

# Consolidated Financial Statements

For the years ended December 31, 2009 & 2008



# **Financial Statements**

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**Consolidated Financial Statements for the  
Years Ended December 31, 2009 & 2008**

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**Ceapro Inc.**

## **Management's Report**

To the Shareholders of **Ceapro Inc.**,

The accompanying consolidated financial statements of Ceapro Inc., and all information presented in this report, are the responsibility of Management and have been approved by the Board of Directors.

The consolidated financial statements have been prepared by Management in accordance with Canadian generally accepted accounting principles. The consolidated financial statements include some amounts that are based on the best estimates and judgments of Management. Financial information used elsewhere in the report is consistent with that in the consolidated financial statements.

To further the integrity and objectivity of data in the consolidated financial statements, Management of the Company has developed and maintains a system of internal controls, which Management believes will provide reasonable assurance that financial records are reliable and form a proper basis for preparation of consolidated financial statements, and that assets are properly accounted for and safeguarded.

The Board of Directors carries out its responsibility for the consolidated financial statements in the report principally through its Audit Committee. The Audit Committee is appointed by the Board, and all of its members are outside and unrelated Directors. The Committee meets periodically with Management and the external auditors to discuss internal controls over the financial reporting process and financial reporting issues, to make certain that each party is properly discharging its responsibilities, and to review quarterly reports, the annual report, the annual consolidated financial statements, management discussion and analysis, and the external auditors' report. The Committee reports its findings to the Board for consideration when approving the consolidated financial statements for issuance to the shareholders. The Company's auditors have full access to the Audit Committee, with and without Management being present.

The consolidated financial statements have been audited by the Company's auditors, Stout & Company LLP, the external auditors, in accordance with auditing standards generally accepted in Canada on behalf of the shareholders.

Sincerely,

**SIGNED "Gilles Gagnon"**  
**Acting President and Acting Chief Executive Officer**

**SIGNED "Branko Jankovic, CA"**  
**Chief Financial Officer**

## **Auditors' report**

To the Shareholders of Ceapro Inc.,

We have audited the consolidated balance sheets of Ceapro Inc. as at December 31, 2009 and 2008, and the consolidated statements of net loss and comprehensive loss and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and 2008, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Edmonton, Canada  
April 13, 2010

SIGNED: "Stout & Company LLP"  
Chartered Accountants

# Financial Statements

## CEAPRO INC.

### Consolidated Balance Sheets

	December 31 2009	December 31 2008
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash	\$ 115,502	\$ 16,525
Accounts receivable	151,144	551,594
Inventories (note 3)	516,821	406,967
Prepaid expenses and deposits	62,309	82,568
	<b>845,776</b>	1,057,654
LICENSE (note 10b)	27,000	30,000
PROPERTY AND EQUIPMENT (note 4)	1,897,878	2,199,740
	<b>\$ 2,770,654</b>	<b>\$ 3,287,394</b>
<b>LIABILITIES</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable and accrued liabilities	\$ 846,538	\$ 1,150,814
Current portion of deferred royalty revenue	60,000	57,125
Current portion of long-term debt (note 5)	138,806	131,582
Current portion of royalties payable (note 7)	758,436	455,549
Current portion of employee future benefits obligation (note 8)	-	187,000
SGGF legal fees (note 10a)	314,983	1,466,283
	<b>2,118,763</b>	3,448,353
DEFERRED ROYALTY REVENUE	220,422	272,944
EMPLOYEE FUTURE BENEFITS OBLIGATION (note 8)	136,786	117,012
LONG-TERM DEBT (note 5)	1,227,426	1,366,232
CONVERTIBLE DEBENTURES (note 6)	440,000	-
ROYALTIES PAYABLE (note 7)	-	13,981
	<b>4,143,397</b>	5,218,522
<b>SHAREHOLDERS' DEFICIENCY</b>		
SHARE CAPITAL (note 9b)	5,479,202	5,016,395
EQUITY COMPONENT OF CONVERTIBLE DEBENTURES (note 6)	60,000	-
CONTRIBUTED SURPLUS (note 9c)	478,945	374,018
DEFICIT	<b>(7,390,890)</b>	<b>(7,321,541)</b>
	<b>(1,372,743)</b>	<b>(1,931,128)</b>
	<b>\$ 2,770,654</b>	<b>\$ 3,287,394</b>

Contingencies (note 10a and 10c)

See accompanying notes

Approved on Behalf of the Board

SIGNED: "John Zupancic"  
Director

SIGNED: "Glenn Rourke"  
Director

# Financial Statements

## CEAPRO INC.

### Consolidated Statements of Net Loss and Comprehensive Loss and Deficit

	Years ended December 31	
	2009	2008
<b>Revenue</b>		
Sales (note 11)	\$ 4,370,070	\$ 4,228,073
Cost of goods sold	2,252,024	2,942,802
Gross margin	2,118,046	1,285,271
<b>Expenses</b>		
General and administration	1,424,344	1,688,978
Royalties	250,663	401,876
Sales and marketing	183,693	385,132
Amortization	44,842	34,955
Interest on long-term debt	77,031	83,651
	1,980,573	2,594,592
Income (loss) from operations	137,473	(1,309,321)
<b>Other income (expenses)</b>		
Research and product development	(577,629)	(891,382)
Bioenergy Feasibility Study	-	(5,868)
Other income (loss) (note 12)	(55,493)	73,385
Loss before SGGF legal fees	(495,649)	(2,133,186)
SGGF legal fees (note 10a)	426,300	(1,466,283)
<b>NET LOSS AND COMPREHENSIVE LOSS FOR THE YEAR</b>	<b>(69,349)</b>	<b>(3,599,469)</b>
Deficit, beginning of year	(7,321,541)	(3,722,072)
<b>Deficit, end of year</b>	<b>\$ (7,390,890)</b>	<b>\$ (7,321,541)</b>
Net loss per common share:		
Basic	\$ (0.00)	\$ (0.08)
Diluted	\$ (0.00)	\$ (0.08)
Weighted average number of common shares outstanding	49,577,953	47,050,063

See accompanying notes

# Financial Statements

## CEAPRO INC. Consolidated Statements of Cash Flows

	Years ended December 31	
	2009	2008
<b>Operating Activities</b>		
Net loss for the year	\$ (69,349)	\$ (3,599,469)
Adjustments to reconcile net loss to cash provided by operating activities		
Amortization	356,958	336,569
Recognition of deferred royalty revenue	(49,647)	(48,306)
Employee future benefits obligation	(167,226)	20,364
Stock based compensation	104,927	114,689
	<b>175,663</b>	<b>(3,176,153)</b>
<b>Changes in Non-Cash Working Capital Items</b>		
Restricted cash	-	50,000
Accounts receivable	400,450	156,571
Inventories	(109,854)	(250,383)
Prepaid expenses and deposits	20,259	47,532
Accounts payable and accrued liabilities	(304,276)	656,401
Deferred revenue	-	(57,009)
SGGF legal fees	(1,151,300)	1,466,283
	<b>(1,144,721)</b>	<b>2,069,395</b>
	<b>(969,058)</b>	<b>(1,106,758)</b>
<b>Investing Activities</b>		
Purchase of license	-	(30,000)
Purchase of property and equipment	(52,096)	(275,891)
	<b>(52,096)</b>	<b>(305,891)</b>
<b>Financing Activities</b>		
Repayment of long-term debt	(131,582)	(114,592)
Proceeds from convertible debenture issue	500,000	-
Proceeds from issuance of share capital	466,000	-
Share capital issue costs	(3,193)	-
Increase in royalties payable	288,906	261,440
	<b>1,120,131</b>	<b>146,848</b>
Increase (decrease) in cash	<b>98,977</b>	<b>(1,265,801)</b>
Cash at beginning of year	<b>16,525</b>	<b>1,282,326</b>
<b>Cash at end of year</b>	<b>\$ 115,502</b>	<b>\$ 16,525</b>
<b>Supplementary information</b>		
Interest paid	\$ 77,031	\$ 83,651
Royalties paid	\$ -	\$ 172,356

See accompanying notes

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 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. 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 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 adverse conditions and events cast significant doubt upon the validity of this assumption. Since inception, the Company has accumulated net losses, negative operating cash flow and has not yet achieved consistent profitability. 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 dependant on obtaining additional financial capital, achieving profitability, and generating positive cash flow. There can be no assurance that the Company will be able to access capital when needed, achieve profitability, or generate positive cash flow.

These 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 POLICIES

#### (a) Use of estimates

The preparation of consolidated financial statements in conformity with Canadian generally accepted accounting principles ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of the assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. The significant areas requiring the use of management estimates relate to provisions made for inventory valuation, amortization of property and equipment, the assumptions used in determining stock based compensation, and the interest rates used in determining the value of employee future benefits obligation and the liability portion of convertible debentures. Actual results could differ from those estimates.

#### (b) Principles of consolidation

The 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., and Ceapro USA Inc.

#### (c) Cash and cash equivalents

Cash and cash equivalents are defined as amounts on deposit with financial institutions and readily convertible term deposits with a maturity of 3 months or less on inception.

#### (d) Revenue recognition

Revenue from the sale of health and wellness products is recognized as revenue at the time the products are shipped to customers.

The sale of royalty interests are recorded as deferred royalty revenue and are recorded against royalty expense on the basis of \$1 of deferred revenue recognized for every \$2 of royalty expense incurred.

Royalty, licenses, and product development fees are recorded in accordance with the terms of the applicable agreements.

#### (e) Inventories

Inventory of raw materials is valued at the lower of cost and net realizable value on a first-in, first-out basis.

Inventory of work-in-process and active ingredients is valued at the lower of cost and net realizable value on an average cost basis.

#### (f) Licenses

Licenses are recorded at cost and are amortized over the life of the license.

#### (g) Property and equipment

Property and equipment are recorded at cost and are amortized over their estimated useful lives as follows:

Manufacturing equipment	10 years straight line
Office equipment	20% declining balance
Computer equipment	30% declining balance
Leasehold Improvements	Over the term of the lease



## 2. ACCOUNTING POLICIES (continued)

- (h) Research and product development expenditures  
Research costs are expensed when incurred. Product development costs are also expensed when incurred unless they are significant and meet generally accepted criteria for deferral. Costs are reduced by government grants and investment tax credits where applicable.
- (i) Foreign currency  
Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at year end exchange rates and non-monetary assets at the exchange rates prevailing when the assets were acquired. Foreign currency denominated revenue and expense items are translated at the rate of exchange in effect at the time of the transaction. Foreign currency gains or losses arising on translation are included in income.
- (j) Income taxes  
The liability method is used for determining income taxes. Under this method, future income tax assets and liabilities are recognized for the estimated tax recoverable or payable that would arise if assets and liabilities were recovered or settled at the financial statement carrying amounts. Future tax assets and liabilities are measured using substantively enacted tax rates expected to apply to taxable income in the year in which temporary differences are expected to be recovered or settled. Changes to these balances, including changes due to changes in income tax rates, are recognized in income in the period in which they occur. The amount of the future income tax assets recognized is limited to the amount that is more likely than not to be realized.
- (k) Lease obligations  
Leases are classified as capital or operating leases. A lease that transfers substantially all of the benefits and risks incidental to the ownership of property is classified as a capital lease. At the inception of a capital lease, an asset and an obligation are recorded at an amount equal to the lesser of the present value of the minimum lease payments and the property's fair value at the beginning of the lease. All other leases are accounted for as operating leases wherein payments are expense as incurred.
- (l) Government assistance  
Government assistance is periodically granted to the Company under available government incentive programs. Government assistance relating to research and development expenditures is recorded as a reduction of the expenditures when received.
- (m) Investment tax credits  
Investment tax credits relating to qualifying scientific research and experimental development expenditures are accrued provided there is a reasonable assurance that the credits will be realized. When recorded, the investment tax credits are accounted for as a reduction of the related expenditures.
- (n) Net loss per common share  
Basic net loss per common share is computed by dividing the net loss by the weighted average number of common shares outstanding during the year. Diluted per share amounts reflect the potential dilution that could occur if convertible securities and convertible debt were converted to common shares. The treasury stock method of calculating diluted per share amounts is used whereby any proceeds from the conversion of convertible securities or convertible debt that are in-the-money are assumed to be used to purchase common shares of the Company at the average market price during the period. When the Company is in a net loss position, the conversion of convertible securities and debt is considered to be anti-dilutive.
- (o) Stock based compensation  
Stock based compensation is accounted for using the fair value method whereby compensation expense related to these programs is recorded in the statement of net loss and comprehensive loss and deficit with a corresponding increase to contributed surplus. The fair value of options granted is determined at the date of grant and expensed over the vesting period. The value of the warrants issued to agents is recorded as share issue costs with a corresponding increase to contributed surplus.
- Consideration paid on the exercise of stock options and warrants is credited to share capital. Upon the exercise of the stock options and warrants, consideration received together with the amount previously recognized in contributed surplus is recorded as an increase to share capital. The Company does not incorporate an estimated forfeiture rate for stock options and agents warrants that may not vest, but accounts for forfeitures as they occur.

## 2. ACCOUNTING POLICIES (continued)

### (p) Employee future benefits

The Company accrues its obligations under an employee defined retirement benefit plan and related costs, net of plan assets. The cost of retirement benefits earned by employees is determined using the accumulated benefit method and management's best estimate of expected plan investment performance and retirement ages of employees. Past service costs relating to plan amendments are accrued and recognized in the year the amendments occur.

### (q) Impairment of long-lived assets

In the event that facts and circumstances indicate that the carrying value of the long-lived assets may be impaired, the Company performs a recoverability evaluation. If the evaluation indicates that the carrying value is not recoverable from undiscounted cash flows attributable to the assets, then an impairment loss is measured by comparing the carrying amount of the asset to its fair value.

### (r) Recently adopted accounting pronouncements

Effective January 1, 2009 the company adopted the new Handbook Section 3064 "Goodwill and Intangible Assets", which replaced Handbook Section 3062 "Goodwill and Other Intangible Assets" and Handbook Section 3450 "Research and Development Costs". This section establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Handbook Section 3062. The Company has determined that the adoption of this new section did not have a material impact on these consolidated financial statements.

Effective January 1, 2009, the Company adopted CICA amendments to Section 3862 "Financial Instruments - Disclosures". These amendments require enhanced disclosures over fair value measurements of financial instruments and liquidity risks. The additional disclosures over fair value measurements include categorization of fair value measurements into one of three levels, ranging from those fair value measurements that are determined through quoted market prices in an active market (Level 1) to those fair value measurements that are based on inputs that are not based on observable market data (Level 3). The additional disclosures over liquidity risks require greater clarification over the application of liquidity risk as well as a maturity analysis for financial liabilities. The additional disclosures have been provided in note 16.

### (s) Future accounting pronouncements

#### IFRS

In 2006, Canada's Accounting Standards Board ("AcSB") ratified a strategic plan that will result in Canadian GAAP, as used by public entities, being converged with International Financial Reporting Standards ("IFRS") over a transitional period. In February 2008, the AcSB confirmed January 1, 2011 as the date that Canadian public entities will be required to start reporting under IFRS. Companies were required to provide qualitative disclosure on the key elements and timing of their transition plan to IFRS no later than their 2008 annual Management Discussion and Analysis. Qualitative disclosure of the impact of the transition is required in companies' 2009 interim and annual Management Discussion and Analysis. Comparative financial information for 2010 will be required when companies begin reporting 2011 results under IFRS.

During the year, the Company began preparing its IFRS conversion plan. This plan is aimed at identifying the differences between IFRS and the Company's current accounting policies, assessing the impact on the Company's financial reporting and, when necessary, analyzing alternative policies that could be adopted.

During 2010 the Company will prepare its financial statements under Canadian GAAP and after completion and release of these financial statements, will produce financial statements for the same periods under IFRS. The financial statements produced under IFRS will be for internal use only in 2010 but in 2011 they will be released as comparative period financial statements.

## 2. ACCOUNTING POLICIES (continued)

### Consolidated financial statements

CICA Handbook Sections 1601, *Consolidated Financial Statements*, and 1602, *Non-Controlling Interests* will replace the former Section 1600, *Consolidated Financial Statements*. These new Sections are effective for interim and annual consolidated financial statements for fiscal years beginning on or after January 1, 2011 but with earlier adoption permitted and provide the Canadian equivalent to International Financial Reporting Standard IAS 27, *Consolidated and Separate Financial Statements*. The new standards are not expected to have a material effect on the Company's financial statements.

### Business Combinations

CICA Handbook Section 1582, *Business Combinations* will replace the former Section 1581, *Business Combinations*. The new Section is effective for acquisitions in fiscal years beginning on or after January 1, 2011 but with earlier adoption permitted and provides the Canadian equivalent to IFRS 3, *Business Combinations*. The new standard is not expected to have a material effect on the Company's financial statements.

## 3. INVENTORIES

	2009	2008
Raw materials	\$ 218,604	\$ 200,548
Work in progress	135,026	98,752
Finished goods	163,191	107,667
	<u>\$ 516,821</u>	<u>\$ 406,967</u>

Inventories expensed in cost of goods sold during the year ended December 31, 2009 is \$2,171,570 (2008 - \$2,777,886). During the year ended December 31, 2009, the Company decreased the carrying value of inventory by \$10,717 (2008 - \$28,663) due to lower estimated realizable values from certain raw materials and certain finished products reaching their expiry date.

## 4. PROPERTY AND EQUIPMENT

	2009		
	Cost	Accumulated Amortization	Net Book Value
Manufacturing equipment	\$ 2,811,773	\$ 1,063,270	\$ 1,748,503
Office equipment	75,861	54,135	21,726
Computer equipment	240,070	152,878	87,192
Leasehold improvements	120,014	79,557	40,457
	<u>\$ 3,247,718</u>	<u>\$ 1,349,840</u>	<u>\$ 1,897,878</u>
	2008		
	Cost	Accumulated Amortization	Net Book Value
Manufacturing equipment	\$ 2,786,259	\$ 788,587	\$ 1,997,672
Office equipment	75,611	48,735	26,876
Computer equipment	231,436	117,558	113,878
Leasehold improvements	103,435	42,121	61,314
	<u>\$ 3,196,741</u>	<u>\$ 997,001</u>	<u>\$ 2,199,740</u>

For the year ended December 31, 2009 the total amortization of \$356,956(2008 - \$336,569) was allocated as follows: \$44,842 (2008 - \$34,955) to amortization expense, \$22,873 (2008 - nil) to inventory, and \$289,243 (2008 - \$301,614) to cost of goods sold.

## 5. LONG-TERM DEBT

	2009	2008
Loan, payable at \$17,384 per month, principal and interest at 5.49%, secured by a general security agreement, due January, 2013.	\$ 1,366,232	\$ 1,497,814
Less current portion	<u>138,806</u>	<u>131,582</u>
	<u>\$ 1,227,426</u>	<u>\$ 1,366,232</u>

Estimated principal payments due in the next four years are as follows:

2010	138,806
2011	146,426
2012	154,465
2013	<u>926,535</u>
	<u>\$ 1,366,232</u>

The effective interest rate of 5.49% is a preferred rate and the monthly payments of \$17,384 reflect this preferred rate. In the event of default of any terms and conditions of the loan and enforcement of these terms and conditions by the lender, the preferred interest rate will be cancelled from the date of enforcement of the action. If such a circumstance were to arise, the interest rate would become 7.49% and result in monthly payments of \$18,925. The security agreement also includes a standard subjective acceleration clause for material adverse events. The company is in compliance with all terms and conditions.

## 6. CONVERTIBLE DEBENTURES

On December 31, 2009, the Company issued secured convertible debentures for cash of \$500,000. The debentures bear interest at 8% per annum, mature on December 31, 2011, and are convertible at any time at a price of \$0.10 per common share at the option of the holder. The debentures may be redeemed at the option of the Company upon giving notice of 60 days. The Company may satisfy interest payments through the delivery of common shares at the weighted average market price of the Common Shares for the 20 trading days the Common Shares traded on the TSX-V immediately prior to the date on which the interest obligation is due. The debenture security ranks subordinate to the company's existing long term debt as well as \$500,000 for a potential working capital facility. Currently there is no working capital facility.

The convertible debentures contain both liability and equity components. The Company has allocated the total proceeds received between the liability and equity components of the convertible debentures using the residual method, based on an interest rate of 15%, which is the estimated cost of borrowing at which the Company could borrow similar debt without a conversion feature. The value of the liability of \$440,000 was credited to liabilities with the remaining amount of \$60,000 recorded as shareholders' equity. Interest and accretion on the liability component will be amortized using the effective interest method until the debentures are converted or reach maturity. No interest or accretion has been recorded in 2009 as the debentures were issued on December 31, 2009.

Total value of the convertible debenture	\$ 500,000
Equity element	<u>(60,000)</u>
Liability element	<u>\$ 440,000</u>

## 7. ROYALTIES PAYABLE

	2009	2008
Royalties payable pursuant to financial assistance received (note 7 (a))	\$ 111,844	\$ 111,844
Royalties payable pursuant to royalty interest offering (note 7 (c),(d),and (e))	<u>646,592</u>	<u>357,686</u>
	<u>758,436</u>	<u>469,530</u>
Less current portion	<u>758,436</u>	<u>455,549</u>
	<u>\$ -</u>	<u>\$ 13,981</u>

## 7. ROYALTIES PAYABLE (continued)

- (a) In the year ended December 31, 1999, the Company received financial assistance in the amount of \$164,882 for the research and development of new products, patents, and markets. The Company is obligated to pay a 5% royalty (to a maximum of two times the financial assistance received) on sales generated from products developed using these funds. The portion of this obligation paid or accrued as at December 31, 2009 was \$329,764 (2008 - \$329,764). Pursuant to an agreement signed in March 2006, the terms of repayment were amended to allow all royalties payable as at December 31, 2005 in the amount of \$223,692 to be repaid \$13,981 per quarter commencing March 31, 2006. Royalties incurred subsequent to December 31, 2005 are to be repaid quarterly within 60 days of the quarter end. The balance of royalties payable under this agreement as at December 31, 2009 was in arrears and totaled \$111,844 (2008 - \$111,844).
- (b) In the year ended December 31, 2004, the Company received a commitment for financial assistance totaling \$250,000 for pre-market activities of CeaProve® (a health and wellness product) upon completion of project objectives as outlined and agreed to by both parties. As at December 31, 2009, \$225,000 (2008 - \$225,000) of this commitment has been received. The Company is obligated to pay a royalty (to a maximum of two times the financial assistance received) on sales generated from CeaProve® on the following basis: 0% of revenues earned to December 31, 2005, 2.5% of revenues earned to December 31, 2006, and 5% thereafter until repaid. No royalties have been incurred during the current or prior years. The Company has repaid at December 31, 2009 \$nil (2008 - \$nil) of this obligation. Upon completion of the repayment of the financial assistance received, the Company will be required to repay \$19,750 advanced during the year ended December 31, 2002. The portion of this obligation paid or accrued as at December 31, 2009 was \$nil (2008 - \$nil).
- (c) In the year ended December 31, 2003, the Company completed a Royalty Income Unit offering through the terms described in an Offering Memorandum. Each royalty interest has a right to receive royalties equal to 0.00001% from the sale or licensing of the Company's active ingredients and animal health products, to a maximum cumulative amount of \$2.08 per unit. Proceeds from the offering of \$516,348 (before related expenses) represent the sale of a 5.163% royalty interest in the Company's future sales and licensing of active ingredients and animal health products. Maximum royalties payable are two times the amount invested or \$1,032,695. The portion of this obligation paid or accrued at December 31, 2009 was \$1,032,695 (2008 - \$886,403). The balance of royalties payable under this offering as at December 31, 2009 was in arrears and totaled \$320,692 (2008 - \$174,397).
- (d) In the year ended December 31, 2003, the Company sold a 1.418% royalty interest in the Company's future sales and licensing of active ingredients and animal health products for \$141,796. In the year ended December 31, 2004, the Company sold an additional 1.724% royalty interest in the future sales and licensing of active ingredients and animal health products for \$172,401. The cumulative royalty interest of 3.142% for \$314,197 results in combined maximum royalties of two times the amount invested or \$628,394. The portion of this obligation paid or accrued at December 31, 2009 was \$628,394 (2008 - \$585,098). The balance of royalties payable under this offering as at December 31, 2009 was in arrears and totaled \$149,445 (2008 - \$106,120).
- (e) On December 28, 2005 the Company sold a 2.285% royalty interest in the Company's future sales and licensing of active ingredients, animal health, and CeaProve® products for \$457,000. Maximum royalties payable are two times the amount invested or \$914,000. The portion of this obligation paid or accrued as at December 31, 2009 was \$350,326 (2008 - \$251,032). The balance of royalties payable under this offering as at December 31, 2009 was in arrears and totaled \$176,455 (2008 - \$77,166).
- (f) In the year ended December 31, 2005, the Company received a commitment for financial assistance totaling \$362,250 for product innovation development in the area of Veterinary Therapeutics and Active Ingredients. As at December 31, 2009 \$362,250 (2008 - \$362,500) of the commitment has been received. The Company is obligated to pay a 2.5% royalty to a maximum of \$75,000 per quarter (to a maximum of two times the financial assistance received or \$724,500) on sales generated from products developed using these funds. These royalties will commence when the royalty payments on investment agreements in note 7(a) are fully satisfied. The portion of the obligation paid or accrued at December 31, 2009 was \$nil (2008 - \$nil).

## 7 ROYALTIES PAYABLE (continued)

(g) In the year ended December 31, 2005 the Company received a commitment for financial assistance totaling \$800,000 for pre-market activities of CeaProve® (a health and wellness product) upon completion of project objectives as outlined and agreed to by both parties. As at December 31, 2009 \$510,000 of this commitment has been received (2008 - \$510,000). The Company is obligated to pay a royalty (to a maximum of one and a half times the financial assistance received or \$765,000) on sales of CeaProve® on the following basis: 0% of net sales and net sub-licensing revenues earned until royalty payments have been fully satisfied under the investment agreement in note 7(b), and 5% thereafter until repaid to a maximum of \$125,000 per quarter. No royalties have been incurred during the current year. The portion of this obligation paid or accrued as at December 31, 2009 was \$nil (2008 - \$nil).

## 8. EMPLOYEE FUTURE BENEFITS OBLIGATION

The Company has an unfunded non-registered, non-indexed defined retirement benefit plan for certain officers. The retirement benefit is two months' salary for each year they are employed by the Company. During the year ended December 31, 2008, pursuant to a termination agreement with the Company's former President and Chief Executive Officer, the company has settled the benefit obligation with this senior officer resulting in a curtailment loss of \$68,751. The Company completed all required payments under the termination agreement on December 31, 2009.

<b>Accrued benefit obligation</b>	<b>2009</b>		<b>2008</b>	
Unfunded balance, beginning of year	\$	<b>304,012</b>	\$	283,648
Curtailment loss		-		68,751
Benefits paid		<b>(187,000)</b>		(67,361)
Current service cost		<b>14,871</b>		14,496
Interest costs on accrued benefit obligation		<b>4,903</b>		4,478
		<b>136,786</b>		304,012
Less current portion		-		(187,000)
	\$	<b>136,786</b>	\$	117,012
<b>Elements of defined benefit costs recognized in the year</b>	<b>2009</b>		<b>2008</b>	
Current service cost	\$	<b>14,871</b>	\$	<b>14,496</b>
Interest cost on accrued benefit obligation		<b>4,903</b>		<b>4,478</b>
Curtailment loss		-		<b>68,751</b>
	\$	<b>19,774</b>	\$	87,725

Management is required to make an estimate regarding the discount rate used to determine the accrued benefit obligation. This estimate is of a long-term nature, which is consistent with the nature of the employee future benefits. The discount rate used to determine the accrued benefit obligation as at December 31, 2009 was 4.19% (2008 - 4.19%).

## 9. SHARE CAPITAL

- (a) Authorized  
Unlimited number of Class A voting common shares  
Unlimited number of Class B non-voting common shares

- (b) Issued - Class A common shares

	<b>2009</b>		<b>2008</b>	
	<b>Number of Shares</b>	<b>Amount</b>	<b>Number of Shares</b>	<b>Amount</b>
Balance at beginning of year	<b>47,050,063</b>	<b>\$ 5,016,395</b>	47,050,063	\$ 5,016,395
Changes during the year:				
Equity placements	<b>4,660,000</b>	<b>466,000</b>	-	-
Share capital issue costs	-	<b>(3,193)</b>	-	-
	<b>51,710,063</b>	<b>\$ 5,479,202</b>	47,050,063	\$ 5,016,395

## 9. SHARE CAPITAL (continued)

On June 17, 2009 the Company completed a private placement share offering of 4,660,000 common shares at (c) Contributed surplus

The following table summarizes the changes in contributed surplus:

	2009		2008	
Balance at beginning of year	\$	374,018	\$	259,329
Stock based compensation expense (note 9 (d))		104,927		114,689
	\$	478,945	\$	374,018

### (d) Stock options

The Company has granted stock options to eligible employees, directors, officers, and consultants under stock option plans that vest over periods ranging from 2 years to five years and have a maximum term of five years.

The Company accounts for options granted under these plans in accordance with the fair value based method of accounting for stock based compensation. In the current year the Company granted 900,000 (2008 - 1,225,000) 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 and life of the options. The weighted average risk-free rate used in 2009 was 2.11% (2008 - 3.22%), the weighted average expected volatility was 112% (2008 - 86%) which was based on prior trading activity of the Company's shares, the weighted average expected life of the options was 5 years, and the expected dividends were nil (2008 - nil). The weighted average grant date fair value of options granted during the year were \$0.10 (2008 - \$0.10) per option. The stock based compensation expense recorded during the current year relating to options granted in 2009, 2008, 2007 and 2006 was \$104,927 (2008 - \$114,689).

A summary of the status of the Company's stock options at December 31, 2009 and 2008 and changes during the years ended on those dates is as follows:

	2009		2008	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise price
Outstanding at beginning of year	1,810,000	\$ 0.21	2,308,092	\$ 0.26
Granted	900,000	0.13	1,225,000	0.16
Expired	(225,000)	0.20	(1,723,092)	0.24
Outstanding at end of year	2,485,000	\$ 0.18	1,810,000	\$ 0.21
Exercisable at end of year	1,314,000	\$ 0.20	786,000	\$ 0.22

The following table summarizes information about the Company's stock options outstanding:

Exercise Price	Year of Expiration	2009	2008
		Number of Options	Number of Options
\$0.13	2014	900,000	-
\$0.12	2013	660,000	780,000
\$0.25	2013	210,000	240,000
\$0.28	2012	390,000	390,000
\$0.30	2012	100,000	100,000
\$0.30	2011	75,000	150,000
\$0.27	2011	150,000	150,000
		2,485,000	1,810,000

## 9 SHARE CAPITAL (continued)

### (e) Warrants

A summary of the status of the Company's warrants at December 31, 2009 and 2008 and changes during the years ended on those dates is as follows:

	2009		2008	
	Number of Warrants	Average Exercise Price	Number of Warrants	Average Exercise Price
Outstanding				
at beginning of year	4,806,608	\$ 0.44	4,806,608	\$ 0.44
Expired	(4,806,608)	0.44	-	-
Outstanding at end of year	-	\$ -	4,806,608	\$ 0.44

All outstanding warrants expired on February 27, 2009.

## 10. CONTINGENCIES AND COMMITMENTS

- (a) Ceapro Inc. commenced litigation against a number of defendants in 2002 in the Court of Queen's Bench of Saskatchewan (the "Saskatchewan Claim"). The defendants against whom the case proceeded to trial were the Government of Saskatchewan, Saskatchewan Government Growth Fund Ltd. (SGGF), Saskatchewan Government Growth Fund Management Corporation (SGGFMC), Gary K. Benson, Janice MacKinnon, and Can-Oat Milling Products Inc. The Saskatchewan Claim raised numerous causes of action against certain of the defendants including a claim against all based in civil conspiracy. Ceapro claimed damages in excess of \$19 million for loss of its investment in Canamino Inc., plus additional damages for loss of goodwill and other losses and for other relief.

During the year ended December 31, 2008, all claims related to the Saskatchewan Claim were dismissed. During the year ended December 31, 2009 the Company and defendants reached an agreement with respect to the settlement of the appeal proceedings and the legal costs payable to the defendants. The Company agreed to consent to the dismissal of all appeal proceedings and to pay to the defendants \$705,000 in legal costs which were payable in four equal quarterly installments of \$176,250 commencing March 31, 2009. The settlement agreement was fully satisfied by the Company in 2009 and there is no further financial exposure to the Company.

During the year ended December 31, 2008 the Company recorded a provision for disputed legal fees in the amount of \$741,283. In 2009 the Company recorded a recovery of \$426,300 of the previously disputed legal fees as one legal firm advised the Company that it would not be pursuing their claim. The remaining disputed balance of \$314,983 is recorded as a liability on the balance sheet as SGGF legal fees.

The Company was required to post a bond with the court in the amount of \$305,000 in connection with the litigation. The bond was released upon satisfaction of the judgement by the Company.

- (b) 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. The Company paid a licensing fee of \$30,000 and will amortize the license over 10 years. The Company is obligated to pay the university an amount equal to eight percent of net sales from products derived from the mint plants subject to minimum payments as follows:

2010	5,760
2011	12,960
2012	20,160
2013	27,360
2014 to 2017	181,440
	<u>\$ 247,680</u>

For 2009 the Company recognized a minimum payment of \$5,760 (2008 - \$2,400) in royalty expense.

- (c) 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.



## 11. SALES

Substantially all sales are export sales to five distributors of the Company's products. The Company is therefore dependent on those distributors to maintain and expand the volume of product sales to existing and new customers.

## 12. OTHER INCOME (LOSS)

	2009	2008
Foreign exchange gains (losses)	<b>(68,047)</b>	85,747
Interest and other income (loss)	<b>12,554</b>	(12,362)
	<b>\$ (55,493)</b>	<b>\$ 73,385</b>

## 13. INCOME TAXES

### (a) Non-capital losses

The Company has accumulated non-capital losses carried forward for federal income tax purposes of approximately \$11,727,100, and for provincial income tax purposes of approximately \$11,530,800, the benefit of which has not been reflected in these consolidated financial statements. These losses may be applied against future taxable income within the limitations prescribed by the Income Tax Act and expire as follows:

	Federal	Alberta
2015	\$ 293,400	\$ 293,400
2026	651,500	651,500
2027	3,701,200	3,504,900
2028	5,383,700	5,383,700
2029	1,697,300	1,697,300
	<b>\$ 11,727,100</b>	<b>\$ 11,530,800</b>

### (b) Capital losses

The Company has accumulated capital losses of approximately \$6,807,000, which can be carried forward indefinitely to offset future capital gains.

### (c) Scientific research and experimental development (SR & ED)

The Company has accumulated an SR & ED expenditure pool of approximately \$1,506,000, which can be carried forward indefinitely to be applied against future taxable income.

### (d) Temporary differences

A future income tax asset reflects the net effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's future income tax asset are as follows:

Income tax effect of deductible temporary differences:	2009	2008
Non-capital losses and SR & ED expenditures carried forward	<b>\$ 3,289,000</b>	\$ 2,884,000
Net capital losses carried forward	<b>851,000</b>	851,000
SR&ED investment tax credits	-	21,000
Undepreciated capital cost for tax purposes in excess of net book value	<b>1,073,000</b>	1,423,000
Deferred revenue recognized for tax purposes	<b>70,000</b>	83,000
Valuation allowance	<b>(5,283,000)</b>	(5,262,000)
	<b>\$ -</b>	<b>\$ -</b>

For consolidated financial statement purposes, no future income tax asset has been recorded at December 31, 2009 and 2008 as it is not likely to be realized.

(e) Income tax reconciliation

The Company's consolidated income tax position comprises tax benefits and provisions arising from the respective tax positions of its taxable entities. The Company's income tax provision differs from that calculated by applying statutory rates for the following reasons:

	2009	2008
Income taxes (recovery) based on federal and provincial statutory income tax rate of 29% (2008 - 29.50%)	\$ (20,111)	\$ (1,061,843)
Tax effect of expenses that are not deductible	13,942	8,839
Tax effect of current year non-capital losses not recognized	492,219	1,588,180
Tax effect of prior years non capital losses and investment tax credits applied against current taxable income	(56,946)	-
Tax effect relating to property and equipment	(360,439)	(504,525)
Tax effect of deferred revenue recognized	(14,397)	(30,651)
Tax effect of deductible employee future benefit obligation payments	(54,268)	-
	\$ -	\$ -

#### 14. RELATED PARTY TRANSACTIONS

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

	2009	2008
Royalties earned by employees and directors	\$ 38,699	\$ 57,461
Royalties earned by former employees	-	11,271
Amounts payable to employees and directors included in royalties payable	84,581	45,882
Convertible debentures purchased by employees and directors	45,000	-
Consulting fees earned by a company controlled by a director	150,000	75,000
Consulting fees payable to a company controlled by a director in accounts payable and accrued liabilities	37,500	-

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

#### 15. 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:

	2009	2008
United States	\$2,679,371	\$2,759,023
Other	1,652,042	1,462,141
Canada	38,657	6,909
	\$4,370,070	\$4,228,073

#### 16. FINANCIAL INSTRUMENTS

The Company has designated its financial instruments as follows: cash is classified as held-for-trading, which is measured at fair value; accounts receivable are classified as loans and receivables which are measured at amortized cost; accounts payable and accrued liabilities, long-term debt, royalties payable, the SGGF legal fees and convertible debentures are classified as other liabilities and are also measured at amortized cost. The fair value of accounts receivable, accounts payable, the current portion of long term debt, royalties payable and the SGGF legal fees approximate their carrying amount due to their short-term nature. The fair values of long-term debt and convertible debentures are estimated to approximate their carrying value because the interest rates do not differ significantly from current interest rates for similar types of borrowing arrangements. The Company accounts for regular-way purchases and sales of financial assets using trade date accounting, and transaction costs on financial instruments are recognized in income in the period.

## 16. FINANCIAL INSTRUMENTS (continued)

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

### a) Credit risk:

The Company makes sales to customers that are well-established and well-financed within their respective industries. There is always a risk relating to the financial stability of customers and their ability to pay, but management views this risk as minimal. Approximately 96% of accounts receivable are due from three customers and all accounts receivable are current. The Company mitigates its exposure to credit risk on its cash balances by maintaining its bank accounts with a Canadian Chartered Bank. The Company's maximum exposure to credit risk on its cash and accounts receivable at December 31, 2009 is \$266,646.

### b) Liquidity risk:

Liquidity risk relates to the risk that the Company will encounter difficulty in meeting its financial obligations. The long-term debt matures in January 2013. It is the intention of the company that refinancing will be negotiated at that time should it be required. The Company may be exposed to liquidity risks if it is unable to collect its trade accounts receivable balances in a timely manner, which could in turn impact the Company's long-term ability to meet commitments under its current facilities. Royalties are in arrears as they have not been paid since the second quarter of 2008 due to the limited financial resources of the Company. In order to manage this liquidity risk, the Company regularly reviews its aged accounts receivable 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. The company relies on cash flow from operations, debt and equity financings and government funding to fund its operations.

There is no assurance that the Company will obtain sufficient funding to execute its business plan.

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

	0 - 1 year	1 - 3 years	4 - 5 years	Total
Accounts payable and accrued liabilities	\$ 846,538	\$ -	\$ -	\$ 846,538
Long term debt, including interest	208,608	417,216	926,535	1,552,359
Royalties payable	758,436	-	-	758,436
Convertible debentures including interest	40,000	540,000	-	580,000
<b>Total</b>	<b>\$ 1,853,582</b>	<b>\$ 957,216</b>	<b>\$ 926,535</b>	<b>\$ 3,737,333</b>

### c) Market risk

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

#### i) 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 Company is exposed to foreign currency fluctuations because a substantial portion of sales are denominated in U.S. dollars. A one percent change in the Canadian/U.S. dollar exchange rate will impact revenues by approximately \$37,380 annually based upon 2009 U.S. dollar sales of \$3,738,000. The Company does purchase some materials and services in U.S. dollars and to a lesser extent in Euros. This amount will vary by product sold.

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

Carrying Amount (USD)	Foreign Exchange Risk (USD)	
	-1%	+1%
	Earnings & Equity	Earnings & Equity
<b>Financial assets</b>		
Accounts receivable	\$ 129,511	\$ 1,295
		\$ (1,295)
<b>Financial liabilities</b>		
Accounts payable and accrued liabilities	\$ 219,134	\$ (2,191)
<b>Total increase (decrease)</b>		\$ (896)
		\$ 896

**16. FINANCIAL INSTRUMENTS (continued)**

The carrying amount of accounts receivable and accounts payable and accrued liabilities in USD represents the Company's exposure at December 31, 2009.

## ii) Interest rate risk

The Company has minimal interest rate risk because its long-term debt is a fixed rate of 5.49%. However, in the event of a default, the rate would increase to 7.49% and result in an increase in the required monthly principal and interest payment by \$1,541.

**17. LEASE COMMITMENTS**

The Company is committed to future annual payments under operating leases for manufacturing facilities and office space as follows:

2010	\$	203,619
2011	\$	121,563

**18. CAPITAL DISCLOSURES**

The Company considers its capital to be working capital and its shareholder deficiency. The Company's objectives 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. 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 2008.

**19. COMPARATIVE FIGURES**

Certain comparative figures have been reclassified to conform with the current year's presentation.