CEAPRO

Nature Enhancing Life™

# Q1 2014

## Unaudited Condensed Consolidated Financial Statements for the First Quarter ended March 31, 2014

The MD&A provides commentary on the results of operations for the periods ended March 31, 2014 and 2013, the financial position as at March 31, 2014, and the outlook of Ceapro Inc. (ȃCeapro") based on information available as at May 22, 2014. The following information should be read in conjunction with the unaudited interim condensed consolidated financial statements as at March 31, 2014, and related notes thereto, as well as the audited consolidated financial statements for the year ended December 31, 2013 and the Management's Discussion and Analysis (MD&A) for the year ended December 31, 2013 which are prepared in accordance with International Financial Reporting Standards (IFRS). All comparative percentages are between the periods ended March 31, 2014 and 2013 and all dollar amounts are expressed in Canadian currency, unless otherwise noted. Additional information about Ceapro can be found on SEDAR at www.sedar.com.

## Forward-looking Statements

This MD&A offers our assessment of Ceapro's future plans and operations as at May 22, 2014, and contains forward-looking statements. By their nature, forward-looking statements are subject to numerous risks and uncertainties, including those discussed below. Readers are cautioned that the assumptions used in the preparation of forward-looking information, although considered reasonable at the time of preparation, may prove to be imprecise and, as such, undue reliance should not be placed on forward-looking statements. Actual results, performance, or achievements could differ materially from those expressed in, or implied by, these forward-looking statements. No assurance can be given that any of the events anticipated will transpire or occur, or if any of them do so, what benefits Ceapro will derive from them. The Company disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise unless required by law.

## Vision, Core Business, and Strategy

Ceapro is incorporated under the Canada Business Corporations Act, and its wholly-owned subsidiaries, Ceapro Technology Inc., Ceapro Veterinary Products Inc., Ceapro Active Ingredients Inc., and Ceapro BioEnergy Inc. are incorporated under the Alberta Business Corporations Act. Ceapro (P.E.I.) Inc. is a wholly-owned subsidiary incorporated in Prince Edward Island. Ceapro USA Inc. is a wholly-owned subsidiary incorporated in the state of Nevada. Ceapro is a growth stage biotechnology company. Our primary business activities relate to the development and commercialization of natural products for personal care, cosmetic, human, and animal health industries using proprietary technology, natural, renewable resources and developing innovation.

Our products include:

- A commercial line of natural active ingredients, including *beta glucan, avenanthramides (colloidal oat extract*), *oat powder, oat oil*, *oat peptides,* and *lupin peptides* which are marketed to the personal care, cosmetic, medical, and animal health industries through our distribution partners and direct sales; and

- Veterinary therapeutic products, including an *oat shampoo*, an *ear cleanser,* and a *dermal complex/conditioner*, which are manufactured and marketed to veterinarians in Japan and Asia, through agreements with Daisen Sangyo Co. Ltd.

Other products and technologies are currently in the research and development or pre-commercial stage. These technologies include:

- *CeaProve*®, a diabetes test meal to screen pre-diabetes and to confirm diabetes diagnosis;

- *A drug delivery* platform using our *beta glucan* technology to deliver compounds for uses ranging from wound care and therapy, to skin care treatments that reduce the signs of aging;

- An extension t*o the active ingredients* product range offering, through new plant extract products;

- A variety of novel manufacturing technologies including Supercritical Fluid drying technology which is currently being tested on oat beta glucan but may have application for multiple classes of compounds; and

- The development of a new oat variety and certain technologies to increase the content of avenanthramides to high levels to enable new innovative products to be introduced to new markets including medicinal foods, nutraceuticals and botanical drugs.

Our vision is to be a global leader in developing and commercializing products for the human and animal health markets through the use of proprietary technology and renewable resources. We act as innovator, advanced processor, and formulator in the development of new products. We deliver our technology to the market through distribution partnerships and direct sales efforts. Our strategic focus is in:

- Identifying unique plant sources and technologies capable of generating novel active natural products;

- Increasing sales and expanding markets for our current active ingredients;

- Developing and marketing additional high-value proprietary therapeutic natural products;

- Developing and improving manufacturing technologies to ensure efficiencies; and

- Advancing new partnerships and strategic alliances to develop new commercial active ingredients, manufacturing technologies, and target markets.

As a knowledge-based enterprise, we will also expand and strengthen our patent portfolio and build the necessary manufacturing infrastructure to become a global technology company.

Our business growth depends on our ability to access global markets through distribution partnerships. Our marketing strategy emphasizes providing technical support to our distributors and their customers to maximize the value of our technology and product utilization. Our vision and business strategy are supported by our commitment to the following core values:

- Adding value to all aspects of our business;

- Enhancing the health of humans and animals;

- Discovering, and commercializing new, therapeutic natural ingredients and bioprocessing technologies;

- Producing the highest quality work possible in products, science, and business; and

- Developing personnel through guidance, opportunities, and encouragement.

To support these objectives, we believe we have strong intellectual and human capital resources and we are developing a strong base of partnerships and strategic alliances to exploit our technology. The current economic environment provides challenges in obtaining financial resources to fully exploit opportunities. To fund our operations, Ceapro relies upon revenues primarily generated from the sale of active ingredients, and the proceeds of public and private offerings of equity securities, debentures, government grants and loans, and other investment offerings.

## Risks and Uncertainties

Biotechnology companies are subject to a number of risks and uncertainties inherent in the development of any new technology. General business risks include: uncertainty in product development and related clinical trials and validation studies, the regulatory environment, for example, delays or denial of approvals to market our products, the impact of technological change and competing technologies, the ability to protect and enforce our patent portfolio and intellectual property assets, the availability of capital to finance continued and new product development, and the ability to secure strategic partners for late stage development, marketing, and distribution of our products. To the extent possible, we pursue and implement strategies to reduce or mitigate the risks associated with our business.

The Company has exposure to credit, liquidity, and market risk as follows:

a) Credit risk:

Trade and other receivables

The Company makes sales to customers that are well-established within their respective industries. Based on previous experience the counterparties had zero default rates and management views this risk as minimal. Approximately 88% of trade receivable is due from one customer at March 31, 2014 and all trade receivables are current. This main customer presents good credit quality and historically has a high quality credit rating.

Other receivables represent amounts due for research program claims, government goods and services taxes, and scientific and research tax credits. Management has assessed the credit risk to be low.

Cash and cash equivalents

The Company has cash and cash equivalents in the amount of $1,213,208 at March 31, 2014 and mitigates its exposure to credit risk on its cash balances by maintaining its bank accounts with Canadian Chartered Banks and investing in low risk, high liquidity investments.

There are no past due or impaired financial assets. The maximum exposure to credit risk is the carrying amount of the Company’s trade and other receivables, cash and cash equivalents and restricted cash and cash equivalents. The Company does not hold any collateral as security.

b) Liquidity risk:

Liquidity risk relates to the risk that the Company will encounter difficulty in meeting its financial obligations. The Company may be exposed to liquidity risks if it is unable to collect its trade and other receivables balances in a timely manner, which could in turn impact the Company’s long-term ability to meet commitments under its current facilities. In order to manage this liquidity risk, the Company regularly reviews its aged trade receivables listing to ensure prompt collections. The Company regularly reviews its cash availability and whenever conditions permit; the excess cash is deposited in short-term interest bearing instruments to generate revenue while maintaining liquidity. There is no assurance that the Company will obtain sufficient funding to execute its strategic business plan.

The following are the contractual maturities of the Company's financial liabilities and obligations.

| | 0 - 1 year<br>$ | 1 - 3 years<br>$ | 4 - 7 years<br>$ | 8-12 years | Total<br>$ |
|---|---|---|---|---|---|
| Accounts payable and accrued liabilities | 1,257,351 | - | - | - | 1,257,351 |
| Loan payable secured by certain intellectual property due January, 2019. | 327,114 | 654,228 | 599,710 | - | 1,581,052 |
| Loan payable secured by a general security agreement due April, 2019. | 221,200 | 482,618 | 502,727 | - | 1,206,545 |
| Long-term debt, including interest | 200,082 | 400,164 | 166,735 | - | 766,981 |
| Royalties interest payable | 70,221 | - | - | - | 70,221 |
| Royalty financial liability | 72,089 | - | - | - | 72,089 |
| Repayable CAAP funding | 83,883 | 167,766 | 335,536 | 83,883 | 671,068 |
| Total | 2,231,940 | 1,704,776 | 1,604,708 | 83,883 | 5,625,307 |

c) Market risk

Market risk is comprised of interest rate risk, foreign currency risk, and other price risk. The Company's exposure to market risk is as follows:

1. Foreign currency risk

Foreign currency risk arises from the fluctuations in foreign exchange rates and the degree of volatility of these rates relative to the Canadian dollar.

The following table summarizes the impact of a 1% change in the foreign exchange rates of the Canadian dollar against the US dollar (USD) and the Euro on the financial assets and liabilities of the Company.

| | Carrying Amount (USD) | Foreign Exchange Risk (USD) | |
|---|---|---|---|
| | | -1%<br>Earnings & Equity | +1%<br>Earnings & Equity |
| **Financial assets** | | | |
| Accounts receivable | 322,217 | 3,222 | (3,222) |
| **Financial Liabilities** | | | |
| Accounts payable and accrued liabilities and Deferred revenue | 256,769 | (2,568) | 2,568 |
| **Total increase (decrease)** | | 654 | (654) |

| | Carrying Amount (EURO) | Foreign Exchange Risk (EURO) | |
|---|---|---|---|
| | | -1%<br>Earnings & Equity | +1%<br>Earnings & Equity |
| **Financial Liabilities** | | | |
| Long-term debt | 968,909 | (9,689) | 9,689 |
| **Total increase (decrease)** | | (9,689) | 9,689 |

The carrying amount of accounts receivable and accounts payable and accrued liabilities and deferred revenue in USD and long-term debt in Euro represents the Company's exposure at March 31, 2014.

2. Interest rate risk.

The Company has minimal interest rate risk because its long-term debt agreements are all at fixed rates.

3. Share price risk.

a) Ceapro's share price is subject to equity market price risk, which may result in significant speculation and volatility of trading due to the uncertainty inherent in the Company's business and the technology industry.

b) There is a risk that future issuance of common shares may result in material dilution of share value, which may lead to further decline in share price. The expectations of securities analysts and major investors about our financial or scientific results, the timing of such results and future prospects, could also have a significant effect on the future trading price of Ceapro's shares.

4. People and process risk.

A variety of factors will affect Ceapro's future growth and operating results, including the strength and demand for the Company's products, the extent of competition in our markets, the ability to recruit and retain qualified personnel, and the ability to raise capital.

Ceapro's consolidated financial statements are prepared within a framework of IFRS selected by management and approved by the Board of Directors. The assets, liabilities, revenues, and expenses reported in the consolidated financial statements depend to varying degrees on estimates made by management. An estimate is considered a critical accounting estimate if it requires management to make assumptions about matters that are highly uncertain and if different estimates that could have been used would have a material impact. The significant areas requiring the use of management estimates relate to provisions made for inventory valuation, amortization of property and equipment, tax liabilities and tax assets, normal provisions, the assumptions used in determining share-based compensation, the interest rates used in determining the employee future benefits obligation and the estimated sales projections to value the royalty financial liability. These estimates are based on historical experience and reflect certain assumptions about the future that we believe to be both reasonable and conservative. Actual results could differ from those estimates. Ceapro continually evaluates the estimates and assumptions.

i) Loss of key personnel:

Ceapro relies on certain key employees whose skills and knowledge are critical to maintaining the Company's success. Ceapro always strives to identify and retain key employees and always strives to be competitive with compensation and working conditions. The current robust economy in Alberta does increase these risks.

ii) Interruption of raw material supply:

Interruption of key raw materials could significantly impact operations and our financial position. Interruption of supply could arise from weather related crop failures or from market shortages. Ceapro attempts to purchase key raw materials well in advance of their anticipated use and is in-licensing technologies from third parties to reduce this risk.

iii) Environmental issues:

Violations of safety, health, and environmental regulations could limit operations and expose the Company to liability, cost, and reputational impact. In addition to maintaining compliance with national and provincial standards, Ceapro maintains internal safety and health programs.

iv) Regulatory compliance:

As a natural extract producer, Ceapro is subject to various regulations and violation of these could limit markets into which we can sell. Ceapro has introduced a range of procedures which will ensure that Ceapro is well prepared for new regulations and obligations that may be required. Significant investments are being made to ensure compliance with the continually evolving regulatory environment.

## Future accounting policies not yet adopted

Financial instruments

The IASB intends to replace IAS 39 - Financial Instruments: Recognition and Measurement ("IAS 39") in its entirety with IFRS 9 - Financial Instruments ("IFRS 9") in three main phases. IFRS 9 will be the new standard for the financial reporting of financial instruments that is principles-based and less complex than IAS 39.

In November 2009 and October 2010, phase 1 of IFRS 9 was issued and amended, respectively, which addressed the classification and measurement of financial assets and financial liabilities. IFRS 9 requires that all financial assets be classified as subsequently measured at amortized cost or at fair value based on the company's business model for managing financial assets and the contractual cash flow characteristics of the financial assets. Financial liabilities are classified as subsequently measured at amortized cost except for financial liabilities classified as at fair value through profit or loss, financial guarantees and certain other exceptions. The effective date of IFRS 9 has not yet been determined by the IASB. The Company has not yet assessed the impact that this new standard is likely to have on its consolidated financial statements.

## Results of Operations

## Periods Ended March 31, 2014, 2013 and 2012

**CONSOLIDATED INCOME STATEMENT**

| *$000s except per share data* | **2014** | **%** | 2013 | % | 2012 | % |
|---|---|---|---|---|---|---|
| **Total revenues** | **1,954** | **100%** | **2,012** | **100%** | **1,190** | **100%** |
| Cost of goods sold | 894 | 46% | 962 | 48% | 521 | 44% |
| **Gross margin** | **1,060** | **54%** | **1,050** | **52%** | **669** | **56%** |
| Research and product development | 225 | 12% | 138 | 7% | 163 | 14% |
| General and administration | 422 | 22% | 436 | 22% | 392 | 33% |
| Sales and marketing | 1 | 0% | 22 | 1% | 71 | 6% |
| Finance costs | 92 | 5% | 51 | 3% | 27 | 2% |
| **Income from operations** | **320** | **16%** | **403** | **20%** | **16** | **1%** |
| Other operating income (loss) | (143) | -7% | 5 | 0% | (20) | 2% |
| **Net income (loss)** | **177** | **9%** | **408** | **20%** | **(4)** | **0%** |
| Basic net income (loss) per common share | 0.003 | | 0.007 | | (0.000) | |
| Diluted net income (loss) per common share | 0.003 | | 0.007 | | (0.000) | |

The Company's revenue decreased by 3% or $58,000 to $1,954,000 from $2,012,000 and cost of goods sold decreased by 7% or $68,000 to $894,000 from $962,000 in comparison with the same period of 2013.

These changes resulted in an increase in gross margin by 1% or $10,000 to $1,060,000 from $1,050,000. Income from operations has decreased by $83,000 to $320,000 from $403,000.

Net income in the period ended March 31, 2014 decreased by $231,000 to $177,000 from $408,000 in 2013.

## Revenue

| | Three Months Ended March 31, | | Change |
|---|---|---|---|
| *$000s* | 2014 | 2013 | |
| Total revenues | 1,954 | 2,012 | -3% |

### PRODUCT SALES

Sales in the period ended March 31, 2014 decreased by $58,000 or 3% primarily as a result of lower sales volumes of beta glucan and veterinary shampoo, offset by increased sales of avenanthramides. Higher sales volumes in 2013 were also assisted by logistical delays in December 2012 that delayed shipments until January 2013.

## Expenses

### COST OF GOODS SOLD AND GROSS MARGIN

| | Three Months Ended March 31, | | Change |
|---|---|---|---|
| *$000s* | 2014 | 2013 | |
| Sales | 1,954 | 2,012 | -3% |
| Cost of goods sold | 894 | 962 | -7% |
| Gross margin | 1,060 | 1,050 | 1% |
| Gross margin % | 54% | 52% | |

Cost of goods sold is comprised of the direct raw materials required for the specific formulation of products, as well as direct labour, quality assurance and control, packaging, transportation costs, plant costs, and amortization on plant and equipment assets. Aside from labour, rent, quality control related expenses, overhead, and property plant and equipment amortization, the majority of costs are variable in relation to the volume of product produced or shipped.

During the period ended March 31, 2014 the cost of goods sold decreased by $68,000 or 7%, from $962,000 in 2012 to $894,000 in 2013. The gross margin in the first quarter of 2014 is higher by 1% mostly due to lower cost of goods sold. The gross margin percentage increased by 2% from 52% in the first quarter of 2013 to 54% in the same period of 2014 due to natural feedstock variations and the beneficial effects of a strong US dollar versus the Canadian dollar on sales revenue.

### RESEARCH AND PRODUCT DEVELOPMENT

| | Three Months Ended March 31, | | Change |
|---|---|---|---|
| *$000s* | 2014 | 2013 | |
| Salaries and benefits | 127 | 167 | |
| Regulatory and patents | 25 | 34 | |
| Other | 73 | (63) | |
| Total research and product development expenditures | 225 | 138 | 63% |

During the period ended March 31, 2014 research and development have increased by 63% primarily due to lower grant revenues recognized which are recorded as an expense reduction.

**GENERAL AND ADMINISTRATION**

| | Three Months Ended March 31, | | Change |
|---|---|---|---|
| *$000s* | 2014 | 2013 | |
| Salaries and benefits | 155 | 164 | |
| Consulting | 67 | 67 | |
| Board of Directors compensation | 51 | 40 | |
| Insurance | 29 | 33 | |
| Accounting and Audit fees | 15 | 15 | |
| Rent | 25 | 25 | |
| Public Company Costs | 8 | 7 | |
| Travel | 24 | 24 | |
| Depreciation | 16 | 11 | |
| Legal | 4 | 20 | |
| Other | 28 | 30 | |
| Total general and administration expenses | 422 | 436 | -3% |

General and administration expense for the period ended March 31, 2014 decreased by $14,000 or 3% from $436,000 to $422,000 reflecting cost control effort by the Company.

**SALES AND MARKETING**

| | Three Months Ended March 31, | | Change |
|---|---|---|---|
| *$000s* | 2014 | 2013 | |
| Travel | - | 13 | |
| Courses, Conferences & Advertising | - | 6 | |
| Other | 1 | 3 | |
| Total sales and marketing | 1 | 22 | -95% |

The period ended March 31, 2014 showed a decrease in expenditures of $21,000 or 95% versus 2013 due to decreased travel and conference in the first quarter and the decision to place greater marketing emphasis on distribution partners.

**FINANCE COSTS**

| | Three Months Ended March 31, | | Change |
|---|---|---|---|
| *$000s* | 2014 | 2013 | |
| Interest on royalty financial liability | 4 | 8 | |
| Interest on long-term loan | 21 | 11 | |
| Transaction costs | 5 | - | |
| Interest on royalties to Guelph & AAFC | 48 | 23 | |
| Accretion of CAAP loan | 14 | 9 | |
| | 92 | 51 | 80% |

As at March 31, 2014, royalty investors received royalties equal to 2.285% (2013 ï 2.285%) of revenues from product sales and royalty, licence, and product development fees of active ingredients and veterinary therapeutic products and *CeaProve*®, to a maximum of two times the amount invested. AVAC Ltd. receives royalties of up to 2.5% to 5% of revenues from eligible product sales, to a maximum of one and a half to two times the amount invested. Royalty expenses will vary directly with fluctuations in eligible product sales, royalty, licence and product development fees, product sales mix, and any new royalty interest offerings that may be completed.

Finance costs increased in the period ended March 31, 2014 in comparison with the same period of 2013 primarily due to minimum royalties payable to the University of Guelph & AAFC, accretion of the CAAP loan and increased interest on long-term debt.

The Company entered into Canadian Agricultural Adaptation Program ("CAAP") repayable contribution agreements for total possible funding of $1,339,625 available over the period from October 7, 2010 through September 30, 2012. During the year ended December 31, 2012, the Company voluntarily decommitted $668,557 as a result of lower anticipated project expenditures to the maximum possible funding under the agreement of $671,068. The end date for project expenditures and start date for repayments were also extended one year to September 30, 2013 and to December 31, 2014 respectively. As the contributions are non-interest bearing, the fair value at inception is estimated as the present value of the principal payments required, discounted using the prevailing market rates of interest for a similar instrument estimated to be 15% per annum. The difference between the fair value of the contributions and the cash received is accounted for as a government grant. The first payment was received in the first quarter of 2011. Accretion of the CAAP loan was $14,000 in the period ended March 31, 2014 (March 31, 2013 – $9,000).

## OTHER OPERATING LOSS (INCOME)

| | Three Months Ended March 31, | | Change |
|---|---|---|---|
| *$000s* | 2014 | 2013 | |
| Foreign exchange loss (income) | 61 | (4) | |
| Loss on disposal of property and equipment | 4 | - | |
| Other (income) | - | (1) | |
| Plant relocation costs | 78 | - | |
| | 143 | (5) | 2960% |

Foreign exchange loss in the period ended March 31, 2014 was $61,000 in comparison with an income of $4,000 in 2013 due to the fluctuations of the US dollar versus the Canadian dollar during the in comparison with the same period of 2013.

## DEPRECIATION AND AMORTIZATION EXPENSES

In the period ended March 31, 2014 the total depreciation and amortization of $75,000 (2013 - $76,000) was allocated as follows: $17,000 to general and administration expense (2013 - $11,000), $10,000 to inventory (2013 - $19,000), and $48,000 (2013 - $46,000) to cost of goods sold.

## QUARTERLY INFORMATION

The following selected financial information is derived from Ceapro's unaudited quarterly financial statements for each of the last eight quarters, all of which cover periods of three months. All amounts shown are in Canadian currency.

| $000s except per share data | 2014 | 2013 | | | | 2012 | | |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Q4 | Q3 | Q2 | Q1 | Q4 | Q3 | Q2 |
| Total revenues | 1,954 | 1,503 | 1,997 | 1,012 | 2,012 | 1,202 | 1,283 | 1,490 |
| Net income (loss) | 177 | (117) | 123 | (252) | 408 | (237) | (137) | (160) |
| Basic net income (loss) per common share | 0.003 | (0.002) | 0.002 | (0.004) | 0.007 | (0.004) | (0.002) | (0.003) |
| Diluted net income (loss) per common share | 0.003 | (0.002) | 0.002 | (0.004) | 0.007 | (0.004) | (0.002) | (0.003) |

Ceapro's quarterly sales and results primarily fluctuate due to variations in the timing of customer orders, different product mixes, and the capacity to manufacture products.

## Liquidity and Capital Resources

**CAPITAL EMPLOYED**

| *$000s* | March 31, 2014 | December 31, 2013 |
|---|---|---|
| Non-current assets | 3,314 | 1,948 |
| Current assets | 2,422 | 3,149 |
| Current liabilities | (2,357) | (2,213) |
| Total assets less current liabilities | 3,379 | 2,884 |
| Non-current liabilities | 2,899 | 2,640 |
| Shareholders' equity | 480 | 244 |
| Total capital employed | 3,379 | 2,884 |

Non-current assets increased by $1,366,000 due to an acquisition of $1,445,000 of property and equipment (net grant proceeds) offset by a depreciation provision of $75,000 and asset disposals of $4,000.

Current assets decreased by $727,000. Cash decreased by $740,000, accounts receivables and prepaid expenses were lower by $34,000. Inventories were higher by $47,000.

Current liabilities totaling $2,357,000 increased by the net amount of $144,000 mostly due to an increase in the current portion of long-term debt of $111,000, an increase in trade payables and accrued liabilities of $263,000, the reclassification of employee future benefit obligation of $78,000 (net of $50,000 payment), increase in the current portion of CAAP loan of $3,000 and an increase in royalty related obligations of $4,000 offset by a decrease in deferred revenue of $315,000.

Non-current liabilities totaling $2,899,000 increased by the net amount of $259,000 due to long-term debt increases of $375,000 and a discounted CAAP loan increased in the amount of $11,000 offset by accrued employee future benefit obligation reclassified to current liabilities in the amount of $127,000.

Equity of $480,000 at March 31, 2014 increased by $236,000 from equity of $244,000 at December 31, 2013 due to net income for the period ended March 31, 2014 of $177,000 and recognized share-based compensation of $46,000 and share options exercised of $13,000.

**NET DEBT**

| *$000s* | March 31, 2014 | December 31, 2013 |
|---|---|---|
| Cash and cash equivalents | 1,213 | 1,953 |
| Current financial liabilities | 2,086 | 1,705 |
| Non-current financial liabilities | 2,899 | 2,513 |
| Total financial liabilities | 4,985 | 4,218 |
| NET DEBT | 3,772 | 2,265 |

**Current and non-current financial liabilities include accounts payable and accrued liabilities, current and non-current portion of long term debt, royalties interest payable, current of royalty financial liability, and a CAAP loan.*

The Company's net debt increased by $1,507,000 due to a decrease of cash and cash equivalent in the amount of $740,000, accounts payable and accrued liabilities increase of $263,000, long-term debt increased in the amount of $486,000, CAAP loan discounted amount recognized of $14,000 and an increased royalty related obligations of $4,000.

## SOURCES AND USES OF CASH

The following table outlines our sources and uses of funds during the periods ended March 31, 2014 and 2013.

| | Three Months Ended March 31, | |
|---|---|---|
| *$000s* | 2014 | 2013 |
| Sources of funds: | | |
| Funds generated from operations (cash flow) | 400 | 548 |
| Changes in non-cash working capital items | (99) | (535) |
| Restricted cash received ot utilized | - | 119 |
| Grant used for capital assets | 85 | 199 |
| Repayable CAAP Funding | - | 63 |
| Share issuance | 13 | - |
| Long-term debt, net of repayments | 525 | - |
| | 924 | 394 |
| Uses of funds: | | |
| Purchase of property and equipment | (886) | (44) |
| Purchase of leasehold improvements | (645) | (199) |
| Employee future benefits obligation repayment | (50) | - |
| Deferred revenue reduction | - | (119) |
| Interest paid | (40) | (11) |
| Repayment of long term debt | (43) | (41) |
| | (1,664) | (414) |
| Net change in cash flows | (740) | (20) |

Net change in cash flow decreased by $720,000 during the period ended March 31, 2014 in comparison with the same period of 2013.

The Company estimates that the cash flows generated by its operating activities as well as cash available through other sources will be sufficient to finance its operating expenses and capital investment but believes there may be other cost uncertainties pertaining to commissioning and start up of a new plant.

The Company relies upon revenues generated from the sale of active ingredients, the proceeds of public and private offerings of equity securities and debentures, income offerings, and government funding programs to support the Company's operations.

Total common shares issued and outstanding as at May 22, 2014 were 60,403,948 (May 7, 2013 ï 60,278,948). In addition, 3,950,000 stock options as at May 22, 2014 (May 7, 2013 ï 4,100,000) were outstanding that are potentially convertible into an equal number of common shares at various prices.

Ceapro's working capital was $65,000 at March 31, 2014, which was decreased by $872,000 from working capital of $937,000 at December 31, 2013.

To meet future requirements, Ceapro intends to raise additional cash through some or all of the following methods: public or private equity or debt financing, income offerings, capital leases, collaborative and licensing agreements, and government funding programs. However, there is no assurance of obtaining additional financing through these arrangements on acceptable terms, if at all.

The ability to generate new cash will depend on external factors, many beyond the Company's control, as outlined in the Risks and Uncertainties section. Should sufficient capital not be raised, Ceapro may have to delay, reduce the scope of, eliminate, or divest one or more of its discovery, research, or development technology or programs, any of which could impair the value of the business.

**GOVERNMENT FUNDING**

a) During the year ended December 31, 2010, the Company was approved for non-repayable funding in the amount of $124,000 from Alberta Innovates Technology Futures (AITF). During the period ended March 31, 2014, the Company received $nil (2013 - $4,583) which was recorded as a reduction of research and product development expenses. This agreement has now been completed.

b) During the year ended December 31, 2012 the Company was approved for a second agreement for non-repayable funding in the amount of $124,000 from AITF. During the current quarter, the Company received $13,750 (2013 - $13,750) which was recorded as a reduction of research and project development expenses. The Company anticipates receiving additional funding of $4,583 in 2014 under this agreement.

c) The Company was approved for non-repayable funding to a maximum of $21,250 of eligible expenditures under the Novel Crops Initiative program from the Prince Edward Island Department of Agriculture. The Company recorded the amount of $nil as a reduction of research and product development expenditures under this program in the period ended March 31, 2014 (2013 - $5,000). This agreement has now been completed.

d) The Company entered into Canadian Agricultural Adaptation Program (“CAAP”) repayable contribution agreements for total possible funding of $1,339,625 receivable over the year from October 7, 2010 through September 30, 2012. During the year ended December 31, 2012, the Company voluntarily amended the maximum possible funding under the agreement to $671,068 as a result of lower anticipated project expenditures. The end date for project expenditures was also extended one year to September 30, 2013. All amounts claimed under the program are repayable interest free over eight years beginning in 2014. The Company has received or recorded as receivable funding of $671,068 to date under this program and no further funds are expected.

e) During the year ended December 31, 2011, the Company entered into a Contribution Agreement with AI-BIO Solutions for a non-repayable grant contribution totaling up to $1,600,000 towards the construction of a new bio-processing facility and subject to compliance with all terms and conditions of the agreement. In accordance with the agreement, the Company received $750,000 in 2011 classified as restricted cash and cash equivalents and deferred revenue, and received of $690,000 in 2013. The amount of $0 (2013 - $198,824) was recorded as a reduction of capitalized expenditures in the period ended March 31, 2014. An amount of $160,000 is expected to be received in 2014.

f) During the year ended December 31, 2012 the Company entered into a contribution agreement with an agency of the federal government to provide funding of up to $253,000 for certain research activities. This contribution agreement was amended to increase the potential non-repayable contribution amount to $345,000 from $253,000 in 2013. During the period ended March 31, 2014 the Company received or recorded as receivable the amount of $nil (March 31, 2013 - $169,009). The agreement is now completed.

g) During the year ended December 31, 2013 the Company entered into an agreement under the Growing Forward 2 program to provide non-repayable grant funding in an amount up to $673,000. During the current quarter the Company received or recorded as receivable the amount of $93,333, of which $85,346 was recorded as a reduction of capital expenditures. The Company anticipates receiving up to an additional $387,322 in 2014.

The Company is currently reviewing additional options available to raise capital.

## Related Party Transactions

During the period ended March 31, 2014, $8,000 (2013 - $8,000) of royalties were earned by employees and directors from their investment in previous Ceapro royalty offerings. As at March 31, 2014, $14,000 (2013 - $13,000) of royalties were payable to employees and directors.

During the period ended March 31, 2014, the Company paid key management salaries, short-term benefits, consulting fees and director fees totaling $132,000 (2013 – $192,000) and key management personnel received share-based payments of 22,000 (2013 - $21,000).

Amount payable to directors at March 31, 2014 was $29,000 (2013 - $29,000).

These transactions are in the normal course of operations and are measured at the amount of consideration established and agreed to by the related parties.

## Commitments and Contingencies

a) During the year ended December 31, 2011, the Company and its wholly owned subsidiary, Ceapro Veterinary Products Inc. were served with a statement of claim from AVAC Ltd. alleging damages of $724,500 pursuant to a product development agreement. The Company and Ceapro Veterinary Products Inc. have filed a statement of defense to refute the claim and believe it has strong defenses to the AVAC allegations. However, at this time the outcome of the litigation is uncertain and no provisions have been made in the consolidated financial statements on account of this litigation.

b) During the year ended December 31, 2012, the Company and its wholly owned subsidiary, Ceapro Technology Inc. were served with a statement of claim from AVAC Ltd. alleging damages of $1,470,000 pursuant to two product development agreements. The Company and Ceapro Technology Inc. have filed a statement of defense to refute the claim and believe it has strong defenses to the AVAC allegations. However, at this time the outcome of the litigation is uncertain and no provisions have been made in the consolidated financial statements on account of this litigation.

c) During the year ended December 31, 2008, the Company entered into a licensing agreement with the University of Guelph for an exclusive variety of a mint plant. During the year ended December 31, 2011, the Company has entered into a new licensing agreement with the University of Guelph for additional market rights for the exclusive variety of a mint plant.

In accordance with the new agreement, there are future minimum royalty prepayments of $10,000 per annum starting in 2012 for royalty payments which will be calculated as 5% of net sales from products derived from the mint plants. The minimum royalty payments are creditable against royalties in years where royalties are due. The agreement is an executory contract and therefore all royalty payments under the contract will be recognized as they become due.

d) During the year ended December 31, 2012 the Company has entered into a new licence agreement for a new technology to increase the concentration of avenanthramides in oats. The Company shall pay an annual royalty percentage rate of 2% of sales, payable every January 1st and July 1st, subject to a minimum annual royalty payment according to the schedule below:

| Year | Amount |
|---|---|
| 2012 | nil |
| 2013 | $12,500 |
| 2014 | $37,500 |
| 2015 | $50,000 |
| 2016 | $50,000 |

And $50,000 each year thereafter while the licence agreement remains in force. The agreements remain in force until the patents expire or are abandoned.

The agreement is an executory contract and therefore all royalty payments under the contract will be recognized as they become due.

e) In the normal course of operations the Company may be subject to litigation and claims from customers, suppliers and former employees. Management believes that adequate provisions have been recorded in the accounts where required. Although it is not possible to estimate the extent of potential costs, if any, management believes that the ultimate resolution of such contingencies would not have a material adverse effect on the financial position of the Company.

## Outlook

We are very pleased with the first quarter 2014 results showing sales of $1,954,000 and a net profit of $177,000. While these results are slightly lower than the results obtained for the same period in 2013, they were achieved during a period of requiring high levels of non-recurrent expenses required for the construction of a new state-of-the-art manufacturing facility and the acquisition and installation of customized equipment.

The successful implementation and commissioning of the new facility remains our top priority for the first half of 2014. We expect the completion of construction to occur in June and currently anticipate to start producing first validation trials at the beginning of Q3, 2014. In order to minimize supply continuity and start up risks, we will run our two plants in parallel for a period of three months to ensure that products specifications are exactly the same in both facilities. We expect to exit the existing manufacturing facility by the end of September 2014. As part of our risk mitigation plan, we will be building up significant inventory for our flagship product, avenanthramides, from which we expect a significant sales increase in 2014.

In addition, we expect to pursue our research and development program with dry formulations of our value drivers, avenanthramides and beta glucan that would be produced in our new facility. A feasibility study to assess the potential of the powders to be developed as active ingredients for nutraceuticals and /or pharmaceuticals markets showed positive results. The stage is now set for pre-clinical studies and further clinical trials to be conducted over a 24 months period. While these studies require major investments, transition to the functional food and/or nutraceutical sectors will represent a significant opportunity for Ceapro.

## Additional Information

Additional information relating to Ceapro Inc., including a copy of the Company's Annual Report and Proxy Circular, can be found on SEDAR at www.sedar.com.

**Unaudited Condensed Consolidated Financial Statements for the First Quarter Ended March 31, 2014**

**Ceapro Inc.**

## Notice of No Auditor Review of Condensed Interim Consolidated Financial Statements

Under National Instrument 51-102, Part 4, subsection 4.3(3)(a), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying condensed interim consolidated financial statements of Ceapro Inc. (the "Company") have been prepared by and are the responsibility of the Company management.

The Company's independent auditor has not performed a review of these consolidated financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

CEAPRO INC.

Consolidated Balance Sheets

Unaudited

| | March 31, 2014 | December 31, 2013 |
|---|---|---|
| | $ | $ |
| ASSETS | | |
| Current Assets | | |
| Cash and cash equivalents | 1,213,208 | 1,953,019 |
| Trade receivables | 361,295 | 250,859 |
| Other receivables | 223,557 | 279,413 |
| Inventories (note 4) | 370,259 | 323,582 |
| Prepaid expenses and deposits | 253,931 | 342,289 |
| | 2,422,250 | 3,149,162 |
| Non-Current Assets | | |
| Deposit | 28,562 | 28,562 |
| Licenses (note 5) | 64,389 | 66,254 |
| Property and equipment (note 6) | 3,221,483 | 1,853,024 |
| | 3,314,434 | 1,947,840 |
| TOTAL ASSETS | 5,736,684 | 5,097,002 |
| LIABILITIES AND EQUITY | | |
| Current Liabilities | | |
| Accounts payable and accrued liabilities | 1,257,351 | 994,408 |
| Deferred revenue | 46,312 | 361,309 |
| Current portion of long-term debt (note 7) | 611,160 | 499,718 |
| Current portion of employee future benefits obligation (note 8) | 224,266 | 145,973 |
| Current portion of CAAP loan (note 10) | 75,677 | 72,942 |
| Royalties interest payable | 70,221 | 31,631 |
| Current portion of royalty financial liability | 72,089 | 106,692 |
| | 2,357,076 | 2,212,673 |
| Non-Current Liabilities | | |
| Employee future benefits obligation (note 8) | - | 127,009 |
| Long-term debt (note 7) | 2,597,156 | 2,222,298 |
| CAAP loan (note 10) | 301,963 | 290,529 |
| | 2,899,119 | 2,639,836 |
| Equity | | |
| Share capital (note 9) | 6,335,914 | 6,315,858 |
| Contributed surplus | 542,340 | 503,829 |
| Accumulated other comprehensive loss | (16,916) | (16,916) |
| Deficit | (6,380,849) | (6,558,278) |
| | 480,489 | 244,493 |
| TOTAL LIABILITIES AND EQUITY | 5,736,684 | 5,097,002 |

*See accompanying notes*

CEAPRO INC.
Consolidated Statements of Net Income and Comprehensive Income
Unaudited

| | Three months Ended March 31, 2014 | 2013 |
|---|---|---|
| | $ | $ |
| Revenue (note 14) | 1,954,347 | 2,012,279 |
| Cost of goods sold | 894,303 | 962,385 |
| Gross margin | 1,060,044 | 1,049,894 |
| Research and product development | 224,506 | 137,711 |
| General and administration | 422,259 | 436,513 |
| Sales and marketing | 1,167 | 22,353 |
| Finance costs (note 13) | 92,123 | 50,506 |
| Income from operations | 319,989 | 402,811 |
| Other operating (loss) income (note 12) | (142,560) | 5,360 |
| Net income for the period | 177,429 | 408,171 |
| Other comprehensive loss | | |
| Actuarial loss on employee future benefit obligation (note 8) | - | (16,916) |
| Total comprehensive income for the period | 177,429 | 391,255 |
| Net income per common share (note 19): | | |
| Basic | 0.00 | 0.01 |
| Diluted | 0.00 | 0.01 |
| Weighted average number of common shares outstanding | 60,355,337 | 60,278,948 |

*See accompanying notes*

CEAPRO INC.
Consolidated Statements of Changes in Equity
Unaudited

| | Share Capital<br>$ | Contributed surplus<br>$ | Deficit<br>$ | Accumulated other comprehensive loss<br>$ | Equity<br>$ |
|---|---|---|---|---|---|
| Balance December 31, 2013 | 6,315,858 | 503,829 | (6,558,278) | (16,916) | 244,493 |
| | | | | | - |
| Share-based payments | - | 46,067 | - | - | 46,067 |
| Stock options exercised | 20,056 | (7,556) | | | 12,500 |
| Net income for the period | - | - | 177,429 | - | 177,429 |
| Balance March 31, 2014 | 6,335,914 | 542,340 | (6,380,849) | (16,916) | 480,489 |
| Balance December 31, 2012 | 6,315,858 | 431,792 | (6,734,086) | - | 13,564 |
| Share-based payments | - | 38,361 | - | - | 38,361 |
| Net income for the period | - | - | 408,171 | - | 408,171 |
| Other comprehensive loss (actuarial loss) (note 8) | - | - | - | (16,916) | (16,916) |
| Balance March 31, 2013 | 6,315,858 | 470,153 | (6,325,915) | (16,916) | 443,180 |

*See accompanying notes*

CEAPRO INC.
Consolidated Statements of Cash Flows
Unaudited

| | Three Months Ended March 31, 2014 $ | 2013 $ |
|---|---|---|
| OPERATING ACTIVITIES | | |
| Net income for the period | 177,429 | 408,171 |
| Adjustments to reconcile net income to cash and cash equivalents provided by operating activities | | |
| Finance costs | 73,236 | 41,478 |
| Transaction costs | 4,718 | - |
| Depreciation and amortization | 75,070 | 76,134 |
| Loss on disposal of property and equipment | 3,680 | - |
| Accretion of CAAP loan (note 10) | 14,169 | 9,028 |
| Grant revenue recognized | - | (32,652) |
| Employee future benefits obligation | 1,284 | 7,411 |
| Share-based payments | 46,067 | 38,361 |
| Net income for the period adjusted for non-cash items | 395,653 | 547,931 |
| CHANGES IN NON-CASH WORKING CAPITAL ITEMS | | |
| Trade receivables | (110,436) | (257,578) |
| Other receivables | 55,856 | 23,098 |
| Inventories | (46,677) | 313,993 |
| Prepaid expenses and deposits | 88,358 | 22,731 |
| Deferred revenue | (314,997) | (728,656) |
| Royalty liability accrued | 3,987 | 7,699 |
| Accounts payable and accrued liabilities | 230,070 | 84,184 |
| | (93,839) | (534,529) |
| Net income for the period adjusted for non-cash and working capital items | 301,814 | 13,402 |
| Interest paid | (40,363) | (11,279) |
| CASH GENERATED FROM OPERATIONS | 261,451 | 2,123 |
| INVESTING ACTIVITIES | | |
| Purchase of property and equipment | (885,407) | (43,907) |
| Purchase of leasehold improvements | (645,283) | (198,824) |
| | (1,530,690) | (242,731) |
| FINANCING ACTIVITIES | | |
| Long-term debt | 524,820 | - |
| Employee future benefits obligation repayment | (50,000) | |
| Stock options exercised | 12,500 | |
| Repayment of Long-term debt | (43,238) | (41,125) |
| Grant used for purchasing of leaseholds, property and equipment and prepaid deposits | 85,346 | 198,824 |
| CAAP loan | - | 62,699 |
| Deferred revenue | - | (118,824) |
| Restricted cash and cash equivalents | - | 118,824 |
| | 529,428 | 220,398 |
| Decrease in cash and cash equivalents | (739,811) | (20,210) |
| Cash and cash equivalents at beginning of the period | 1,953,019 | 273,106 |
| Cash and cash equivalents at end of the period | 1,213,208 | 252,896 |

*See accompanying notes*

Cash and cash equivalents are comprised of $206,474 (2013 - $196,394) on deposit with financial institutions, $6,734 (2013 - $56,502) held in money market mutual funds, and $1,000,000 (2013 - $nil) held in guaranted investment certificates.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**
**MARCH 31, 2014 AND 2013.**

## 1. NATURE OF BUSINESS OPERATIONS AND GOING CONCERN

Ceapro Inc. (the "Company") is incorporated under the Canada Business Corporations Act and is listed on the TSX Venture Exchange under the symbol CZO. The Company's primary business activities relate to the marketing and development of various health and wellness products and technology relating to plant extracts.

The Company's head office address is Suite 4174 Enterprise Square, 10230 Jasper Avenue, Edmonton, AB T5J 4P6.

The consolidated financial statements have been prepared on a going concern basis which assumes that the Company will continue in operation for the foreseeable future and will be able to realize its assets and discharge liabilities in the normal course of operations. However, certain conditions may cast significant doubt upon the validity of this assumption. Since inception, the Company has accumulated net losses, generated inconsistent operating cash flow and has not yet achieved consistent profitability. During the three months ended March 31, 2014 the Company recorded net income of $177,429 and as of that date had accumulated a deficit of $6,380,849.

The Company is currently in progress to complete a new manufacturing facility. This involves substantial capital expenditures for engineering and design, permitting, construction of leaseholds, equipment, as well as other related costs required to meet the requirements of major customers. The total investment required for these items is currently estimated at $5,600,000 of which the Company has completed approximately $4,180,000. The Company believes that based on work completed and paid to date and its cash resources, additional funds available to it under long term debt facilities, additional grant funds, and other identified miscellaneous sources that it has the funding in place to complete the project.

When a new manufacturing facility is brought into commercial production, there is always a risk as to the magnitude of investment of human and financial resources required for start up and commissioning activities. While the Company intends to fully utilize its expertise to complete these activities and minimize risks, there is considerable risk inherent in these activities. Additional funds may be required to conduct these essential activities.

The Company will have much higher debt repayment requirements in 2014 as a result of the two new long term debt facilities entered into in 2013. The Company may need to supplement its operating cash flows with additional cash resources to maintain compliance with all debt agreements.

The Company has relied on the proceeds of public and private offerings of equity securities and debentures, debt, and other income offerings to support the Company's operations. The Company's ability to continue as a going concern is dependent on obtaining additional financial capital, achieving profitability, and generating consistent positive cash flow. Management is pursuing additional funding with long term partners, government programs, and other sources to fully fund its anticipated needs. There can be no assurance that the Company will be able to access capital when needed, achieve profitability, or generate positive cash flow.

These consolidated financial statements do not reflect the adjustments that might be necessary to the carrying amount of reported assets, liabilities and revenues and expenses and the balance sheet classification used if the Company were unable to continue operations. Such adjustments could be material.

## 2. ACCOUNTING PRINCIPLES FOR INTERIM FINANCIAL STATEMENTS

These interim condensed consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) applicable to the preparation of consolidated financial statements, including IFRS 34, ñInterim Financial Reportingö. The accounting principles and methods of computation adopted in these financial statements are the same as those of the annual financial statements for the year ended December 31, 2013.

Omitted from these statements are certain information and note disclosures normally included in the annual financial statements. The financial statements and notes presented should be read in conjunction with the annual financial statements for the year ended December 31, 2013.

The Audit Committee authorized these interim condensed consolidated financial statements for issue on May 22, 2014.

<u>Basis for Presentation</u>

These interim condensed consolidated financial statements have been prepared on the historical cost basis. All transactions are recorded on an accrual basis.

The interim condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Ceapro Technology Inc., Ceapro Veterinary Products Inc., Ceapro Active Ingredients Inc., Ceapro BioEnergy Inc., Ceapro (P.E.I) Inc. and Ceapro USA Inc.

All intercompany accounts and transactions have been eliminated on consolidation.

## 3. CHANGES IN ACCOUNTING POLICIES

**Future accounting policies not yet adopted**

<u>Financial instruments</u>

The IASB intends to replace IAS 39 - Financial Instruments: Recognition and Measurement (ñIAS 39ö) in its entirety with IFRS 9 - Financial Instruments (ñIFRS 9ö) in three main phases. IFRS 9 will be the new standard for the financial reporting of financial instruments that is principles-based and less complex than IAS 39.

In November 2009 and October 2010, phase 1 of IFRS 9 was issued and amended, respectively, which addressed the classification and measurement of financial assets and financial liabilities. IFRS 9 requires that all financial assets be classified as subsequently measured at amortized cost or at fair value based on the companyøs business model for managing financial assets and the contractual cash flow characteristics of the financial assets. Financial liabilities are classified as subsequently measured at amortized cost except for financial liabilities classified as at fair value through profit or loss, financial guarantees and certain other exceptions. The effective date of IFRS 9 has not yet been determined by the IASB. The Company has not yet assessed the impact that this new standard is likely to have on its consolidated financial statements.

## 4. INVENTORIES

The Company had the following inventories at the end of each reporting period:

| | March 31, 2014 $ | December 31, 2013 $ |
|---|---|---|
| Raw materials | 202,803 | 224,671 |
| Work in progress | 54,188 | - |
| Finished goods | 113,268 | 98,911 |
| | 370,259 | 323,582 |

Inventories expensed to cost of goods sold during the three months ended March 31, 2014 are $862,175 (March 31, 2013 - $952,721).

## 5. LICENCES

During the year ended December 31, 2012 the Company entered into a new licence agreement for a new technology to increase the concentration of avenanthramides in oats. The Company paid a fee of $44,439 to cover previous patent costs and commenced amortizing the licence over 15 years, in April 2012. Amortization of $740 has been included in general and administration for the three months ended March 31, 2014 (March 31, 2013 - $741) (see note 15(d)).

During the year ended December 31, 2011, the Company entered into a new licensing agreement with the University of Guelph for an exclusive variety of a mint plant. This agreement replaced the agreement the Company entered during the year ended December 31, 2008. The Company paid a licensing fee of $30,000 in 2008 and $15,000 in 2011. The remaining unamortized portion of the licence fee from 2008 and the new fee in 2011 is being amortized over 10 years, being the term of the new licensing agreement, commencing in 2011. Amortization of $1,125 has been included in general and administration for the three months ended March 31, 2014 (March 31, 2013 - $1,125) (see note 15(c)).

| **Cost of Licenses** | $ |
|---|---|
| Balance - December 31, 2013 | 89,439 |
| Additions | - |
| Balance - March 31, 2014 | 89,439 |
| **Accumulated amortization** | |
| Balance - December 31, 2013 | 23,185 |
| Amortization | 1,865 |
| Balance - March 31, 2014 | 25,050 |
| **Net book value** | |
| Balance - March 31, 2014 | 64,389 |
| Balance - December 31, 2013 | 66,254 |

## 6. PROPERTY AND EQUIPMENT

| Cost | Equipment not available for use $ | Manufacturing Equipment $ | Office Equipment $ | Computer Equipment $ | Leasehold Improvements $ | Total $ |
|---|---|---|---|---|---|---|
| December 31, 2013 | 27,939 | 3,645,045 | 82,100 | 300,101 | 277,301 | 4,332,486 |
| additions | 881,871 | - | - | 3,536 | 645,283 | 1,530,690 |
| cost reduced by grant | (85,346) | - | - | - | - | (85,346) |
| disposal | - | (10,209) | (8,844) | (12,970) | - | (32,023) |
| March 31, 2014 | 824,464 | 3,634,836 | 73,256 | 290,667 | 922,584 | 5,745,807 |
| **Accumulated depreciation** | | | | | | |
| December 31, 2013 | - | 2,042,607 | 68,710 | 247,781 | 120,364 | 2,479,462 |
| additions | - | 68,510 | 664 | 4,031 | - | 73,205 |
| disposal | - | (6,721) | (8,675) | (12,947) | - | (28,343) |
| March 31, 2014 | - | 2,104,396 | 60,699 | 238,865 | 120,364 | 2,524,324 |
| **Carrying value** | | | | | | |
| March 31, 2014 | 824,464 | 1,530,440 | 12,557 | 51,802 | 802,220 | 3,221,483 |
| December 31, 2013 | 27,939 | 1,602,438 | 13,390 | 52,320 | 156,937 | 1,853,024 |

Leasehold improvements for the new manufacturing facility are not being amortized as the facility is not yet in the condition necessary to commence commercial operations.

Depreciation expense allocation for the following periods:

| | Cost of goods sold $ | Inventory $ | General and administration $ | Total $ |
|---|---|---|---|---|
| Three Months Ended March 31, 2014 | 47,981 | 10,420 | 14,804 | 73,205 |
| Three Months Ended March 31, 2013 | 45,906 | 18,731 | 9,631 | 74,268 |

## 7. LONG-TERM DEBT

| | March 31, 2014 $ | December 31, 2013 $ |
|---|---|---|
| Loan payable secured by a general security agreement, due January, 2018 (a). | 714,795 | 758,033 |
| Loan payable secured by certain intellectual property due January, 2019 (b). | 1,475,357 | 1,465,500 |
| Loan payable secured by a general security agreement due April, 2019 (c). | 1,094,315 | 579,352 |
| Transaction costs | (76,151) | (80,869) |
| | 3,208,316 | 2,722,016 |
| Less current portion | 611,160 | 499,718 |
| | 2,597,156 | 2,222,298 |

Interest expense is presented under finance costs for the following periods:

| | |
|---|---|
| Period Ended March 31, 2014 | 21,476 |
| Period Ended March 31, 2013 | 11,147 |

(a) During the year ended December 31, 2012 the loan was renewed to January 1, 2018 at an interest rate of 3.71% with monthly payments of $16,674 starting February 1, 2013. The loan is secured by a general security agreement covering all present and after acquired personal property subject by a subordination of the claim for certain intellectual property that has been pledged as security for the long term debt described in note 7 (b).

(b) During the year ended December 31, 2013, the Company entered into a new loan agreement which is secured by certain intellectual property and due January 2, 2019. The loan is for 1 million Euros, is repayable over 5 years at an interest rate of 2.85%. At March 31, 2014 the loan balance was $1,475,357 in Canadian currency. Monthly blended principal and interest payments in the amount of $17,902 Euro commence February 1, 2014. Based on the exchange rate at March 31, 2014, the monthly payment is $26,412 in Canadian currency.

(c) During the year ended December 31, 2013, the Company entered into a new loan secured by a general security agreement and due April 1, 2019. The loan can be drawn to maximum $1,600,000 Canadian dollars, is repayable over a 5 year term and has an interest rate of 3.91%. At March 31, 2014 $1,094,315 was drawn on this loan (December 31, 2013, $579,352). Assuming the loan is fully drawn to $1,600,000, monthly blended principal and interest repayment in the amount of $29,352 will commence on May 1, 2014. The loan is secured by a general security agreement covering all present and after acquired personal property subject to a subordination of the claim for certain intellectual property that has been pledged as security for the long term debt described in note 7(b).

The Company is in compliance with all terms and conditions of its long term debt agreements.

## 8. EMPLOYEE FUTURE BENEFITS OBLIGATION

The Company has an unfunded, non-registered, non-indexed defined retirement benefit plan for an officer. The retirement benefit is two monthsôsalary for each year the employee is employed by the Company up to age 55.

Management is required to make an estimate regarding the discount rate used to determine the accrued benefit obligation. This estimate is of a short-term nature, which is consistent with the nature of the revised agreement. Actuarial losses of $16,916 arose from changes of discount rate from 4.19% in 2012 to 2.3% in 2013.

The agreement was revised during the year ended December 31, 2013 and the total amount of $277,009 will be paid as per the following installments:

| | |
|---|---|
| January 1, 2014 | $50,000 |
| July 1, 2014 | $100,000 |
| January 1, 2015 | $127,009 |
| Total: | $277,009 |

As a result of an amendment to the agreement, the Company recorded a loss on curtailment of $14,815 in the year ended December 31, 2013. The present value of the installments at March 31, 2014 was $224,266 and no further expenses under current service costs will be incurred as a result of this amendment.

| Accrued benefit obligation | **Three Months Ended March 31, 2014 $** | Year Ended December 31, 2013 $ |
|---|---|---|
| Unfunded balance, beginning of period | **272,982** | 217,219 |
| Current service cost | **-** | 18,301 |
| Loss on curtailment (or past service costs) | **-** | 14,815 |
| Interest costs on accrued benefit obligation | **1,284** | 5,731 |
| Actuarial losses, net of $nil tax | **-** | 16,916 |
| Benefit repayment | **(50,000)** | - |
| | **224,266** | 272,982 |
| Less current portion | **224,266** | 145,973 |
| | **-** | 127,009 |

| Elements of defined benefit costs recognized in the period | **Three Months Ended March 31, 2014 $** | Year Ended December 31, 2013 $ |
|---|---|---|
| Current service cost | **-** | 18,301 |
| Loss on curtailment | **-** | 14,815 |
| Interest cost on accrued benefit obligation | **1,284** | 5,731 |
| | **1,284** | 38,847 |

Defined benefit costs have been presented under research and product development expenses in the consolidated statements of net income for the period.

## 9. SHARE CAPITAL

a. Authorized

i. Unlimited number of Class A voting common shares. Class A common shares have no par value.

ii. Unlimited number of Class B non-voting common shares. There are no issued Class B shares.

b. Issued - Class A common shares

| | **Three Months Ended March 31, 2014** | | Year Ended December 31, 2013 | |
|---|---|---|---|---|
| | **Number of Shares** | **Amount $** | Number of Shares | Amount $ |
| Balance at beginning of the period | **60,278,948** | **6,315,858** | 60,278,948 | 6,315,858 |
| Stock options exercised | **125,000** | **20,056** | - | - |
| Balance at end of the period | **60,403,948** | **6,335,914** | 60,278,948 | 6,315,858 |

c. Stock options outstanding are as follows:

| Fair Value $ | Exercise Price $ | Year of Expiration | Weighted Average Contractual Life Remaining (years) | **March 31, 2014 Number of Options** | December 31, 2013 Number of Options |
|---|---|---|---|---|---|
| 0.09 | 0.10 | 2024 | 9.8 | **930,000** | - |
| 0.05 | 0.10 | 2023 | 8.8 | **1,240,000** | 1,265,000 |
| 0.09 | 0.10 | 2022 | 8.3 | **300,000** | 300,000 |
| 0.11 | 0.15 | 2016 | 2.2 | **325,000** | 325,000 |
| 0.06 | 0.10 | 2015 | 1.4 | **330,000** | 430,000 |
| 0.10 | 0.13 | 2014 | 0.3 | **825,000** | 825,000 |
| | | | 6.1 | **3,950,000** | **3,145,000** |

The Company has granted stock options to eligible employees, directors, officers, and consultants under stock option plans that vest over two years period and have a maximum term of ten years.

The Company accounts for options granted under these plans in accordance with the fair value based method of accounting for share-based payments. In the period ended March 31, 2014 the Company granted 930,000 (December 31, 2013 ï 1,400,000) stock options. The application of the fair value based method requires the use of certain assumptions regarding the risk-free market interest rate, expected volatility of the underlying stock, life of the options and forfeiture rate. The weighted average risk-free rate used in 2014 was 2.34% (2013 - 1.62%), the weighted average expected volatility was 107% (2013 - 111%) which was based on prior trading activity of the Company's shares, the weighted average expected life of the options was 10 years (2013 ï 10 years), forfeiture rate was 0% (2013 - 0%), the weighted average share price was $0.09 (2013 ï $0.06), the weighted average exercise price was $0.10 (2013 ï $0.10), and the expected dividends were nil (2013 - nil). The weighted average grant date fair value of options granted in the period ended March 31, 2014 were $0.09 (2013 - $0.05) per option.

## 10. CAAP LOAN

The balance of repayable contribution is derived as follows:

| | Three Months Ended March 31, 2014 $ | Year Ended December 31, 2013 $ |
|---|---|---|
| Opening balance | 363,471 | 220,978 |
| Funding received or receivable | - | 197,495 |
| Grant revenue recognised | - | (97,072) |
| Accretion of CAAP loan | 14,169 | 42,070 |
| | 377,640 | 363,471 |
| Less current portion | 75,677 | 72,942 |
| | 301,963 | 290,529 |

The principal repayment required for amounts received or receivable from inception to March 31, 2014 is $83,883 annually from 2014 through 2021.

## 11. RELATED PARTY TRANSACTIONS

Related party transactions during the periods not otherwise disclosed in these consolidated financial statements are as follows:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2014 | 2013 |
| | $ | $ |
| Royalties earned by employees and directors | 7,814 | 8,141 |
| Amounts payable to employees and directors included in royalties payable | 13,781 | 12,773 |
| Key management salaries, short-term benefits, consulting fees and director fees | 131,650 | 191,750 |
| Key management personnel share based payments | 21,664 | 21,248 |
| Amount payable to directors | 28,750 | 28,750 |

These transactions are in the normal course of operations and are measured at the amount of consideration established and agreed to by the related parties.

## 12. OTHER OPERATING LOSS (INCOME)

| | Three Months Ended March 31, | |
|---|---|---|
| | 2014 | 2013 |
| | $ | $ |
| Foreign exchange loss (income) | 60,639 | (3,871) |
| Loss on disposal of property and equipment | 3,680 | - |
| Other (income) | - | (1,489) |
| Plant relocation costs | 78,241 | - |
| | 142,560 | (5,360) |

## 13. FINANCE COSTS

| | Three Months Ended March 31, | |
|---|---|---|
| | 2014 | 2013 |
| | $ | $ |
| Interest on royalty financial liability | 4,001 | 7,831 |
| Interest on long-term loan | 21,476 | 11,147 |
| Transaction costs | 4,718 | - |
| Royalties to University of Guelph & AAFC | 47,500 | 22,500 |
| Accretion of CAAP loan | 14,169 | 9,028 |
| Bank charges | 259 | - |
| | 92,123 | 50,506 |

## 14. SEGMENTED INFORMATION

The Company operates in one industry segment, which is the active ingredient product technology industry. The majority of the revenue is derived from sales in North America. All the assets of the Company, which support the revenues of the Company, are located in Canada. The distribution of revenue by location of customer is as follows:

| | Three Months Ended March 31, 2014 $ | 2013 $ |
|---|---|---|
| United States | 1,592,956 | 1,495,096 |
| Germany | 329,388 | 379,016 |
| Other | 32,003 | 130,896 |
| Canada | - | 7,271 |
| | 1,954,347 | 2,012,279 |

## 15. EMPLOYEE BENEFITS

| | Three Months Ended March 31, 2014 **$** | 2013 $ |
|---|---|---|
| Employee benefits | 583,331 | 591,664 |

Employee benefits include wages, salaries, bonus, and CPP, EI, WCB contributions and benefit premiums.

## 16. CONTINGENCIES AND COMMITMENTS

a) During the year ended December 31, 2011, the Company and its wholly owned subsidiary, Ceapro Veterinary Products Inc. were served with a statement of claim from AVAC Ltd. alleging damages of $724,500 pursuant to a product development agreement. The Company and Ceapro Veterinary Products Inc. have filed a statement of defense to refute the claim and believe it has strong defenses to the AVAC allegations. However at this time the outcome of the litigation is uncertain and no provisions have been made in the consolidated financial statements on account of this litigation.

b) During the year ended December 31, 2012, the Company and its wholly owned subsidiary, Ceapro Technology Inc. were served with a statement of claim from AVAC Ltd. alleging damages of $1,470,000 pursuant to two product development agreements. The Company and Ceapro Technology Inc. have filed a statement of defense to refute the claim and believe it has strong defenses to the AVAC allegations. However at this time the outcome of the litigation is uncertain and no provisions have been made in the consolidated financial statements on account of this litigation.

c) During the year ended December 31, 2008, the Company entered into licensing agreement with the University of Guelph for an exclusive variety of a mint plant. During the year ended December 31, 2011, the Company has entered into a new licensing agreement with the University of Guelph for additional market rights for the exclusive variety of a mint plant.

In accordance with the new agreement, there are future minimum royalty prepayments of $10,000 per annum starting in 2012 for royalty payments which will be calculated as 5% of net sales from products derived from the mint plants. The minimum royalty payments are creditable against royalties in years where royalties are due. The agreement is an executory contract and therefore all royalty payments under the contract will be recognized as they become due.

d) During the year ended December 31, 2012 the Company entered into a new licence agreement for a new technology to increase the concentration of avenanthramides in oats. The Company shall pay an annual royalty percentage rate of 2% of sales, payable every January 1$^{st}$ and July 1$^{st,}$ subject to a minimum annual royalty payment according to the schedule below:

| Year | Amount |
|---|---|
| 2012 | nil |
| 2013 | $12,500 |
| 2014 | $37,500 |
| 2015 | $50,000 |
| 2016 | $50,000 |

And $50,000 each year thereafter while the licence agreement remains in force. The agreements remain in force until the patents expire or are abandoned.

The agreement is an executory contract and therefore all royalty payments under the contract will be recognized as they become due.

(e) In the normal course of operations the Company may be subject to litigation and claims from customers, suppliers and former employees. Management believes that adequate provisions have been recorded in the accounts where required. Although it is not possible to estimate the extent of potential costs, if any, management believes that the ultimate resolution of such contingencies would not have a material adverse effect on the financial position of the Company.

## 17. FINANCIAL INSTRUMENTS

The estimated fair value of the Company's financial instruments approximates the amount for which the financial instruments could currently be exchanged in an arms length transaction between willing parties who are under no compulsion to act.

The fair value of cash and cash equivalents, trade and other receivables, accounts payable and accrued liabilities, deferred revenue related to prepaid sales orders and royalties interest payable approximate their carrying amount due to their short-term nature. The fair value of long-term debt is estimated to approximate its carrying value because the interest rate does not differ significantly from current interest rates for similar types of borrowing arrangements (level 2).

The Canadian Agricultural Adaptation Program ("CAAP") loan is recorded at the amount drawn under the agreement, discounted using the prevailing market rate of interest for a similar instrument, which represents the estimated fair value of the obligation.

The fair value of the CAAP loan and the repayable research funding are not materially different from their carrying amounts as funding received has been discounted using an estimate of a market rate of interest and is being accreted back to its nominal amount (level 2).

The royalty financial liability was estimated using a discount rate that results from the estimated future repayment of that obligation which is based on expected sales. As there has been no significant change in estimated future repayments, and as the estimated discount rate also approximates the Company's estimated cost of capital for similar borrowing arrangements, management believes the carrying amount of this obligation does not differ significantly from its fair value (level 3).

The Company has exposure to credit, liquidity and market risk as follows:

a) Credit risk:

Trade and other receivables

The Company makes sales to customers that are well-established within their respective industries. Based on previous experience the counterparties had zero default rates and management views this risk as minimal. Approximately 88% of trade receivable is due from one customer at March 31, 2014 and all trade receivables are current. This main customer presents good credit quality and historically has a high quality credit rating.

Other receivables represent amounts due for research program claims, government goods and services taxes, and scientific and research tax credits. Management has assessed the credit risk to be low.

Cash and cash equivalents

The Company has cash and cash equivalents in the amount of $1,213,208 at March 31, 2014 and mitigates its exposure to credit risk on its cash balances by maintaining its bank accounts with Canadian Chartered Banks and investing in low risk, high liquidity investments.

There are no past due or impaired financial assets. The maximum exposure to credit risk is the carrying amount of the Company҆s trade and other receivables, cash and cash equivalents and restricted cash and cash equivalents. The Company does not hold any collateral as security.

b) Liquidity risk:

Liquidity risk relates to the risk that the Company will encounter difficulty in meeting its financial obligations. The Company may be exposed to liquidity risks if it is unable to collect its trade and other receivables balances in a timely manner, which could in turn impact the Company҆s long-term ability to meet commitments under its current facilities. In order to manage this liquidity risk, the Company regularly reviews its aged trade receivables listing to ensure prompt collections. The Company regularly reviews its cash availability and whenever conditions permit; the excess cash is deposited in short-term interest bearing instruments to generate revenue while maintaining liquidity. There is no assurance that the Company will obtain sufficient funding to execute its strategic business plan.

The following are the contractual maturities of the Company's financial liabilities and obligations.

| | 0 - 1 year<br>$ | 1 - 3 years<br>$ | 4 - 7 years<br>$ | 8-12 years | Total<br>$ |
|---|---|---|---|---|---|
| Accounts payable and accrued liabilities | 1,257,351 | - | - | - | 1,257,351 |
| Loan payable secured by certain intellectual property due January, 2019. | 327,114 | 654,228 | 599,710 | - | 1,581,052 |
| Loan payable secured by a general security agreement due April, 2019. | 221,200 | 482,618 | 502,727 | - | 1,206,545 |
| Long-term debt, including interest | 200,082 | 400,164 | 166,735 | - | 766,981 |
| Royalties interest payable | 70,221 | - | - | - | 70,221 |
| Royalty financial liability | 72,089 | - | - | - | 72,089 |
| Repayable CAAP funding | 83,883 | 167,766 | 335,536 | 83,883 | 671,068 |
| Total | 2,231,940 | 1,704,776 | 1,604,708 | 83,883 | 5,625,307 |

c) Market risk:

Market risk is comprised of interest rate risk, foreign currency risk and other price risk. The Company҆s exposure to market risk is as follows:

1. Foreign currency risk

Foreign currency risk arises from the fluctuations in foreign exchange rates and the degree of volatility of these rates relative to the Canadian dollar.

The following table summarizes the impact of a 1% change in the foreign exchange rates of the Canadian dollar against the US dollar (USD) and the Euro on the financial assets and liabilities of the Company.

| | Carrying Amount (USD) | Foreign Exchange Risk (USD) | |
|---|---|---|---|
| | | -1% | +1% |
| | | Earnings & Equity | Earnings & Equity |
| **Financial assets** | | | |
| Accounts receivable | 322,217 | 3,222 | (3,222) |
| **Financial Liabilities** | | | |
| Accounts payable and accrued liabilities and Deferred revenue | 256,769 | (2,568) | 2,568 |
| **Total increase (decrease)** | | 654 | (654) |

| | Carrying Amount (EURO) | Foreign Exchange Risk (EURO) | |
|---|---|---|---|
| | | -1% | +1% |
| | | Earnings & Equity | Earnings & Equity |
| **Financial Liabilities** | | | |
| Long-term debt | 968,909 | (9,689) | 9,689 |
| **Total increase (decrease)** | | (9,689) | 9,689 |

The carrying amount of accounts receivable and accounts payable and accrued liabilities and deferred revenue in USD and long-term debt in Euro represents the Companyŝ exposure at March 31, 2014.

2. Interest rate risk.

The Company has minimal interest rate risk because its long-term debt agreements are all at fixed rates.

## 18. CAPITAL DISCLOSURES

The Company considers its capital to be its equity. The Company's objective in managing capital is to ensure a sufficient liquidity position to finance its manufacturing operations, research and development activities, administration and marketing expenses, working capital and overall capital expenditures, including those associated with patents and trademarks. The Company makes every effort to manage its liquidity to minimize dilution to its shareholders when possible.

The Company has funded its activities through public offerings and private placements of common shares, royalty offerings, loans, convertible debentures, and grant contributions.

The Company is not subject to externally imposed capital requirements and the Company's overall strategy with respect to capital risk management remains unchanged from the year ended December 31, 2013.

## 19. INCOME PER COMMON SHARE

| | Three Months Ended March 31, 2014 | 2013 |
|---|---|---|
| Net income (loss) for the year for basic and diluted earnings per share calculation | $177,429 | $408,171 |
| Weighted average number of shares outstanding | 60,355,337 | 60,278,948 |
| Potential shares to be issued for options exercisable | 1,666,667 | - |
| Diluted shares outstanding | 62,022,004 | 60,278,948 |
| Income (loss) per share - basic | $0.00 | $0.01 |
| Income (loss) per share - diluted | $0.00 | $0.01 |

For the period ended March 31, 2014, the Companyõs 1,150,000 stock options outstanding have not been included in the diluted income per share calculation because the optionsô exercise prices were greater than the average market price of the common shares during the period.

## 20. SUBSEQUENT EVENTS

Subsequent to the period ended March 31, 2014, the Company signed a licencing and development agreement with the University of Alberta for the rights to a technology entitled ôformation of Micro/Nanoparticles and Encapsulation of Bioactives Using Supercritical Fluid Technologyö.