase in adjusted EBITDA loss was due to higher operating expenses partly offset by increased gross profit. Adjusted EBITDA for the six months ended June 30, 2014 was a loss of \$6.1 million compared to \$6.0 million for the same period last year. The increase in adjusted EBITDA loss was due to an increase in loss from operations.

## 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 (loss) 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.

### ***Share-based compensation***

The Company operates equity-settled share-based compensation plans under which the Company receives services from employees, directors, advisers, officers, contractors and consultants as consideration for equity instruments (share options, PSOs, RSUs, and deferred share units (DSUs)) of the Company.

Each tranche of a share option award is considered a separate award with its own vesting period and recorded at fair value on the date of grant. 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 periodically, with any impact being recognized in the consolidated statement of operations. Any contribution paid by an employee or director on the exercise of share options is credited to common shares with any previously recognized compensation expense.

A PSO provides a right, but not an obligation, to purchase common shares of the Company at a stated price for a given period of time. PSOs vest at a rate of 33.33% per year following the grant date subject to the achievement of performance hurdles and can only be settled in common shares issued from treasury. In the event that performance exceeds targeted performance hurdles, vesting can accelerate for PSOs granted; however, in no event can the cumulative vesting exceed 100%. All PSOs expire at the end of 10 years. The fair value of a PSO is recorded over the expected vesting period, subject to management's estimate of the achievement of the performance hurdles. The fair values of the PSOs are recognized as compensation expense over the vesting period with a corresponding increase to contributed surplus. Fair value is determined based on the average closing price of common shares on the Toronto Stock Exchange (TSX) five trading days immediately prior to the date as of which market value is determined. The Company has estimated the length of the expected vesting period at grant date based on the most likely outcome of the performance conditions. The Company will revise its estimate of the length of the vesting period, if necessary, if subsequent information indicates that the length of the vesting period differs from previous estimates and any change to compensation cost will be recognized in the period in which the revised estimate is made. Forfeitures are estimated at the grant date and are revised to reflect a change in expected or actual forfeitures.

The restricted share unit plan (RSU Plan) provides that restricted share unit awards (the RSUAs) may be granted by a committee that administers the RSU Plan to full-time employees, officers and eligible contractors of the Company or an affiliate in a calendar year as a bonus for services rendered to the Company as determined at the sole discretion of the Board. The number of restricted share units awarded will be credited to the participants' accounts effective on the grant date of the RSUs. Each RSUA entitles the holder to receive common shares issued from treasury of the Company. RSUs fully vest at the end of a three-year period subject to continued employment with the Company and the achievement of performance hurdles. The Company has estimated the probability of achieving the performance hurdles and will revise its estimate if subsequent information indicates that the expected outcome related to the achievement of the performance hurdles differs from previous estimates. Accordingly, any change to compensation cost will be recognized in the period in which the revised estimate is made. Forfeitures are estimated at the grant date and are revised to reflect a change in expected or actual forfeitures.

The deferred share unit plan (DSU Plan) provides for awards of DSUs to non-employee directors of the Company. Under the DSU Plan, non-executive directors may receive a grant of DSUs in satisfaction of their annual retainer. Each DSU is equivalent to one common share and vest on a quarterly basis. DSUs must be retained until the director leaves the Board, at which time the DSUs will be settled through common shares. In the event dividends are declared and paid, additional DSUs would be credited to reflect dividends paid on common shares. The number of DSUs to be awarded are determined based on the average closing price of the common shares on the TSX on five trading days immediately prior to the date as of which market value is determined. Compensation cost for DSUs granted under the DSU Plan is recorded as an expense with a corresponding increase in contributed surplus.

### **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**

There were no changes in the Company's internal control over financial reporting during the three months ended June 30, 2014 that have materially affected, or are reasonable likely to materially affect, the Company's internal control over financial reporting.

### **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, 2013. 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, are available on SEDAR at [www.sedar.com](http://www.sedar.com).

### **Common Share Trading Information**

The Company's common shares trade on the Toronto Stock Exchange under the symbol "ECO". As at July 30, 2014, the Company had the equivalent of 56,665,888 common shares issued and outstanding assuming conversion of all rights pursuant to the put/call agreement. In addition, if all outstanding share options were exercised and assuming the settlement of outstanding RSU's and DSU's through common shares, there would be the equivalent of 60,117,567 common shares issued and outstanding on a fully diluted basis as at July 30, 2014.

### **Outlook**

In the first six months of fiscal 2014 we delivered revenues that were well below our expectations. Latex prices remain lower than their historical averages, both in absolute values and in relation to the cost of petroleum. Sustained downward pressure on latex prices negatively influence our market as the cost advantage of substituting our EcoSphere® biolatex® binders for latex is reduced. Despite the negative impact of latex prices in our end market, we are experiencing a recovery in margins from last year's historic lows due to improved raw material prices.

In order to return to the growth trajectory we expect from the business we are focused on three core areas: (1) converting mill trials into customers within our first market, paper and paperboard; (2) expanding into new markets, specifically building materials; and (3) leveraging the power of our proprietary technology to develop new applications of our sustainable polymers. We recently launched a new grade of biolatex targeting paper applications which has resulted in a healthy increase in mill trial activity and received positive customer feedback which we believe will lead to additional conversions. We have conducted multiple industrial scale trials with potential customers in the wood composites and insulation markets. In addition, our product development team continues to make progress in the development of new products targeting other industrial applications which provide a strong

foundation for future growth.