EcoSynthetix Inc.

Consolidated Financial Statements
December 31, 2013 and December 31, 2012
(expressed in US dollars)

March 4, 2014

Independent Auditor's Report

**To the Shareholders of
EcoSynthetix Inc.**

We have audited the accompanying consolidated financial statements of EcoSynthetix Inc. and its subsidiaries, which comprise the consolidated balance sheets at December 31, 2013 and December 31, 2012 and the consolidated statements of operations and comprehensive loss, shareholders' equity 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 audits 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.

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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, 2013 and December 31, 2012 and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards

(Signed) “PricewaterhouseCoopers LLP”

Chartered Professional Accountants, Licensed Public Accountants

EcoSynthetix Inc.

Consolidated Balance Sheets

At December 31

(expressed in US dollars)

	2013	2012
Assets		
Current assets		
Cash	80,506,957	93,260,296
Accounts receivable (note 5)	3,691,791	4,309,355
Inventory (note 6)	6,470,410	6,822,619
Government grants receivable (note 7)	261,648	184,118
Prepaid expenses	276,856	154,492
	91,207,662	104,730,880
Non-current assets		
Intangible assets (note 8)	124,009	163,501
Property, plant and equipment (note 9)	12,775,188	13,174,416
Total assets	104,106,859	118,068,797
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities (note 10)	3,947,385	4,282,296
Deferred government grant (note 7)	-	226,920
Total liabilities	3,947,385	4,509,216
Shareholders' Equity		
Common shares (note 13)	492,600,022	492,065,820
Contributed surplus	7,661,849	6,831,354
Accumulated deficit	(400,102,397)	(385,337,593)
Total shareholders' equity	100,159,474	113,559,581
Total liabilities and shareholders' equity	104,106,859	118,068,797

Approved by the Board of Directors

(signed)	**(signed)**
John van Leeuwen, Director	John E. Barker, Director

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

EcoSynthetix Inc.

Consolidated Statements of Operations and Comprehensive Loss

For the years ended December 31

(expressed in US dollars)

	2013	2012
Net sales	22,229,846	19,552,345
Cost of sales	18,620,771	15,694,487
Gross profit on sales	3,609,075	3,857,858
Expenses		
Selling, general and administrative	12,916,606	11,266,518
Research and development	5,814,787	4,382,854
	18,731,393	15,649,372
Loss from operations	(15,122,318)	(11,791,514)
Interest income	357,514	360,779
Net loss and comprehensive loss	(14,764,804)	(11,430,735)
Basic and diluted loss per common share (note 18)	(0.26)	(0.21)
Weighted average number of common shares outstanding	56,113,610	55,288,432

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

EcoSynthetix Inc.

Consolidated Statements of Shareholders' Equity

For the years ended December 31

(expressed in US dollars)

	Common shares	Contributed surplus	Accumulated deficit	Total
Balance - January 1, 2012	492,353,321	6,073,080	(373,906,858)	124,519,543
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	492,065,820	6,831,354	(385,337,593)	113,559,581
Balance - January 1, 2013	492,065,820	6,831,354	(385,337,593)	113,559,581
Warrants exercised (note 13)	124,628	-	-	124,628
Common share options exercised (note 12)	409,574	(125,730)	-	283,844
Share-based compensation (note 12)	-	956,225	-	956,225
Net loss and comprehensive loss	-	-	(14,764,804)	(14,764,804)
Balance - December 31, 2013	492,600,022	7,661,849	(400,102,397)	100,159,474

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)

	2013	2012
Cash provided by (used in)		
Operating activities		
Net loss	(14,764,804)	(11,430,735)
Items not affecting cash		
Depreciation and amortization (notes 8 and 9)	1,731,765	1,207,584
Share-based compensation (note 12)	956,225	847,104
Changes in non-cash working capital		
Accounts receivable	617,564	(1,192,910)
Inventory	490,539	3,535,225
Government grants receivable (note 7)	(77,530)	455,567
Prepaid expenses	(122,364)	28,350
Accounts payable and accrued liabilities	123,088	(6,120)
Deferred government assistance	(226,920)	(10,080)
	(11,272,437)	(6,566,015)
Investing activities		
Purchase of intangible assets and property, plant and equipment (notes 8 and 9)	(1,889,374)	(5,748,063)
Financing activities		
Repurchase of common shares	-	(521,729)
Exercise of common share options	283,844	145,398
Exercise of warrants	124,628	-
Increase in government grant (note 7)	-	237,000
	408,472	(139,331)
Decrease in cash during the year	(12,753,339)	(12,453,409)
Cash - Beginning of year	93,260,296	105,713,705
Cash - End of year	80,506,957	93,260,296

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

(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 4, 2014.

Basis of preparation

The consolidated financial statements have been prepared under International Financial Reporting Standards (IFRS), using the historical cost convention except for liabilities related to share-based payment arrangements that 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 useful lives of property, plant and equipment, 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 wholly owned and controlled by the company.

(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 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.

(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 accounts receivables, government grants and cash 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 accounts payable and accrued liabilities. Accounts payable 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. 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 occurring after the impairment was recognized.

Inventory

Inventory is 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.

(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 period 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, plant 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 in-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.

(expressed in US dollars, unless otherwise noted)

Provisions

Provisions are recognized when the company has a present legal or constructing 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 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.

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 risks 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 the risks 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. Raw materials consist of the costs of cornstarch feedstock and process chemicals.

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. The company has classified all outstanding exchangeable shares of its subsidiaries as issued and outstanding of the parent company.

(expressed in US dollars, unless otherwise noted)

Share-based compensation

The company operates equity-settled share-based compensation plans under which the company receives services from employees, advisers, officers, directors, contractors and consultants as consideration for equity instruments (share options, performance-based share options (PSOs), restricted share units (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 statements of operations and comprehensive loss. 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 values of PSOs are 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 RSUs 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.

(expressed in US dollars, unless otherwise noted)

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 vests 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 is 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.

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 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.

(expressed in US dollars, unless otherwise noted)

Operating leases

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 that 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.

New accounting standards

a) IFRS 10, Consolidated Financial Statements (IFRS 10), replaces the guidance on control and consolidation in IAS 27, Consolidated and Separate Financial Statements, and Standing Interpretations Committee (SIC)-12, Consolidation - Special Purpose Entities. IFRS 10 requires consolidation of an investee only if the investor possesses power over the investee, has exposure to variable returns from its involvement with the investee and has the ability to use its power over the investee to affect its returns. Detailed guidance is provided on applying the definition of control.

   The company adopted IFRS 10 effective January 1, 2013. The company assessed its consolidation conclusions on January 1, 2013 and determined that the adoption of IFRS 10 did not result in any change in the consolidation status of any of its subsidiaries.

b) IFRS 11, Joint Arrangements (IFRS 11), requires a venturer to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting, whereas for a joint operation, the venturer will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or equity account for interests in joint ventures. IFRS 11 supersedes IAS 31, Interests in Joint Ventures, and SIC-13, Jointly Controlled Entities - Non-monetary Contributions by Venturers.

   The company adopted IFRS 11 effective January 1, 2013. The company assessed its consolidation conclusions on January 1, 2013 and determined that the adoption of IFRS 11 was not applicable as the company does not have any joint arrangements.

(expressed in US dollars, unless otherwise noted)

c) IFRS 12, Disclosure of Interests in Other Entities (IFRS 12), establishes disclosure requirements for interests in other entities, such as subsidiaries, joint arrangements, associates and unconsolidated structured entities. The standard carries forward existing disclosures and introduces significant additional disclosure that address the nature of, and risks associated with, an entity's interests in other entities.

The company adopted IFRS 12 effective January 1, 2013. The company assessed its disclosure on January 1, 2013 and determined that the adoption of IFRS 12 did not result in any change in the disclosures for the company.

d) IFRS 13, Fair Value Measurement (IFRS 13), provides a single framework for measuring fair value. The measurement of the fair value of an asset or liability is based on assumptions that market participants would use when pricing the asset or liability under current market conditions, including assumptions about risk. The company adopted IFRS 13 on January 1, 2013 on a prospective basis. The adoption of IFRS 13 did not require any adjustments to the valuation techniques used by the company to measure fair value and did not result in any measurement adjustments as at January 1, 2013.

e) IAS 1, Presentation of Items of Other Comprehensive Income (IAS 1). The company has adopted the amendments to IAS 1 effective January 1, 2013. These amendments required the company to group other comprehensive loss items by those that will be reclassified subsequently to net loss and those that will not be reclassified. These changes did not result in any adjustments to other comprehensive loss or comprehensive income loss.

3 Risk management and financial instruments

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

	2013	2012
Loans and receivables	3,691,791	4,309,355
Other financial liabilities	3,947,385	4,282,296
Deferred government grant	-	226,920

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. 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.

(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, 2013, the company's three largest customers accounted for 68% (2012 - three customers at 48%) 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 trade accounts receivable have a carrying amount of $3,460,764 at December 31, 2013 (2012 - $4,055,247), representing the maximum exposure to credit risk of those financial assets, exclusive of the allowance for doubtful accounts. An insignificant number of these receivables were past due at December 31, 2013. The company's exposure to credit risk for trade receivables by geographic area at December 31 was as follows:

	2013 %	2012 %
North America	41	23
Latin America	9	9
EMEA	5	14
Asia Pacific	45	54
	100	100

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 $80,506,957 at December 31, 2013 (2012 - $93,260,296), representing the maximum exposure to credit risk of these financial assets. Approximately 99% (2012 - 75%) of the company's cash at December 31, 2013 was held with one financial institution. The company's exposure to credit risk relating to cash segmented by geographic area at December 31 was as follows:

	2013 %	2012 %
Canada	99.7	77.1
United States of America	0.2	22.7
The Netherlands	0.1	0.2
	100.0	100.0

(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 losses in the year ended December 31, 2013 of $73,895 (2012 - $42,066).

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 would not be significant (2012 - $25,128) 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 be $35,814 (2012 - not significant) due to exchange rate fluctuations and this amount would be recorded in the consolidated statements of operations and comprehensive loss.

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 would be a gain or loss of $41,410 (2012 - $14,371).

Fair value

The carrying amounts of 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).

(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, 2013 were as follows:

	Level 1	Level 2	Level 3	Total
Accounts receivable	-	3,691,791	-	3,691,791
Accounts payable and accrued liabilities	-	(3,947,385)	-	(3,947,385)
Government grants receivable	-	261,648	-	261,648
	-	6,054	-	6,054

4 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 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, 2013 is $158,991,368 (2012 - $158,582,896). 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

	2013	2012
Trade accounts receivable	3,460,764	4,055,247
Commodity taxes receivable and other	231,027	254,108
	3,691,791	4,309,355

(expressed in US dollars, unless otherwise noted)

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

	2013	2012
Current	2,755,453	2,926,554
Past due 1-30 days	672,215	981,031
Past due 31-60 days	2,169	1,035
Past due 61-90 days	-	138
Past due greater than 91 days	30,927	146,489
	3,460,764	4,055,247

6 Inventory

	2013	2012
Raw materials	772,252	1,118,460
Finished goods	5,698,158	5,704,159
	6,470,410	6,822,619

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, 2013. 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.

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. The company collected $nil (2012 - $0.5 million) from the SDTF during the year ended December 31, 2013 and expects to collect the remaining balance of $0.2 million within the next 12 months.

In fiscal 2012, the company was formally granted an additional SDTF non-repayable government grant, Grant 2, securing $2.1 million of funding on completion of project milestones. For the fiscal year ended December 31, 2013, in accordance with the provisions of Grant 2, the company recognized $0.4 million (2012 - $0.2 million) primarily related to operating expenditures and received $0.1 million in cash (2012 - $0.5 million) and expects to collect the remaining balance of $0.1 million within the next 12 months.

(expressed in US dollars, unless otherwise noted)

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, 2012	381,520
Additions	36,330
December 31, 2013	417,850
Accumulated amortization	
December 31, 2012	(218,019)
Amortization	(75,822)
December 31, 2013	(293,841)
Carrying amount	
December 31, 2012	163,501
December 31, 2013	124,009

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

(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, plant and equipment	Total
Cost					
January 1, 2012	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
Additions	394,693	157,182	49,325	793,845	1,395,045
Disposals	(1,923,525)	-	-	-	(1,923,525)
Transfers	789,331	-	25,245	(814,576)	-
December 31, 2013	13,809,247	948,540	284,277	219,218	15,261,282
Accumulated depreciation					
January 1, 2012	(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)
Depreciation expense	(1,628,194)	(103,023)	(63,056)	-	(1,794,273)
Disposals	1,923,525	-	-	-	1,923,525
December 31, 2013	(2,046,853)	(256,761)	(182,480)	-	(2,486,094)
Net carrying amount					
December 31, 2012	12,206,564	637,620	90,283	239,949	13,174,416
December 31, 2013	11,762,394	691,779	101,797	219,218	12,775,188

The company incurred $1.4 million (2012 - $3.7 million) in capital asset additions for the year ended December 31, 2013, net of $0.02 million (2012 - $0.1 million) in government grants. The additions primarily relate to both the manufacturing equipment required for the company's production and the company's research and development facility in Burlington, Ontario and dry material handling solutions for certain customers. In fiscal 2012, $0.5 million of capital asset additions were included in accounts payable and accrued liabilities. No such amounts were included in accounts payable and accrued liabilities as at December 31, 2013.

During the year ended December 31, 2013, the company recognized an impairment loss of $0.2 million as depreciation expense included in selling, general and administrative expenses associated with redundant machinery and equipment that is no longer in use.

(expressed in US dollars, unless otherwise noted)

10 Trade payables and accrued liabilities

	2013	2012
Trade payables	2,422,717	2,093,659
Accrued liabilities	1,524,668	2,188,637
	3,947,385	4,282,296

11 Key management compensation

Key management personnel include those individuals having authority and responsibility for planning, directing and controlling the activities of the company directly or indirectly. Key management personnel include 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:

	2013	2012
Salaries and other short-term employee benefits	2,642,280	2,028,605
Share-based payments	731,429	490,775
	3,373,709	2,519,380

12 Shared-based compensation

At December 31, 2013, the company had outstanding share options to purchase 6,064,281 common shares of the company. The share options expire at various dates through August 7, 2023.

	Number of share options outstanding	Weighted average exercise price
Outstanding - December 31, 2011	5,837,640	0.80
Share options granted	99,471	4.04
Share options exercised	(161,826)	0.92
Outstanding - December 31, 2012	5,775,285	0.85
Share options cancelled	(41,379)	2.49
Share options granted	1,306,403	3.84
Share options exercised	(976,028)	0.30
Outstanding - December 31, 2013	6,064,281	1.61

The weighted average contractual life of the outstanding share options at December 31, 2013 is 5.26 years (2012 - 2.18 years). The total number of share options exercisable at December 31, 2013 is 4,469,511 (2012 - 4,826,715), which have a weighted average exercise price of $0.87 (2012 - $0.55) per share.

(expressed in US dollars, unless otherwise noted)

	Number of share options outstanding	
	2013	**2012**
Range of exercise prices		
$0.01 - $0.50	2,184,862	2,897,097
$0.51 - $1.00	1,297,717	1,562,717
$1.01 - $10.00	2,581,702	1,315,471
	6,064,281	5,775,285

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:

	2013	**2012**
Expected dividend yield	-%	-%
Risk-free interest rate	1.31% to 1.75%	1.00% to 2.00%
Expected share option life (in years)	5	5
Volatility	60% to 70%	70%

The aggregate fair value of share options granted during the year is $2,906,605 (2012 - $215,082). The weighted average fair value of the share options is $2.22 (2012 - $2.16) per share.

For the year ended December 31, 2013, 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 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.

a) Performance share options

Under the company's Long-Term Incentive Plan (LTIP), which was adopted in 2013, the company may issue PSOs to employees, directors and officers in accordance with the company's 2011 stock option plan (2011 Plan). The purpose of the PSO Plan is to attract, retain and motivate employees of the company. During the fiscal year ended December 31, 2013 the company issued 767,840 PSOs in accordance with the provisions of the LTIP. For the year ended December 31, 2013 the company determined that the performance hurdles related to the PSOs had not been achieved. As a result, the company recorded a reversal of the previously recorded share-based compensation expense of $250,000.

(expressed in US dollars, unless otherwise noted)

b) Restricted share unit plan

On March 5, 2013, the Board approved the adoption of a RSU Plan as part of the company's LTIP, which was subsequently approved by shareholders on May 8, 2013. The purpose of the RSU Plan is to attract, retain and motivate employees of the company. During the fiscal year ended December 31, 2013, the company issued 62,399 RSUs in accordance with the provisions of the RSU Plan. For the year ended December 31, 2013, the company determined that the performance hurdles related to the RSUs had not been achieved. As a result, the company recorded a reversal of the previously recorded share-based compensation expense of $33,000.

c) Deferred share unit plan

On March 5, 2013, the Board approved the adoption of a DSU Plan, which was subsequently approved by shareholders on May 8, 2013. During the fiscal year ended December 31, 2013, 30,275 DSUs were issued to non-employee directors of the company. During the fiscal year ended December 31, 2013, the company recognized a share-based compensation expense of $112,000 related to DSUs with a corresponding increase in contributed surplus.

13 Common shares

	Number of common shares	Share capital
Balance - December 31, 2011	55,243,059	492,353,321
Common share options exercised	161,826	234,228
Common shares repurchased	(145,800)	(521,729)
Balance - December 31, 2012	55,259,085	492,065,820
Common share options exercised	976,028	409,574
Warrants exercised	158,270	124,628
Balance - December 31, 2013	56,393,383	492,600,022

Share exchange

On November 11, 2013, 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 TSX. The number of shares to be purchased will not exceed 2,478,823 common shares. The period of the Bid will occur from November 13, 2013 to November 12, 2014. During the year ended December 31, 2013, the company did not repurchase any common shares.

On August 17, 2012, the company received regulatory approval for a Bid to repurchase a certain number of its outstanding common shares through the facilities of the TSX. The number of shares to be purchased will not exceed 2,348,261 common shares. The period of the Bid occurred from August 20, 2012 to August 19, 2013. During the year ended December 31, 2013, the company did not repurchase any common shares. During the

(expressed in US dollars, unless otherwise noted)

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, 2013, 158,270 (2012 - nil) warrants were exercised into common shares, generating proceeds of $124,628 (2012 - $nil). At December 31, 2013, the company had outstanding warrants for the purchase of 202,958 common shares of the company, exercisable at $0.81 per share. These shares are exercisable up to February 28, 2014.

14 Income taxes

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

	2013	2012
Net loss before income taxes	(14,764,804)	(11,430,735)
Income tax benefit at statutory rate	(3,912,673)	(3,029,144)
Cost (benefit) resulting from		
Research and development credit	(1,007,337)	(439,603)
Deferred income tax assets expired	20,896	89,348
Deferred income tax assets not recognized	4,899,114	3,379,399
Income tax expense	-	-

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:

	2013	2012
Estimated deferred income tax assets attributable to		
Net operating loss carry-forwards	17,696,631	14,851,129
Research and development credits	2,134,632	1,147,998
Other deferred income tax assets	2,577,256	2,437,490
Deferred income tax assets	22,408,519	18,436,617
Valuation allowance	(22,408,519)	(18,436,617)
Net deferred income tax assets	-	-

(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,				
2014	-	-	33,235	-
2015	-	-	393,740	-
2016	252,561	-	8,927	-
2017	317,961	-	9,677	-
2018	1,009,888	-	12,611	-
2019	1,561,172	11,664	14,006	-
2020	2,063,163	42,132	541,588	-
2021	2,564,511	55,822	671,919	-
2022	1,338,594	52,731	2,181,239	-
2023	1,321,285	44,965	-	-
2024	1,532,264	46,333	-	-
2025	1,629,456	47,245	-	-
2026	1,562,856	41,905	379,937	-
2027	2,011,361	35,351	-	-
2028	2,717,038	69,118	1,445,850	-
2029	2,854,334	63,226	-	-
2030	1,207,399	96,302	-	51,074
2031	3,927,982	-	5,946,290	443,884
2032	1,127,104	-	7,063,629	706,894
2033	2,518,097	-	8,381,066	748,164
	31,517,026	606,794	27,083,713	1,950,016

(expressed in US dollars, unless otherwise noted)

15 Commitments

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

Year ending December 31, 2014	5,654,871
2015	435,699
2016	376,082
2017	330,671
Thereafter	992,014
	7,789,337

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, 2013, the company was committed to purchases of feedstock of approximately $5.0 million prior to June 30, 2014.

16 Segmented information and enterprise wide disclosures

Segmented reporting

The company operates in one reportable segment and generates revenue primarily from the sale of its Ecosphere Biolatex (R) Bindery.

Sales by geographic location

The company is domiciled in Canada. During the year ended December 31, 2013, revenue from external customers located in Canada was $3,074,451 (2012 - $65,606). The total revenue from external customers in the following regions is as follows:

	2013	2012
North America	10,319,080	5,938,119
Latin America	2,189,304	1,685,437
EMEA	2,482,469	2,315,804
Asia Pacific	7,238,993	9,612,985
	22,229,846	19,552,345

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, 2013, revenue attributable to the individual countries representing greater than 10% of total revenues included United States, Japan, Canada and Germany, which represented 33%, 27%, 14% and 10%, respectively.

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.

(expressed in US dollars, unless otherwise noted)

Sales to major customers

The company derives a significant portion of its revenues from certain customers. Five customers represented 27%, 16%, 14%, 10% and 10%, respectively, of total revenue for the year ended December 31, 2013 (2012 - three customers represented 33%, 12% and 10%, respectively). The concentrations listed do not necessarily apply to the same customer year over year.

Property, plant and equipment and intangible assets

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

	2013	2012
Canada	3,540,808	2,727,975
United States of America	5,318,289	6,087,898
The Netherlands	4,040,100	4,522,044
	12,899,197	13,337,917

17 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:

	2013	2012
Wages and salaries	9,417,539	6,793,528
Share-based compensation	956,225	847,104
Depreciation and amortization	1,731,765	1,207,584

18 Loss per share

Basic loss per share is calculated by dividing the profit attributable to equity holders 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.

19 Contingencies and guarantees

In connection with the company's initial public offering on March 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

(expressed in US dollars, unless otherwise noted)

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 closing. The company has assessed the likelihood of incurring the liability as remote and, accordingly, has not recorded a provision at December 31, 2013.